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Comprehensive study on credit programs to smallholders

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Philippine Institute for Development Studies
Surian sa mga Pag-aaral Pangkaunlaran ng Pilipinas

Comprehensive Study on Credit Programs to Smallholders

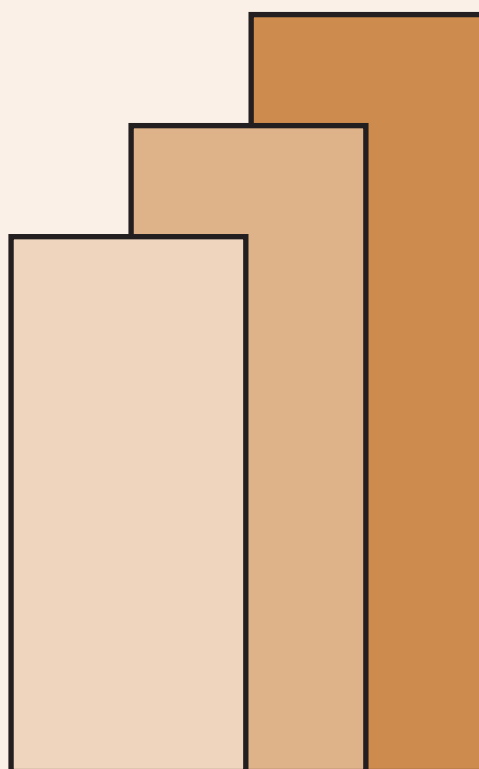
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and Jocelyn Alma R. Badiola*

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Abstract: This paper looks at the existing credit programs for smallholders including agrarian reform beneficiaries (ARBs). It also assesses the Agrarian Production Credit Program, which is a program being implemented in collaboration with the Department of Agriculture and the Land Bank of the Philippines for ARBs using agrarian reform beneficiary organizations as retailers. Moreover, the study determines specific gaps and issues related to meeting the credit needs of smallholders and identifies possible strategic interventions by both government and private sector that can enhance access of smallholders to financial services.

Keywords: smallholders, agrarian reform beneficiaries, landless rural workers, capacity building financial inclusion, financial literacy, innovative lending programs, wholesalers, retailers and support services

EXECUTIVE SUMMARY

I. Understanding the Problem

One of the components of the Comprehensive Agrarian Reform Program (CARP) is the provision of support services including credit to agrarian reform beneficiaries (ARBs). While several credit programs for ARBs are being implemented, there remains an increasing unmet demand for credit not only among Agrarian Reform Beneficiaries (ARBs) but also among the increasing number of landless farm workers who are not ARBs but are tilling agrarian reform lands on behalf of ARBs or some other farm-owners. This study therefore looks at existing credit programs for ARBs and non-ARBs including landless farm-workers in order to determine the effectiveness of the said credit programs in meeting the demand for credit. It also assesses the Agrarian Production and Credit Program (APCP) which is a program being implemented in collaboration with the Department of Agriculture (DA) and the Land Bank of the Philippines, by taking a look at how much agrarian reform beneficiary organizations (ARBOs) have helped in facilitating credit access and if indeed they are a crucial element in designing and implementing credit programs for smallholders in general and ARBs in particular. Moreover, the study tries to determine specific gaps and issues related to meeting the credit needs of smallholders as well as possible strategic interventions by both government and private sector.

II. Objectives of the Study

Based on the study terms of reference, the study objectives are:

- a) Review and document existing practices (i.e. program and policy environment) of other countries similarly situated as the Philippines.
- b) Conduct a comprehensive review of the existing conditions in the credit market and policies for credit access of smallholders with due emphasis on the gaps and limitations of prevailing credit programs and how to properly address them;
- c) Assess existing programs of lending institutions, banks, and other government financial institutions (GFIs) in terms of loan purpose, loan terms and condition, monitoring and collection;
- d) Conduct a program review of the Agricultural Production and Credit Program (APCP) in terms of credit assistance, program organization and beneficiary feedback;
- e) Assess the capacity of smallholder organizations (ARBOs and non-ARBOs)¹ in terms of preparing credit proposals, implementing re-lending schemes and managing credit, and provide appropriate interventions;
- f) Craft relevant policies and strategies of government/private banking institutions to improve credit delivery to smallholders, and identify appropriate credit enhancement measures (e.g. insurance, guarantees), if needed; and

¹ Agrarian Reform Beneficiaries Organizations (ARBOs) are farmers organizations, cooperatives or associations registered with the CDA, SEC or DOLE/BRW wherein majority of its members (50%+1) are agrarian reform beneficiaries (ARBs) or ARB household members

- g) Identify key parameters that should be considered in designing an appropriate lending and capacity-building program for smallholders.

III. Methodology of the Study

To accomplish the objectives, the basic conceptual framework for financial inclusion was adopted in analyzing and determining small holders' access to financial services. Under this framework, smallholders are considered financially included when they have access to affordable financial services that are tailored fit to their financial needs. The framework, thus, suggests that small holders' access to sustainable financial services is determined by both demand and supply for the service. Demand for financial services depends on the ability and willingness of small holders to access and use financial services while the supply of financial service is dependent on the entry and willingness of financial service providers to provide the needed financial service or product. For purposes of this study, focus was on small holders' access to credit services only.

Moreover, the study used both process and outcome evaluation to assess the delivery and effectiveness of credit programs designed and implemented for smallholders. Desk research, key informant interviews and focus group discussions with key stakeholders were conducted. To validate whether the existing credit programs and non-credit programs aimed at facilitating smallholders' access to credit are able to address the demand and supply constraints, specific questions were formulated for the FGDs and the key informant interviews. Specific questions to determine and evaluate the role of ARBO in facilitating credit access were also formulated and used during FGDs.

IV. Smallholder Farmers and the Philippine Agriculture

Smallholder farmers are often referred to as the marginalized farmers. They comprise a large majority of the rural population. These farmers are able to generate a significant proportion of production in most agricultural economies making them an important segment of the agriculture sector. They should, therefore, not be left out when working towards inclusive growth.

Some of the characteristics of smallholders include the following: 1) small land sizes with low productivity; 2) poor market linkages; 3) multiple sources of income; 4) considered high risk by lending institutions; and 4) lack of access to finance.

So far, data from the Registry System of Basic Sectors of Agriculture (RSBSA) conducted by the Philippine Statistics Authority for the Department of Budget and Management (DBM) indicate that there are 6.6 million farmers of which 4.5 million (68%) are considered small farmers.). On the other hand, data gathered from the Department of Agrarian Reform show that the total number of agrarian reform beneficiaries (ARBs) is 2,753,036. As a proportion of the total number of small farmers registered in the RSBSA, ARBs comprise about 41 percent.

V. Agrarian Reform Beneficiaries and Landless Rural Workers as Smallholders

ARBs are former landless workers who benefited from the redistribution of public and private agricultural land assets under the Comprehensive Agrarian Reform Program

(CARP) mandated by RA 6657 of 1988, which was later expanded in 2009 by RA 9700 or CARP Extension with Reform or (CARPER). They are considered smallholders. However, despite land redistribution and interventions from the government in the form of support services such as credit, training and technology, studies indicate that access of ARBs to financing from formal sources remains inadequate. The same is true with landless rural workers who rely largely on informal sources. While microfinance institutions (MFIs) also lend to landless rural workers, loans are mostly for non-farm or off-farm enterprises and for consumption smoothing.

VI. Financing Smallholders in the Philippines

To increase access of smallholders to financing from formal sources, different mechanisms were adopted over the years. Prior to the reforms of the 1980s, the predominant approach was largely supply-led, i.e., lending by government directly to farmers at subsidized interest rates through special lending programs. Examples of these programs include Masagana 99 for rice, Masaganang Maisan for corn, Bakahang Barangay for livestock and Gulayan sa Kalusugan for vegetables, among others. However, the benefits derived from these programs especially in terms of significant increases in production were short-lived. Due to large default rates, these programs had to be terminated. The failure of these programs, therefore, resulted in many lessons learned which then gave rise to reforms. In particular, Republic Act 8435 or the Agriculture and Fisheries Modernization Act (AFMA) of 1997 as well as the National Strategy for Microfinance initiated by the Department of Finance through the National Credit Council instituted reforms that were anchored on the following principles: 1) increased participation of the private sector; 2) adoption of market-based financial and credit policies; 3) focus on proper management and utilization of the loan fund; 4) active participation of banks and government financial institutions; and 5) government to provide the enabling policy and regulatory environment and critical support services.

The adoption of the policy reforms therefore led to the termination of all directed lending programs. Under the AFMA, all the funds of phased-out and terminated directed credit programs in the agriculture sector were consolidated and transferred into the Agricultural Modernization Credit and Financing Program (AMCFP). AFMA mandates AMCFP to serve as the umbrella credit program of the Department of Agriculture (DA) that would provide for the financing needs of small farmers and fisherfolk. AMCFP funds are channeled through Government Financial Institutions (GFIs) which act as wholesalers of agricultural credit funds to private financial institutions (PFIs).

VII. Smallholder Credit Programs

Smallholder Credit Programs currently being implemented can be categorized as follows: 1) Programs funded by the AMCFP in partnership with government financial institutions; 2) Programs of DA in partnership with DAR; 3) Programs of DAR; 4) Regular Lending Programs of Land Bank; 5) Agriculture Guarantee Fund Pool; 6) Programs of the Philippine Crop Insurance Corporation (PCIC)

Programs funded by the AMCFP. These include the Agriculture and Fisheries Financing Program (AFFP) which aims to lend to marginalized farmers and fishers who are not served or are underserved by financial institutions. In particular, the AFFP targets those who are listed in the RSBSA. Another program funded under the AMCFP is the Sikat Saka Program which targets small palay farmers through Irrigators Associations that act as conduits. Other programs funded by the AMCFP include the Coop Bank Agri lending program which provides support to cooperative banks; the

Agricultural Microfinance Program which provides loans to women of agricultural households who are engaged in on-farm and off-farm income generating activities; and the calamity assistance program that aims to help farmers and fishers affected by calamities.

Program of the Department of Agriculture in partnership with DAR. This is the Agrarian Production Credit Program or the APCP which aims to address the credit needs of ARBs on various economic activities such as agricultural crop production, agri-enterprise and livelihood projects and to target new ARBs who belong to organizations that are not yet eligible under the existing regular lending programs of LANDBANK.

Regular Lending Programs of Land Bank. The regular lending programs of Land Bank include the *Credit Assistance for Cacao Agri-Business and Other Organization Program (CACAO-100)* which provides short term and long term credit facility for the following: establishment of cacao nurseries, new cacao plantation and rehabilitation of old cacao plantation; the *Kalikasang Kabuhayan para Wastong Pamayanan (KAWAYAN)* which provide loans to cooperatives/farmer associations, non-government organizations, countryside financial institutions, small and medium enterprises, agribusiness entities and local government units that want to venture into bamboo growing and production; the *Food Supply Chain Program*; the Integrated Support for the Development of Aquaculture Program or ISDA; Masustansyang Inumin para sa likas na Kalusugan or MILK; and the LBP-SMC Corn and Cassava Assemblers/Consolidators Financing Program.

Lending Programs of the Department of Agrarian Reform (DAR). Aside from the APCP which has already been discussed above, other DAR lending programs are, as follows: *DAR-LANDBANK Credit Assistance Program for Program Beneficiaries Development (CAP-PBD)*² which is a program that provides credit assistance to non-bank eligible ARB cooperatives and farmers' associations and capacitates them to become bank-eligible organizations through interventions that include institutional and enterprise development coupled with provision of small loans; *DAR-LANDBANK Microfinance Capacity Development Program in Agrarian Reform Areas* which aims to provide ARBs in agrarian reform areas easier access to finance by linking them with well-established micro-finance institutions (MFIs) as well as to develop ARB cooperatives in becoming effective and efficient microfinance service providers; *Micro-Agri Loan Product (MALP) Development Program* which aims to develop various micro-agri credit products (MALPs) channeled through bank-assisted cooperatives and countryside financial institutions (CFIs) in order to increase access of ARBs to appropriate credit products that address requirements of ARBs; DAR-CARD, Inc. which is a capacity building program for ARB Cooperatives in ARCs that is implemented in partnership with CARD, Inc. in order to turn ARB Coops into viable microfinance (MF) providers; and *DAR-NATCCO-Microfinance Innovations in Cooperatives in Agrarian Reform Areas (MICOOP)* which is being implemented in partnership with the National Confederation of Cooperatives (NATCCO) in order to help coops expand their outreach to more poor households that desire to engage in micro, small and medium enterprises but have no access to formal lending institutions.

Agriculture Guarantee Fund Pool (AGFP). The AGFP is a pool of funds meant to provide 85% guarantee cover on agricultural production loans granted by accredited private financing institutions and other lending entities against all types of risks of non-repayment by farmer-borrowers except willful default or fraud. The objective is to

² Unlike APCP, CAP-PBD is an off-book credit program implemented by the LBP.

encourage banks, cooperatives and other lending institutions to increase their loans to SFF and reduce risk on the part of the lenders.

Programs of the Philippine Crop Insurance Corporation (PCIC). PCIC provides small farmers and farmer associations with insurance protection against crop losses, particularly for palay, corn, high-value commercial crops, livestock, fisheries, and non-crop agricultural assets (i.e., warehouses, rice mills, transport facilities, and other farm equipment due to perils like fire, theft, and earthquake).

Comparing Smallholder Lending Programs

Program Modality. Programs are implemented by either wholesaling the funds to retail institutions such as cooperatives, rural banks and farmers organizations (e.g. APCP, CAP-PBD, ISDA and MILK) or lending directly to individual farmers and fishers (e.g. SIKAT-SAKA and AFFP).

Loan Purpose. Majority of the programs provide loans for working capital (e.g. Milk, Cacao, Isda and Kawayan regular programs of the Land Bank as well as the AFFP, CAP-PBD, APCP) as well as for production loans (Cacao, Isda, Sikat Saka, Kawayan, AFFP and FCSP) and fixed assets (AFFP, CAP-PBD APCP and FCSP).

Eligible Borrowers. These include small farmers and fishers, in general (for programs like Sikat-Saka and AFFP); agrarian reform beneficiaries and agrarian reform beneficiary organizations (for APCP and CAP-PBD); small farmer and fishers organizations, cooperatives, NGOs and Cooperative Federations (MILK, CACAO, ISDA, KAWAYAN, Step-Up Loan and the FCSP); LGUs (for CACAO and KAWAYAN); and countryside financial institutions (for MILK, ISDA and Step-Up Loan).

Terms and Conditions. All programs provide both short-term (6 months to 1 year) and term loans (more than 1 year) except for Sikat Saka and APCP which provide only short-term loans. With respect to collateral, real estate mortgage or REM is one form of collateral required or accepted by most programs except Sikat Saka, AFFP and APCP. Collateral substitutes in lieu of REM are allowed as well such as promissory notes from cooperatives and farmers organizations (for MILK program of Land Bank, Sikat Saka, Kawayan, AFFP, CAP-PBD, APCP and FCSP); chattel mortgage is also accepted by all programs; other programs accept guarantee as a substitute to collateral which is provided under the Agricultural Guarantee Fund Pool of the Department of Agriculture and Land Bank of the Philippines. .

Outreach and Repayment Performance.

Discussion on the performance of smallholder credit programs is focused on three programs that directly target small farmers, agrarian reform beneficiaries and small fishers, particularly, the AFFP, Sikat Saka and the APCP. The AFFP-PCFC has a 100% repayment rate as of December 31, 2015; followed by Sikat Saka at 92% as of December 31, 2015; APCP at 89.46% as of Feb. 29, 2016 and the AFFP-LBP at 78.47% as of December 31, 2015. On the other hand, AFFP-Land Bank and the APCP have repayment rates of 78.47% and 89.68%, respectively. The program with the highest past due ratio is AFFP-Land Bank at 21.53%, followed by APCP at 10.54% and Sikat Saka at 7.78%.

With respect to amount of loans granted, programs that reached the billion mark include Sikat Saka and APCP at P2.2 billion and P2 billion, respectively. Meanwhile, APCP posted the greatest number of individual borrowers at 31,036 followed by AFFP-PCFC at 16,458; Sikat Saka at 9,413 and AFFP-LBP at 1,231.

Some Observations on Smallholder Credit Programs.

There is a variety of credit programs targeted towards small farmers with almost very similar features. Basic difference lies in the source of funds which essentially determines the purpose and the specific target clientele, e.g. irrigated rice farmers for Sikat Saka, RSBSA farmers for AFFP, ARBs for APCP etc. Moreover, after the consolidation of agricultural credit programs into the AMCFP sometime in the late 90s, it appears that commodity specific credit programs have made a comeback. These credit programs are implemented through the same conduit (LBP), and cater to the same small farmer with almost the same terms and conditions. These are also credit programs funded and implemented by either the DA or the DAR. As several studies have observed, the overlap reflect the observation that there seem to be some disconnect between and among line agencies dealing with farmers. As with the other rural development programs, there is weak coordination between and among agencies assisting small farmers. This leads to duplication or at times even conflicting signals.

VIII. Assessing the Agrarian Production Credit Program (APCP)

The APCP is a P2 billion-credit facility, which was designed to meet the credit needs of Agrarian Reform Beneficiaries (ARBs). The program provides credit assistance to newly organized ARBOs, Farmers Organizations (FOs) and People's Organizations (Pos) or existing ARBOs that are generally not qualified under the regular lending program of LBP.

Program Performance. As of February 29, 2016, a total amount of 1.95 billion pesos have been released to 526 ARBOs providing credit access to 31,036 ARBs. Of the amount released, P953.96 million is still outstanding of which 10.54% was registered as past due. Repayment rate of the program was 89.68%. Some ARBOs are not able to pay their loan due to their inability to collect from all of their sub-borrowers. Because most of the ARBOs are small and do not have buffer funds for relending, ARBOs choose to default on their loans when some of the sub-borrowers are not able to pay. Recognizing that because of non-payment of some borrowers, the whole ARBO is not qualified for a re-loan, some ARBOs opt to default on their loan to be able to provide loans to the good-paying borrowers. Loans collected are used to provide re-loans to good paying borrowers.

Program Design. Since the APCP is designed to provide credit assistance to ARB organizations that do not qualify under the regular lending window of LBP for smallholders, the documentary requirements are less tedious and the lending procedures adopted under the program are relatively simpler and has fewer procedural steps compared to the requirements and procedures under the LBP regular lending programs.

Lending Policies and Procedures. While lending policies and procedures are kept simple in order facilitate access of ARBs to credit, there are, however, some policies that can jeopardize the viability and sustainability of the program, such as: 1) allowing ARBOs that have at least six months of operation to qualify under the program as this is too short to determine if the prospective ARBO borrower is ready and has the potential to grow; 2) Waiving the debt to equity ratio for ARBOs which result in ARBO borrowers that are too small with very limited amount of capital for operations making it difficult for them to pay the loan when one of their member-ARB borrower defaults on their individual loan; 3) No rigorous screening of APCP borrowers is conducted by Land Bank; 4) Lack of incentives to encourage rural banks to participate in the program; 5) short program life which could be counterproductive as this could

encourage default among borrowers who would rather not pay when they believe they can no longer get a re-loan.

Program Implementation. The LBP and the DAR jointly implement the APCP with support from the DA and DENR. A project management committee (PMC) comprised of high-level officials from the DA, DAR, DENR, LBP, DOF and a farmer representative. The PMC is supported by a technical working group comprised of technical staff from each of the agencies represented in the PMC. A secretariat headed by the ACPC supports both the TWG and the PMC.

The Land Bank screens the prospective borrower using a more relaxed criteria. Moreover, the loan approval limit of the LBP lending center head is higher (P5 million) than that of the regular lending program (only P1million).

LBP uses its own funds for APCP lending. In view of this, APCP program targets are included in the LBP lending centers' key result areas and performance targets. The Php 2 billion APCP fund facility is deposited in a trust account with LBP and is used to guarantee APCP loans extended by LBP.

On the other hand, DAR acts as the marketing and facilitating agent of the APCP. DAR also closely coordinates and liaises with LBP on the status of loan approval and loan releases. In some cases, DAR also assists LBP in following up repayment of loans. DAR also provides capacity building support to the ARBOs.

Since the APCP forms part of Land Bank's key result areas and performance targets, its implementation is therefore considered priority. As noted above, the evaluation criteria followed is more relaxed as compared to Land Bank's regular accreditation criteria. No lending center interviewed recalls of denying the loan of an ARBO that was recommended by a DAR program officer provided the ARBO complies with all the documentary requirements of the program.

Despite using its own funds, Land Bank does not bear any credit risk since the APCP fund is immediately called upon in cases of loan default. There are, therefore, very limited incentives for serious credit screening and evaluation.

Finally, the Local PMC, which is supposed to meet regularly to address program implementation issues rarely meets at the local level particularly in the provinces covered in the FGDs.

Capacity Building Component. For the year 2014, DAR allotted P72.5 million to support the various capacity development activities of targeted agrarian reform beneficiary organizations (ARBOs). However, only 27.5 million was utilized to fund 31% (161 ARBOs) of the 523 ARBOs targeted for capacity development in 2014.

As designed, the APCP lends to ARBOs and cooperatives and their members who do not yet qualify under the LBP regular lending window. It is therefore the program's goal for APCP borrowers to graduate from APCP and to qualify under the regular lending window of the LBP through capacity building.

However, it appears that training and capacity building activities were not designed to systematically build and strengthen the capacities of the ARBOs to become viable institutions that can eventually qualify and graduate into the LBP regular lending program. Mentoring and handholding activities were rarely conducted and if they were, these were not done on a sustained basis until specific performance targets are met. Also, capacity building support towards enabling the ARBO-borrowers to meet

the standard accreditation and risk rating criteria of the LBP are not provided. It is, therefore, important to institute a metrics and/or evaluation system that will determine whether the activities conducted under the capacity building component results in an improved and better performance of the ARBOs leading to their graduation into the LBP's regular lending window. To facilitate this, it is suggested that the ARBO-borrowers still be subjected to the ECAC and RAAC system of LBP but with lower hurdles. The results of the evaluation can then be used to determine specific support for capacity enhancements.

Effectiveness of the Program. The APCP has two objectives: 1) to increase access of ARBs and ARBOs to credit; and 2) to enhance the capacities of ARBOs. So far, the APCP seems to have accomplished its objective of increasing the flow of credit to ARBs and ARBOs. As already mentioned above, a total amount of 1.95 billion pesos have been released to 526 ARBOs providing credit access to 31,036 ARBs, as of February 29, 2016. In terms of enhancing capacities, however, capacity building assistance received from APCP has been mostly random, sporadic and not systematic. While most of the trainings maybe considered demand based, they do not seem to lead towards the development of the ARBO as a viable organization that could access funds from formal financial institutions. APCP-ARBOs, who are mostly small and lack working capital are not able to fully pay its APCP loan when one of the member-ARB borrowers defaults which results in non-repayment for some ARBOs.

IX. Emerging Issues

Demand Side. For both ARBs (APCP and non-APCP borrowers) and non-ARBs, constraints to borrowing from banks are essentially one and the same. Said constraints include *“having no collateral”* and *“many and tedious requirements”*. Other constraints mentioned are *“have existing past due loans from banks”*; *“fear of not being able to pay”*; *“lack of or no information on existing lending programs of banks”*. Most APCP borrowers noted their preference for cooperatives than banks because of the former's lower interest rates, lesser documents required and faster loan processing and release. Farmers also noted the inaccessibility of banks given the distance of their municipalities to the poblacion where banks are located as well as poor road conditions and lack of transportation, prevent them from getting bank loans.

Supply Side. According to the banks interviewed, lending to agriculture, particularly to small farmers remains very risky not only because of climate change but also because support services from the government are not yet fully in place including farm-to-market roads, post-harvest facilities, capacity-building, technology and marketing opportunities, among others. Small farmers especially those in remote areas find it difficult to transport, sell their produce and get a good price. Small farmers need to improve their creditworthiness and to be educated further on financial management. These banks also mentioned that while they are aware that small farmers find the documentary requirements quite cumbersome, they, according to the banks, cannot release the loan if such requirements are incomplete in compliance with Bangko Sentral ng Pilipinas policies. They may also require additional documents should they see the need to do so after analysis of the applicants' capacity to pay.

X. Some Imperatives to Enhance Access of Smallholders to Financial Services

Addressing Demand Barriers

Existing government credit programs are trying to address the tedious documentary and collateral requirements that are usually imposed by private financial institutions. In the case of the APCP, for example, a certification from the Municipal or Provincial Agrarian Reform Officer that a smallholder is an ARB replaces the collateral requirement. With respect to the transaction cost barrier given the inaccessibility of banks, this is being addressed by using cooperatives and farmers' organization as conduits of LBP funds. Other barriers such as low farm productivity and insufficient cash flows to service the loans as well as market uncertainty that results in low prices of produce can be addressed by other types of support services highlighting the need for a coordinated development assistance for smallholders.

Addressing Supply Barriers

Private financial institutions are constrained to lend to agriculture because of the risks and costs associated with agriculture lending. In order to mitigate risks, therefore, banks require collateral to secure agricultural loans. For small farmers and fishers who have no collateral to offer, banks can be encouraged to lend to them through crop insurance and credit guarantee. Moreover, banks and other formal financial institutions interested in lending to agriculture may also need to design products and adapt lending methodologies that are tailor-fitted to the needs and circumstances of smallholders. New and/or different lending processes and procedures may be designed and adopted. For instance, use of conduits that are familiar with and located closely to smallholders can reduce costs and risks, as well (e.g. coops and ARBOs).

Policy Imperatives for Government

Learning from the lessons of previous subsidized directed credit programs in agriculture, results of various studies show that government's role in smallholder finance should be focused on i) establishment of the appropriate policy and regulatory environment and ii) provision of the necessary basic and support infrastructure that will reduce the costs and risks associated with agricultural lending in general and smallholder finance in particular.

In providing the appropriate environment for increased private sector participation in smallholder finance, government should reduce costs and risks associated with agricultural lending and smallholder finance.

Reducing Costs. Costs of lending to smallholders can be reduced through the following: 1) strengthen and build capacities of smallholders' and/or farmers' organization as viable and sustainable conduits of financial services in rural areas; 2) allow banks to use innovative means of delivering financial services to the rural areas (e.g. use of agents such as farmer's cooperatives and organizations); 3) promote the use of mobile technology that will allow roaming agents to distribute finance and collect information from smallholders; 4) build the required support infrastructure (e.g. farm-to-market roads) that will reduce the costs of reaching the small farmers.

Reducing Risks. Risks of lending to agriculture are largely due to climate change and weather disturbances; constrained economic opportunities due to inadequate transportation and communication infrastructure; income variability and price volatility; seasonality of crop and production schedules; poor market linkages and lack of adequate market information. In reducing risks, government can: 1) support the

collection of systematic set of smallholder information that can be used by relevant financial institutions in determining the credit risk profile of a smallholder; 2) strengthen and link farmer producer organization to structured value chains for effective market linkages; 3) implement a systematic, sustained and demand-driven capacity building program that will strengthen and build viable and sustainable cooperatives and farmers' organizations; 4) implement an effective and responsive crop insurance program that pays out claims immediately; 5) implement an effective guarantee program for smallholder financing; and 6) provide the necessary rural infrastructure support (e.g. farm to market roads, irrigation, post harvest facilities, farm technology) that will open up economic opportunities of smallholders.

Imperatives for the Private Sector

Banks can overcome constraints to agricultural lending by employing innovative lending schemes through a mix of product, distribution and collateral customization that serves the financing needs of smallholders effectively. These may include: 1) use of agents in distributing finance and in collecting relevant information about smallholders; 2) collaborating with agricultural experts to design loans with flexible repayment terms that are linked to actual crop cycle; 3) Use of farmers' organization as hub for loan distribution and collection; 3) use of warehouse receipts and equipment leasing as collateral substitutes; 4) understanding the value chains and buyer relationships to determine future cash flows and improve the credit assessments of smallholders; 5) product innovations (e.g. credit card concept, with accredited input dealers and suppliers); 6) use of mobile/electronic banking for farmers --- also to provide digital footprints for smallholders.

Imperatives for Development Organizations

Donors can provide support in reducing the riskiness of smallholders as borrowers by helping them acquire skills in financial literacy (e.g. focus budgeting, roles and responsibilities as borrowers) and in improving their farm productivity. On the supply side, donors can provide technical assistance to financial service providers in assessing the risks associated with smallholders and using the results in designing and customizing appropriate agricultural financial products. Some donors³ are willing to make equity investments in banks that have showed interest and commitment to smallholder finance. They provide equity investments and offer training and technical support in adopting specific lending methodologies as well as in establishing relevant lending procedures, systems and processes for effective and efficient smallholder financing.

³ Examples of these donors are: Rabo Development and Grameen Credit Agricole

Comprehensive Study on Credit Programs to Smallholders⁴

Ma. Piedad S. Geron, Gilberto M. Llanto and Jocelyn Alma R. Badiola⁵

1. Understanding the Problem

The Philippine Agrarian Reform Program has been implemented for almost four decades now.⁶ Aside from distributing lands, the Comprehensive Agrarian Reform Program (CARP) is also designed to provide the needed support services to Agrarian Reform Beneficiaries (ARBs), one of which is credit. By the very nature of the Agrarian Reform Program, most ARBs are categorized as smallholders⁷. The government, through DAR, has implemented credit programs designed to meet the financing needs of ARBs. It seems that those credit programs have delivered mixed results with reports stating that ARBs have in general been able to obtain formal credit on the one hand but there still seems to remain a substantial number of ARBs with unmet demand for credit, on the other hand.

A recent phenomenon is the rise in number of landless farm-workers, who are not ARBs but are tilling agrarian reform lands on behalf of ARBs or some other farm-owners. DAR sees here a “second generation” problem in credit provision. The first generation problem is how to provide ARBs with access to credit. The second-generation problem is how to provide landless farm workers tilling agrarian reform lands with access to credit. DAR categorizes both ARBs and landless farm-workers as “smallholders” in need of financial assistance [credit, being a type of financial assistance].

In view of this, the problem of smallholders’ access to formal credit has been a major and continuing concern of government. A number of credit programs that aim to serve the credit needs of ARBs have been designed and implemented. These credit facilities are mostly designed to accommodate landed smallholders and ARBs but not the landless farm-workers whom DAR believes to be part of its constituency. Agricultural leaseholders who are oftentimes living in more dire conditions, seemed to have been overlooked. This study will look at existing credit programs for ARBs and non-ARBs, with landless farm-workers included in the latter category to determine the effectiveness of those credit programs in meeting the demand for credit.

DAR has organized ARBOs⁸ in different agrarian reform communities to serve as hubs of support services in agrarian reform communities. Since one of the support services is credit, DAR is implementing a program that strengthens the capacity of ARBOs to access credit facilities, retail and collect individual ARB loans.

⁴ Study conducted by the Philippine Institute for Development Studies (PIDS) in behalf of the Department of Agrarian Reform (DAR).

⁵ The authors are grateful for the research contribution and inputs of Mr. Alberto E. Pascual. They are also grateful to the research assistance provided by Maureen Anne Rosellon, Cherry Ann Madiaga and Christine Ruth Salazar.

⁶ Includes the Philippine Agrarian Reform Program under PD 27. The Comprehensive Agrarian Reform Program (CARP) was enacted in 1988.

⁷ Smallholders are defined as small farmers tilling not more than 5 hectares of land. They may either be ARBs or non-ARBs.

⁸ Per Memorandum Circular No. 01 series of 2012, Implementing Rules in the Implementation of Agricultural Production Credit Program (APCP): Agrarian Reform Beneficiaries Organizations (ARBOs) are farmers organizations, cooperatives or associations registered with the CDA, SEC or DOLE/BRW wherein majority of its members (50%+1) are agrarian reform beneficiaries (ARBs) or ARB household members.

To provide ARBs access to credit, DAR also implements the Agricultural Production and Credit Program (APCP) in partnership with the DA and the LBP. Under the APCP, documentary requirements for accessing credit are streamlined. Aside from being conduits of credit, the ARBOs also provide capacity building assistance to its member ARBs to access credit from formal sources. This study will find out how much ARBOs have helped in facilitating credit access and if indeed they are a crucial element in designing and implementing credit programs for smallholders in general and ARBs in particular.

Specific gaps and issues related to meeting the credit needs of smallholders shall be identified and possible strategic interventions by both government and private sector shall be identified.

2. Objectives of the Study and Methodology adopted

Based on the study terms of reference, the study objectives are:

- a) Review and document existing practices (i.e. program and policy environment) of other countries similarly situated as the Philippines.
- b) Conduct a comprehensive review of the existing conditions in the credit market and policies for credit access of smallholders with due emphasis on the gaps and limitations of prevailing credit programs and how to properly address them;
- c) Assess existing programs of lending institutions, banks, and other government financial institutions (GFIs) in terms of loan purpose, loan terms and condition, monitoring and collection;
- d) Conduct a program review of the Agricultural Production and Credit Program (APCP) in terms of credit assistance, program organization and beneficiary feedback;
- e) Assess the capacity of smallholder organizations (ARBOs and non-ARBOs)⁹ in terms of preparing credit proposals, implementing re-lending schemes and managing credit, and provide appropriate interventions;
- f) Craft relevant policies and strategies of government/private banking institutions to improve credit delivery to smallholders, and identify appropriate credit enhancement measures (e.g. insurance, guarantees), if needed; and
- g) Identify key parameters that should be considered in designing an appropriate lending and capacity-building program for smallholders.

To accomplish the objectives, the basic conceptual framework for financial inclusion was adopted in analyzing and determining small holders' access to financial services. Small holders are financially included when they have access to affordable financial services that are tailored fit to their financial needs. For purposes of this study, we focus on small holders' access to credit services only.

⁹ Agrarian Reform Beneficiaries Organizations (ARBOs) are farmers organizations, cooperatives or associations registered with the CDA, SEC or DOLE/BRW wherein majority of its members (50%+1) are agrarian reform beneficiaries (ARBs) or ARB household members

To meet the study objectives and validate the research hypotheses, the study used both process and outcome evaluation to assess the delivery and effectiveness of credit programs designed and implemented for smallholders. Desk research, key informant interviews and focus group discussions with key stakeholders were conducted. To validate whether the existing credit programs and non-credit programs aimed at facilitating smallholders' access to credit are able to address the demand and supply constraints, specific questions were formulated for the FGDs and the key informant interviews. Specific questions to determine and evaluate the role of ARBO in facilitating credit access were also formulated and used during FGDs.

Given resource and time constraints, assessment of the ARBO and APCP program was mainly done using secondary data and information gathered from the conduct of focus group discussions and key informant interviews.

3. Smallholder Farmers and the Philippine Agriculture Sector

Smallholders comprise a large majority of the rural population and generate a large proportion of agricultural production in most agricultural economies. Because of this, they are considered an important segment of the sector with specific needs and peculiarities that should be taken into consideration for inclusive growth in the agriculture sector. The following describes smallholders.

Small land sizes with low productivity. They are generally described as those who cultivate less than three hectares of land whose production is mostly characterized by low yield, low quality of produce due mostly to the lack of access to optimal inputs such as high yielding seeds, fertilizer, irrigation and farm equipment. With relatively low yield and smaller areas of cultivation, smallholders are more vulnerable to risks than those who are engaged in large scale agricultural production that are able to engage in crop diversification. Most smallholders also rely on manual family labor. (1)

Poor market linkages. With very small produce, smallholders lack the ability and resources to negotiate better prices for their produce. Most of them are not aware of prevailing market prices and are therefore at the mercy of traders. They also have poor linkages to market and have very little access to formal and organized markets for their produce. Their farms are mostly located in hard to reach areas with very minimal if not absent infrastructure that will link them to the market.

Multiple sources of income. Smallholders have varying sources of income from various economic activities that often include farm-based, non-farm and off-farm activities. Some smallholders also receive remittances and transfers from other household members who work outside of the agriculture sector. According to IFAD (2011), 30–60 percent of rural households earn approximately 75 percent of their total income from more than two sources. Having multiple sources of income enable smallholders to manage risks. Income from one economic activity compensates for the decline in one source of income. (2) For instance, a decline in income resulting from low farm production arising from weather disturbance may be covered by income from non-farm activities or from remittances and transfers.

Considered high risk by lending institutions. While most smallholders are able to manage risks through multiple sources of income, lending to the agriculture sector in general and to smallholders in particular is still considered risky by most formal financial institutions. Smallholders are considered “high risk” in lending since they are

living in hard to reach areas with dispersed population and low literacy rates. Their economic opportunities are constrained by the inadequacy of transportation and communication infrastructure. Smallholders have variable incomes and are vulnerable to exogenous economic shocks. The seasonality of crops and production schedules lead to spikes in loan demand and shortage in both funding and labor in certain periods. The heavy concentration on agriculture and agriculture-related activities also exposes the smallholders to multiple risks. Compounding the risks is the lack of relevant market information for their produce. Studies have shown that perception of these kinds of risks confronting smallholders prevails among financial institutions. Because of such, financial institutions are reluctant to lend thereby limiting smallholders' access to credit and financial services.

Lack access to finance. Lack of or inadequate access to finance is considered one of the major constraints faced by smallholders. This is considered a major constraint for smallholders since financial services provide an important means by which smallholders finance their daily and fundamental source of livelihood, i.e. purchase of agriculture inputs; payment for hiring labor for planting/harvesting; transporting goods to markets; making and receiving payments; managing peak season to cover expenses during the low season; making investments in education, shelter and health; as well as in dealing with emergency situations. [ILO, 2009]. However, ILO [2010] reports that for the most part, rural communities remain underserved.

Most rural households lack access to reliable and affordable finance for agriculture and other livelihood activities. Many smallholders live in remote areas with no access to basic market infrastructure where retail banking is limited and production risks are high. Todd and Sharma [2010] explain that when poor people have limited saving or borrowing options, their investment plans are stifled and it becomes harder for them to break out of poverty. If households have no access to insurance and are unable to accumulate small savings that enable them to pay for household and business expenses, especially during lean seasons, they are forced to limit their exposure to risk even if high returns are expected. In view of this, smallholders continue to have low yield, low quality of produce and are unable to link to markets which makes the pathway out of poverty more arduous than necessary.

3.1. Smallholders in Philippine Agriculture

Based on the latest available data from the Census of Agriculture (2012), total land area cultivated by small farmers (those with farm sizes of 5 hectares and below) is about 5.6 million hectares. Total number of holdings for these land sizes is 4.4 million.

Table 1. No. of Farm Holdings, By Size of Area

As of December 31, 2012

Farm Size	No. of holdings	Total Area (ha)
Total	4,822,739	9,670,793
under 0.5 ha	973,601	232,731
0.5 and under 1 ha	962,273	594,300
1 and under 2 ha	1,349,903	1,635,995
2 and under 3 ha	624,669	1,365,613
3 and under 5 ha	508,880	1,778,383
5 and under 7 ha	221,198	1,248,615
7 and under 10 ha	81,941	665,781
10 and under 25 ha	88,658	1,192,188

25 ha and over	11,616	957,187
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Source: NSO

The Registry System of Basic Sectors of Agriculture (RSBSA) which was recently conducted by the Department of Budget and Management (DBM) reported that there are 6.6 million farmers of which 4.5 million (68%) are considered small farmers. Total number of agrarian reform beneficiaries (ARBs) is 2,753,036¹⁰. ARBs comprise about 41 percent of the total number of small farmers registered in the RSBSA.

3.2. Agrarian Reform Beneficiaries as Smallholders

In the Philippines, ARBs are considered smallholders. ARBs are former landless farm workers who benefited from the redistribution of public and private agricultural land assets under the Comprehensive Agrarian Reform Program (CARP) mandated by RA 6657 of 1988, which was later expanded in 2009 by RA 9700 or CARP Extension with Reform or (CARPER)¹¹. Aside from distributing lands, the government is also mandated to provide support services (e.g. credit, technology services etc) to ARBs to ensure that the distributed lands are put into productive use resulting in increased private investments in ARB areas which will eventually lead into the improvement of the economic welfare of ARBs.

Studies have shown, however, that land ownership has not improved ARBs' access to financing from formal sources. The prohibition on making transfers (through sale, lease, or other means) of CARP-distributed land until it is fully paid, and the land having no collateral value because it is not yet titled (Llanto, 2005; Fabella, 2013)¹² have not enticed a number of formal financial institutions to lend to ARBs. Most banks refuse to accept the Certificate of Land Ownership Award (CLOA) because these lands cannot be sold nor transferred to non-agrarian reform beneficiaries.

The beneficiaries' inability to transfer the assets has discouraged banks and other formal credit sources from offering and providing loans to ARBs. Rural banks, which primarily serve the agriculture and fisheries sector in the countryside, are not able to meet the 10% loan allocation for ARBs under the Agri-Agra Law. Most of them opt to pay the penalties rather than face the risks of lending to ARBs (Almario & Mendoza, 2014). In view of this, Teves (2014) observed that CARP seems to have weakened the value of land as collateral and consequently, its capacity to command credit.

3.3. Landless rural workers as smallholders

Aside from ARBs, smallholders are also comprised of landless rural workers after CARP. Harking (1975) noted that if the ownership of the land by the tenant is successful in encouraging him to substitute his own family's labor for hired labor which aggravates the plight of the landless agricultural workers. Most landless agricultural workers are also adversely affected especially in terms of access to credit, extension services and benefits from other government programs. Some of

¹⁰ Data on ARBs came from DAR.

¹¹ The government's agrarian reform program was created in an effort to boost countryside development by allowing farmers to own, till and earn from their own land.

¹² While some claim that the CLOA is considered a land title, this is not deemed acceptable by financial institution inasmuch as ownership of the land under CLOA cannot be transferred and hence cannot be foreclosed by the bank in case of loan defaults.

these landless rural workers get their credit from informal sources of income. A number of microfinance institutions also provide credit to landless rural workers. Financing from MFIs is mostly used to finance non-farm or off-farm enterprises and is also used for consumption smoothing.

4. Providing Smallholders Access to Financial Services

4.1. Adopting the Financial Inclusion Framework

The basic conceptual framework for financial inclusion is adopted in analyzing and determining small holders' access to financial services. Small holders are financially included when they have access to affordable financial services that are tailored fit to their financial needs. For purposes of this study, we shall focus on small holders' access to credit services only.

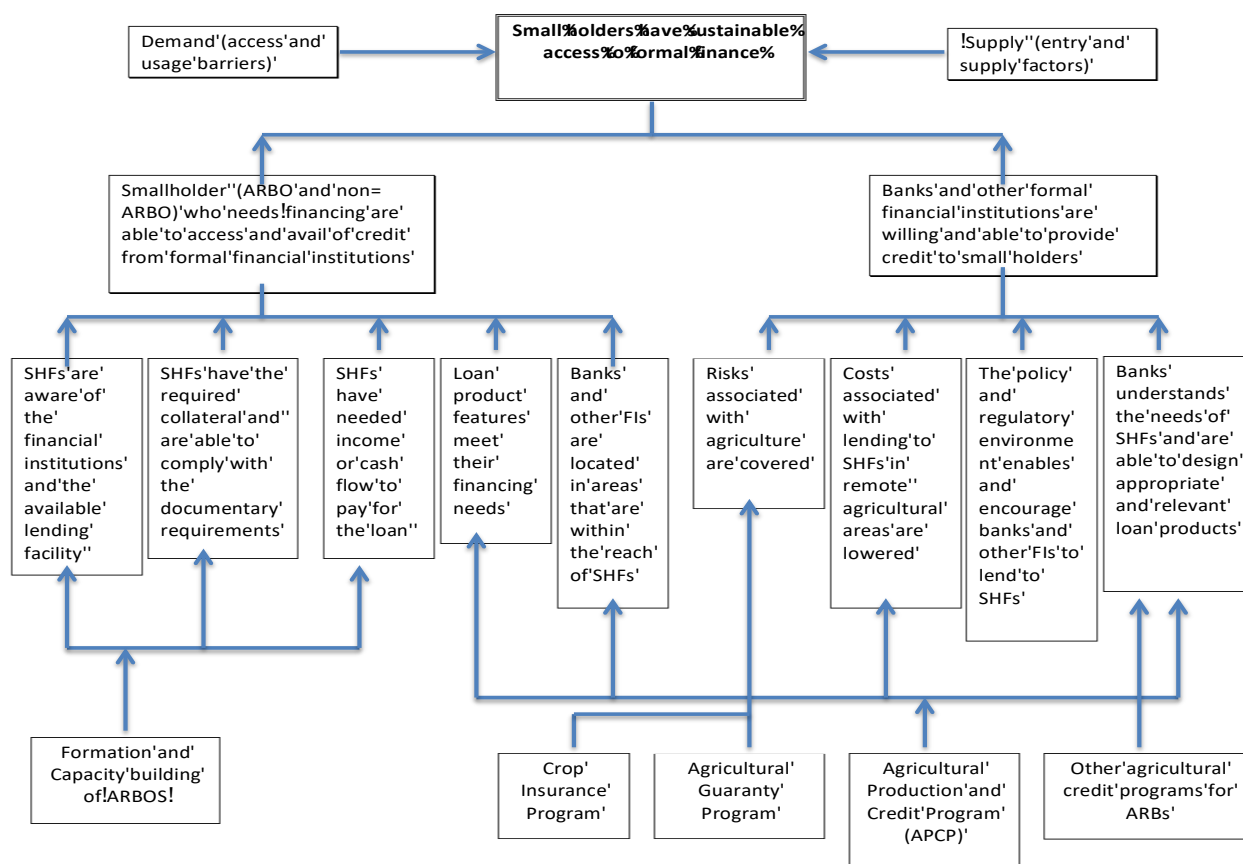
The framework in Figure 1 shows that small holders' access to sustainable financial services is determined by both demand and supply for the service. Demand for financial services depends on the ability and willingness of small holders to access and use financial services while the supply of financial service is dependent on the entry and willingness of financial service providers to provide the needed financial service or product. For purposes of this study, small holders shall include both the Agrarian Reform Beneficiaries (ARBs) and the non-ARBs.

There is demand for credit services when small holders who need financing are able to **access and use** credit services. Small holders are able to do so when they: i) are aware of the presence of financial institutions and the available lending facilities; ii) have the required collateral; iii) understand and are able to comply and provide the documentary requirements; iii) have sufficient cash flow to repay the loan; iv) are offered loan product features that are tailored fit to their financial needs and v) can have immediate and convenient access to banks and other formal financial institutions, i.e. financial service providers are within the reach or are located within the reach of the small holder.

There is supply of credit services when banks and other formal financial institutions enter the smallholder financing market and are able to provide the needed credit services. This happens when: i) risks associated with agriculture is minimized or is appropriately covered; ii) costs associated with lending to smallholders particularly those in remote agricultural areas are lowered; iii) the regulatory environment encourages and enables banks and other FIs to lend to small holders and iv) banks and other financial service providers understand the credit needs of small holders and are able to design appropriate and relevant loan products.

Given the factors that affect the demand and supply of financial services, government design and implement programs to enable small holders to have sustainable access to financial services. Some private financial institutions also design and offer specific lending programs and credit facilities for small holders. This study shall determine if these programs and lending facilities address the barriers to the supply and demand for credit services of smallholders. The study will then identify specific gaps and issues related to the provision of access to sustainable credit services by small holders.

Figure 1. Smallholder Access to Financial Services under a Financial Inclusion Framework



5. Financing Smallholders in the Philippines

To improve the flow of credit to smallholders, various tools were used over the years. These include the following: direct and special lending programs with subsidized interest rates; credit quotas; refinancing or rediscounting schemes; credit guarantee schemes; and lending by development banks or specialized institutions (Adams, et al., 1984; Tunahan and Dizkirici, 2012; Llanto, 2004; Saldana, 2000).

Prior to reforms, the predominant approach was lending by government at subsidized interest rates because this was deemed the appropriate mechanism in attracting financial institutions to lend to smallholders given the costs and risks associated with agriculture lending (Meyer and Nagarajan, 2003). Subsidized lending, usually by government non-financial institutions, was targeted to specific groups of farmers, specific areas or regions and specific crops. This was known as directed credit. Credit was treated as an input to production like seeds and fertilizer and was therefore incorporated into production programs like the Masagana 99 of the Philippines. Governments were so focused on increasing the supply of loans that other support services like market linkaging and institution capacity building were given little attention (Castillo, et al, 2000). Meyer and Nagarajan (2003) also noted that since the directed credit policy was considered the most appropriate development approach, multilateral and bilateral donor projects in the rural sector commonly supported directed credit projects to promote agricultural development.

Unfortunately, however, these developments were short-lived. The directed credit approach may have helped improve agricultural yields in the short term, but they overwhelmingly entailed high costs that were unsustainable over the long term and thus, failed to reach the majority of farmers (Adams, et al, 1984; Castillo, 2001; Llanto, 2005; Meyer and Nagarajan, 2003; Meyer, 2011).

Thus, various lessons were learned from implementing directed credit programs. These include the following (Castillo, 2001; Buttari, 1995; Helfand, 2001; Meyer and Nagarajan, 2003; Roumasset, 2004; Llanto, 2005; Meyer, 2011):

- Credit cannot compensate for urban bias;
- Credit subsidies almost never reach the poor;
- The efficiency and effectiveness of rural financial systems and institutions should be measured not only in terms of outreach but of self-sustainability as well;
- A successful rural finance institution should be:
 - Rural-based and not just specialized in agriculture;
 - Autonomous;
 - Able to charge market interest rates;
 - Able to mobilize savings and reduce reliance on donor or state funds;
 - Able to collect on loans and have fewer losses; and
 - Able to provide staff incentives.
- The farm household should be seen as an economic unit with farm, non-farm as well as consumption requirements and that financial services are as critical to rural non-farm enterprises as they are to farming;
- Agricultural credit should be viewed not as a direct input in agricultural production, but is provided as the result of a process of financial intermediation
- Credit is fungible, meaning, it can be diverted to other uses, making it costly and difficult for lending institutions to ensure that it is used for its intended purpose;
- Lenders should be allowed to charge market-determined interest rates so that they can totally cover their costs and in effect, sustain their operations;
- Reducing dependency on external funds will reduce the politics and/or government intervention in the rural financial markets;
- Reforms in financial market policies are more often hampered by political obstacles than by economic forces; and
- Governments should focus on creating a conducive policy environment, providing the needed infrastructure and support services including opportunities for institution building in order to increase participation of the private sector in the delivery of credit to agriculture.

By the 1990s, clearer evidence on the failure of the directed credit approach was established. In effect, donors exited and rural credit projects were discontinued (Von Pischke, 1996). These led critics to question whether the government's scarce resources can be utilized more effectively and efficiently through other strategies or mechanisms for rural income expansion and poverty reduction (Conning, et al, 2007). Because of the increasing concern about the wisdom of the directed credit paradigm,

scholars and policymakers alike studied and debated on the appropriate agricultural credit policies that could make a much more positive contribution to rural development.

5.1. Policy Framework adopted.

Recognizing the lessons learned from the implementation of directed credit programs, policy reforms were put into place. The Philippine government veered away from directly intervening in the credit market and focused on the creation of an enabling policy and regulatory environment for sound rural financial markets. These reforms were anchored on the following policy principles (Castillo, 2001; Llanto, 2005; ACPC, 2010):

- Increased participation of the private sector
- Adoption of market-based financial and credit policies
- Focus on proper management and utilization of the loan fund
- Active participation of banks and government financial institutions
- Government to provide the enabling policy and regulatory environment and critical support services

The adoption of the policy reforms provided the backbone and fueled the growth of the microfinance industry in the Philippines, foremost of which is the National Strategy for Microfinance (NSM) (Micu, 2010). The shift to market-based principles as espoused by the NSM attracted greater participation of the private sector in the provision of microfinance services. Likewise, the mainstreaming of microfinance in the banking sector through amendments in the General Banking Law to consider the peculiar characteristics of microfinance facilitated the significant entry of rural banks as retailers (Llanto, 2005; Conning, et al., 2007; Meyer, 2010; Micu, 2010).

Consistent with market-based principles espoused in the NSM, policies and regulation that would enhance and not distort rural financial markets were also crafted (Armendariz, et al., 2010; Llanto and Badiola, 2010; FAO, 2011; Meyer, 2011). Market based policy principles in agriculture lending were adopted through the enactment of the Agriculture Fisheries and Modernization Act (AFMA). Under the AFMA, implementation of subsidized directed credit programs was phased-out, market-based credit policies are adopted and government non-financial agencies are no longer allowed to implement agricultural credit programs. All the funds of phased-out and terminated directed credit programs in the agriculture sector were consolidated and transferred into the Agricultural Modernization Credit and Financing Program (AMCFP), which is mandated to provide for the financing needs of small farmers and fisherfolk. AMCFP funds shall be channeled to Government Financial Institutions (GFIs) and qualified cooperative banks which will act as wholesalers of agricultural credit funds to private financial institutions (PFIs). The PFIs shall provide for and meet the financing needs of small farmers and fisherfolk using market-based financial and credit policies. As a result, rural financial institutions adopted a more open mind to the benefits of market orientation (Meyer, 2011).

5.2. Smallholder Credit Programs Implemented

With the adoption of the new policy framework in agriculture lending, the following credit programs espousing the policy principles of the new framework were implemented. These are:

5.2.1. *The Agro-Industry Modernization Credit and Financing Program (AMCFP) of the Philippines.*

With the phase-out of directed credit programs, the Agro-Industry Modernization Credit and Financing Program (AMCFP) became the DA's umbrella credit program for agriculture and fisheries which is mandated to provide credit and financing for farm, off-farm and non-farm income-generating projects of farming and fishing households, especially the small ones. Unlike the DCPs of the past, the AMCFP has the following features: (i) demand-driven and not supply-led; (ii) not commodity-specific but covers a whole gamut of income-generating projects which farm households may choose to undertake; (iii) government not involved in credit decision-making as the program is implemented as a two-step loan program with government financial institutions as wholesalers and qualified private banks as retailers; and (iv) adopts market-determined rates as opposed to the subsidized rates of the past.

Aside from just being provided credit funds, borrowers and lending institutions participating in the AMCFP are also given capacity-building assistance to professionalize their management skills, enhance knowledge in technology, and strengthen borrowers' and retailers' capacity to access and manage credit (ACPC, 2014). Table 2 below presents the key features as well as the extent of outreach of the credit programs funded by the AMCFP as of June 15, 2015.

Table 2 Performance of Credit Programs funded by the AMCFP

As of June 15, 2015

Name of Credit Program under AMCFP	Implementing Institution	Total Amount of Funds from AMCFP (in M)	Pass On Interest Rates to end-borrowers	Total Amount of loans released to date (in M)	Total Amount of loans outstanding to date (in M)	Total No. of Borrowers reached	Past Due Ratio (%)
AFFP-LBP	LBP	P 550 m	15%	P 41.26	-	426	21.53
AFFP-PCFC	PCFC	P450 m	21%	P102.59	-	8,977	N.a
Sikat-Saka	LBP	P 200 m	15%	P 1,754.89	-	7,947	7.03
AMP-PCFC	PCFC	P200 m	24%	P 820.26	P 60.0	72,865	N.a.
CoopBank Agri-Lending Program (CBAP)	Coop Banks	P 400 m	15%	P 2,944.97	P 389.44	56,973	N.a.
Calamity Assistance Program	Various FIs	P 100 m	Interest free, Service Charge is 5% max	P 117.31	P 38.39	5,022	N. a.

* Refers to the financial institution to which the AMCFP funds were released. This is also the institution that is supposed to wholesale the AMCFP funds.

Source: ACPC

LBP lending programs to the agriculture sector. As the Government Financial Institution (GFI) mandated to lend to the agriculture sector in general and the small farmers and fisherfolk in particular, LBP implements several agricultural lending facilities using either its own funds (regular lending window) or in partnership with the DA (using AMCFP funds or budgetary appropriation) or the DAR. Those funded by the DA or the DAR are special credit programs designed for specific types of clientele¹³. As of June, 2015, total loans outstanding to small farmers and fisherfolks amount to P29.4 billion accounting for 7.5 percent of its total loan portfolio.

The following are the LBP agricultural lending facilities:

Programs in Partnership with DA/DAR

- *Agriculture and Fisheries Financing Program (AFFP)* is a credit program funded by the AMCFP that aims to increase access to financing of small, marginalized farming and fishing households in areas which are not served or underserved by financial institutions. Small farmers and fisherfolk who are registered in the Registry System for Basic Sectors in Agriculture (RSBSA)¹⁴ are eligible to borrow under the program. Funding for the program came from the budgetary appropriation to the AMCFP through the ACPC. Under the 2013 General Appropriations Act (GAA), P1 billion was allotted to ACPC of which P550 million was released to LBP and another P450 million to the People's Credit and Finance Corporation (PCFC). The program will initially be implemented in the 20 poorest provinces.¹⁵ Based on the RSBSA list, more than 40,000 farmers and fishers are potential beneficiaries of the program. As of August, 2015, Php 86.2 million have already been released to 907 borrowers (Table 3).
- *Sikat-Saka Program.* This is a credit program designed to provide an integrated support to small palay farmers in irrigated areas. The program is implemented in 45 provinces with initial funding of P600 million from LBP and P800 million from the DA/ACPC–AMCFP funds. Under the program, LBP provides retail production loans to qualified small-irrigated palay farmers who are members of an Irrigators' Association (IAs) that are certified by the National Irrigation Administration (NIA). The IAs act as the loan aggregator and facilitator of the loans to individual farmers. A management takeover agreement is executed by and between the farmer-borrower and the IA. Upon willful default of the loan by the farmer, the IA takes over the farm management and is obligated to pay the loan of the

¹³ Most of the credit programs implemented by LBP but funded by the DA or DAR are directed towards borrowers that cannot qualify under the regular lending program of LBP.

¹⁴ The RSBSA is a nationwide database of baseline information of farmers, farm laborers and fisher folk from identified provinces, as well as geographical coordinates of agricultural and fishery workers households. These data will be used as basis for developing programs and policies for the agriculture and fishery sectors

¹⁵ These include the following provinces: that include Abra, Agusan del Sur, Apayao, Camarines Sur, Davao Oriental, Eastern Samar, Ifugao, Kalinga, Masbate, Mountain Province, North Cotabato, Northern Samar, Romblon, Sarangani, Siquijor, Sultan Kudarat, Surigao del Norte and del Sur, Western Samar and Zamboanga del Norte.

farmer to the LBP. The IAs are also used as collecting agents by the LBP with appropriate incentives¹⁶. Interest rates on loan starts at 15% per annum and declines to 9% by the 9th crop cycle. As of September, 2015, **more than** Php 2 billion have already been released to 7,763 farmers. About Php 677 million are still outstanding as of the same date (Table 3).

- *Agrarian Production Credit Program (APCP)*, is a five year credit and capacity development program implemented jointly with the Department of Agriculture (DA), Department of Agrarian Reform (DAR) and the Department of Environment and Natural Resources designed to address the credit needs of ARBs on various economic activities such as agricultural crop production, agri-enterprise and livelihood projects and to target new ARBs who belong to organizations that are not yet eligible under the existing regular lending programs of LANDBANK. As shown in Table 3, the APCP has released close to 2 billion pesos to 526 ARBOs and has an outstanding balance of around P954 million as of Feb. 29, 2016.

Land Bank Regular Lending Programs

- *The Food Supply Chain Program (FSCP)*. The Food Supply Chain Program of the Land Bank of the Philippines (LBP) is a program that links the economic units in the supply chain. LBP allocated P 50.0 billion for production loans (crop, livestock, and fishery) and working capital loans for key food players (agri-producers, processors, consolidators, agri-exporters, service providers)¹⁷. Technical assistance and capacity-building support is also provided to strengthen farmers cooperatives and forge market linkages between agricultural producers and processors. As of July, 2015, **around** P 38 billion was released to 521 borrowers comprised mostly of farmer cooperatives, farmers' organizations and Non-Government Organization (NGO) producers and 140 anchor firms (Table 3).
- *Credit Assistance for Cacao Agri-Business and Other Organization Program (CACAO-100)*. Recognizing the increasing global demand for cacao and the potential of this commodity as espoused in the 2013-2020 Cacao Action Plan formulated by the National Cacao Development Cluster, LBP provides short term and long term credit facility for the following: establishment of cacao nurseries, new cacao plantation and rehabilitation of old cacao plantation. LBP finances 80% of the total project cost. As of August 15, 2015, around P326 million has been released to 29 institutions including cooperatives and farmers organizations, among others.
- *Kalikasang Kabuhayan para Wastong Pamayanan (KAWAYAN)*. Considered as a commodity that could be used for various purposes (i.e. furniture making, crafts, environmental protection, reforestation etc) and recognizing the country's potential to produce bamboo, LBP recently

¹⁶ 0.50%, if, at least, 90% collection rate of the total loan of the borrowers per batch is achieved; or 1.00%, if 100% collection rate of the total loan of the borrowers per batch is achieved.

¹⁷ The program is basically a contract growing scheme which links small cooperative and SME producers to anchor firms or large institutional buyers. The anchor firms buy the produce of the cooperatives and SMEs and provide technical assistance to improve production efficiency.

designed a credit facility for bamboo growers and planters. KAWAYAN intends to provide loans to cooperatives/farmer associations, non-government organizations, countryside financial institutions, small and medium enterprises, agribusiness entities and local government units that want to venture into bamboo growing and production. LBP will finance 80% of the project cost with a maximum loan amount of Php86,000 per hectare for 7 year term in the case of new plantation. Short and long term loans are available for production, working capital or fixed asset acquisition. So far, Land Bank has yet to release its loans under this program.

Other credit programs implemented by the LBP using its own funds are:

- *Integrated Support for the Development of Aquaculture Program (ISDA)*
- *Masustansyang Inumin para sa Likas na Kalusugan (MILK)*
- *LBP- SMC Corn and Cassava Assemblers/Consolidators Financing Program*

The status of these credit programs are shown in Table 3 below:

Table 3. Credit Programs implemented by the LBP, Various Periods

(Amount in million pesos)

LENDING PROGRAMS	Cumulative Releases		Outstanding Balance	No. of Borrowers
AFFP*	86.20		69.49	907
Sikat Saka Program**	2,006.72		677.45	7,763
Food Supply Chain Program**	37,956.41		6,551.37	521
KAWAYAN****	-		-	-
ISDA*	391.07		381.94	46
MILK*	45.53		32.45	5
CACAO-100*	325.96		167.66	29
LBP-SMC Corn and Cassava Assemblers/Consolidators Financing Program *	33.17		167.66	29
APCP*****	1,948.76		953.96	526
CAP-PBD***	160.83		44.66	86

*data as of 15 August, 2015

** data as of 31 July 2015

*** data as of 30 September 2015, no. of borrowers refer to individual farmers

**** with approved amount of 31 Million, no releases yet

***** data as of February 29, 2016

5.2.2. *The Livelihood Credit Assistance Program (LCAP)*. The National Livelihood Development Corporation (NLDC) implements the LCAP to provide livelihood and enterprise development assistance to small farmer beneficiaries in the Agrarian Reform Communities and members of the marginalized sectors by providing access to micro credit. NLDC conduits lends to its network of accredited Microfinance Institutions (MFI) partners comprised of rural financial institutions, cooperatives, non-government organizations, and people's organizations.

5.2.3. *Programs of the Department of Agrarian Reform (DAR)*¹⁸. The DAR is implementing six credit/microfinance and capacity building programs through financial institutions such as Land Bank of the Philippines, CARD Bank and the National Confederation of Cooperatives (NATCCO). Almost all of these programs are credit programs with capacity building components designed to build and strengthen the capacities of the various organization of agrarian reform beneficiaries and be able to graduate into the regular lending program of LBP. These programs include the following:

- *Agrarian Production Credit Program (APCP)*, which, as mentioned above, is being implemented in collaboration with the Department of Agriculture (DA), Department of Environment and Natural Resources (DENR) and Land Bank of the Philippines (LBP). Its specific objective is to address the credit requirements of ARBs for their income-generating projects and to target new ARBs who belong to organizations that are not yet eligible under the existing regular lending programs of LANDBANK. As noted earlier, the APCP has released close to 2 billion pesos to 526 ARBOs and has an outstanding balance of around P954 million as of Feb. 29, 2016.
- *DAR-LANDBANK Credit Assistance Program for Program Beneficiaries Development (CAP-PBD)*¹⁹ which is a program that provides credit assistance to non-bank eligible ARB cooperatives and farmers' associations and capacitates them to become bank-eligible organizations through interventions that include institutional and enterprise development coupled with provision of small loans. As of September, 2015 the program has released Php160.8 million to 86 ARB cooperatives and/or farmers' associations. Loans outstanding as of the same period is Php 44.6 million (Table 3).
- *DAR-LANDBANK Microfinance Capacity Development Program in Agrarian Reform Areas* which aims to provide ARBs in agrarian reform areas easier access to finance by linking them with well-established micro-

¹⁸ Drawn from www.dar.gov.ph

¹⁹ Unlike APCP, CAP-PBD is an off-book credit program implemented by the LBP.

finance institutions (MFIs) as well as to develop ARB cooperatives in becoming effective and efficient microfinance service providers. DAR enters into a partnership agreement with Microfinance Institutions (MFIs), Cooperative Rural Banks (CRBs), and strong Bank-Assisted Cooperatives (BACs) with lending and/or MF operations. DAR provides capacity development grant to partner institutions which are then encouraged to use their own funds to lend to ARBs/ARB households.

- *Micro-Agri Loan Product (MALP) Development Program* which aims to develop various micro-agri credit products (MALPs) channeled through bank-assisted cooperatives and countryside financial institutions (CFIs) in order to increase access of ARBs to appropriate credit products that address requirements of ARBs. Under the program, DAR provides capacity building assistance to partner MFIs through a service provider. MFIs provide the necessary credit funds to lend out to ARBs. As of December, 2015, loans amounting to Php 330 million have been released by 23 participating institutions to 18,783 borrowers. Loans were mainly used for agricultural production and other agri-related activities.
- DAR-CARD, Inc. is a capacity building program for ARB Cooperatives in ARCs that is implemented in partnership with CARD, Inc. The program aims to turn ARB Coops into viable microfinance (MF) providers. CARD provides technical assistance to participating cooperatives and NGOs through handholding and mentoring activities for these institutions to have viable microfinance operations. Aside from technical assistance provided by CARD, it has also provided some P45 million counterpart loan fund for the ARB coops. As of December 31, 2015, some 55 institutions were assisted and as a result, these institutions were able to provide microfinance loans to 34,436 members using mostly internal funds, amounting to Php 651.3 million.
- *DAR-NATCCO-Microfinance Innovations in Cooperatives in Agrarian Reform Areas (MICOOP)* is being implemented in partnership with the National Confederation of Cooperatives (NATCCO). The program aims to help coops expand their outreach to more poor households that desire to engage in micro, small and medium enterprises but have no access to formal lending institutions. NATCCO enters into a partnership with a viable and qualified coop to help the coop put up new branches or satellite offices in areas with high poverty incidence. Similar to DAR-CARD program NATCCO provides technical and mentoring assistance to participating cooperative. NATCCO also provides loans to the partner cooperatives for on-lending to its members. As of December 31, 2015, more than 3 billion pesos have been released to 36,146 borrowers.

Agricultural Guarantee Fund Program. AGFP provides 85% guarantee cover on agricultural production loans granted by accredited private financing institutions and other lending entities against all types of risks of non-repayment by farmer-borrowers except willful default or fraud. The objective is to encourage banks, cooperatives and other lending institutions to increase their loans to SFF and reduce risk on the part of the lenders. As of December 31, 2015, the program has provided a total guarantee coverage of 5.2 billion pesos to 101 partner institutions and has benefitted a total of 105,007 small farmers and fisherfolk. Its total guarantee claims paid, on the other hand, reached 235.7 million pesos. The 101 partner institutions include 53 banks, 41 cooperatives and 7 NGOs/FOs.

5.2.4. *Programs of the Philippine Crop Insurance Corporation (PCIC)*²⁰.

PCIC provides small farmers and farmer associations with insurance protection against crop losses, particularly for palay, corn, high-value commercial crops, livestock, fisheries, and non-crop agricultural assets (i.e., 9 warehouses, rice mills, transport facilities, and other farm equipment due to perils like fire, theft, and earthquake) (Teves, 2014). In 2012, PCIC's penetration rate was only 4%, equivalent to 311,388 farmers, fisherfolk, livestock raisers and other stakeholders but this went up to 8% in 2013 as PCIC was able to provide agricultural insurance to 732,654 stakeholders (PCIC, 2014). Under the General Appropriations Act of 2014, the government gave PCIC around P1.2 billion for the full cost of insurance premium of subsistence farmers and fisherfolk registered in the government's Registry System for Basic Sectors in Agriculture (RSBSA) (PCIC, 2014). It covers rice, corn, high-value crops, coconut, livestock, and non-crop agricultural assets insurance within the 20 priority provinces²¹. Outside of these 20 provinces, however, only rice and corn crop insurance are subsidized by the government.

To accelerate the processing of insurance claims, PCIC has recently started work on specialized programs like the weather index-based insurance (WIBI)²² and the area-based yield index insurance (ARBY)²³. Under these insurance schemes, indemnities are paid based on agreed weather indices or yield thresholds, and not on actual damages suffered by the producers. Therefore, pay-outs are released once a certain index is breached without the necessity of a farmer's filing a claim or of PCIC conducting field assessments (Cajucum, 2014).

²⁰ PIDS conducted an assessment of PCIC in 2015. Key findings of the study are shown in Annex A (DP 2015-07: Review of Design and Implementation of the Agricultural Insurance Programs of the Philippine Crop Insurance Corporation and DP 2015-08: Targeting the Agricultural Poor: The Case of PCIC's Special Programs)

²¹ Abra, Agusan del Sur, Apayao, Camarines Sur, Davao Oriental, North Cotabato, Northern Samar, Romblon, Sarangani, Ifugao, Kalinga, Masbate, Mountain Province, Sultan Kudarat, Surigao del Norte, Surigao del Sur, Western Samar, Zamboanga del Norte, Siquijor, and Eastern Samar.

²² WIBI uses 30-year historical weather data from a weather station within 20 kilometers of a municipality, along with climate scenarios for 2020 and 2050. To implement WIBI, PCIC will rely on the rainfall report of the Philippines Atmospheric, Geophysical and Astronomical Services Administration (PAGASA). This will enable farmers to get compensation when there is very little or excessive rainfall.

²³ ARBY, on the other hand, will compensate farmers if their yield falls below the average, e.g., if, on the average, a farmer in a certain area harvests 100 cavans per hectare and this falls to 60 cavans during one season, he would be promptly compensated. Crop data for ARBY, will be obtained from DA, local government units and focus group discussions with farmers

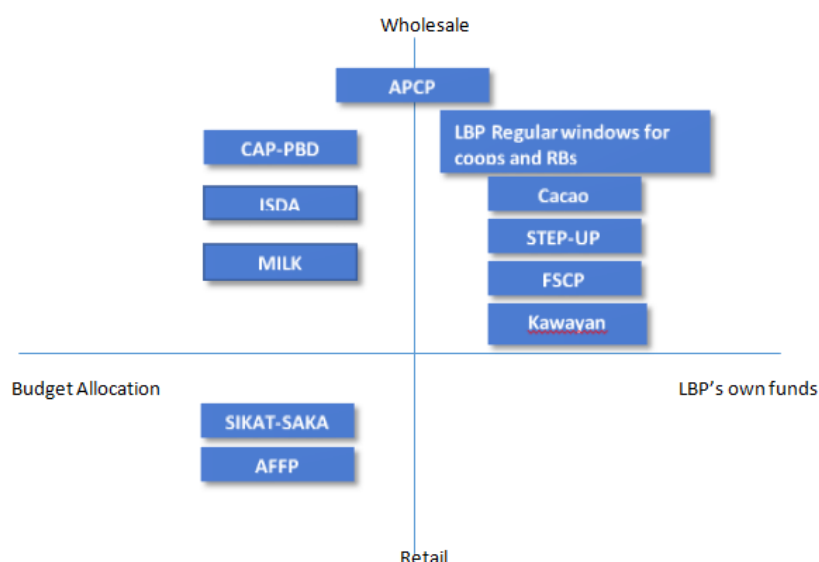
5.3. Comparative Assessment of Various Credit Programs for Smallholders

This section describes and compares the different credit programs for small holders with regards to program modalities, eligible borrowers, loan purpose and terms and conditions. Table 4 presents a mapping of the various credit programs according to the said features.

Program Modalities. As the financial institution mandated to provide loans and other financial services to the agricultural sector, the Land Bank of the Philippines is able to perform its mandate by using either : 1) its own funds or; 2) funds from the budget of non-financial government agencies (NFGAs) like the Department of Agriculture (DA) and the Department of Agrarian Reform (DAR).

These NFGAs such as DAR and DA earmark a portion of their budget for lending to small farmers because despite the agriculture lending facilities implemented by LBP, there is still a good number of smallholders that are not able to borrow. In compliance with the current policy framework on the implementation of government credit programs, these funds are channeled through GFIs, particularly LBP. Budget funds are deposited in a trust account with LBP and loan portfolio performance is considered off-books and therefore does not affect LBP's bottom line. Programs funded out of budgetary allocation are implemented using the following modalities: i) LBP wholesales the funds to cooperatives, NGOs, farmers' and fishers' organizations and ii) LBP directly retails the funds to small farmers. These programs are on the left side of the quadrant of Figure 2 below:

Figure 2. Credit Program Modalities



Except for two credit programs (Sikat Saka and AFFP) which are implemented as a retail credit program by LBP where loans are provided directly to small farmers and fisherfolk, all of the programs are implemented through retail private financial institutions (e.g. coops, farmers organization and/or countryside financial institutions such as rural banks).

The LBP implements four major credit programs on top of its regular lending facility that provides wholesale funds to eligible cooperatives, rural banks and farmers organizations. These four major credit programs include , APCP, CAP-PBD, ISDA and MILK. Cooperatives and rural banks that borrow under LBP's regular lending facility on-lend the funds to its members and clients for various purposes, majority of which is for agricultural production and/or enterprises.

Unlike the other programs funded by budgetary allocation, the Agriculture Production Credit Program (APCP) uses its budgetary allocation as guarantee funds. The DAR funds are deposited in an LBP trust account and is only used as a guarantee fund. . LBP uses its own funds for lending to program clients. When there is a loan default, LBP debits the past due amount from the guarantee fund.

Eligible Borrowers. Programs like Sikat Saka and AFFP are designed for small farmers and fishers, in general. On the other hand, the APCP and CAP-PBD lend specifically to agrarian reform beneficiaries (ARBs) and agrarian reform beneficiary organizations (ARBOs). Similarly, programs like the MILK, CACAO, ISDA, KAWAYAN, Step-Up Loan and the FCSP target small farmer and fisher (SFF) organizations, cooperatives, NGOs and Coop Federations. Other sectors targeted by these programs include LGUs (for CACAO and KAWAYAN), countryside financial institutions (for MIK, ISDA and Step-Up Loan).

Loan Purpose. Majority of the programs (8 of 10) provide loans for working capital. These programs include the Milk, Cacao, Isda and Kawayan regular programs of the Land Bank as well as the AFFP, CAP-PBD, APCP AND ACSP programs. Programs that provide production loans, on other hand, are Cacao (HVCC), Isda (Fisheries), Sikat Saka (Rice), Kawayan, AFFP and FCSP .The AFFP, CAP-PBD APCP and FCSP provide loans for fixed assets as well.

Terms and Conditions. All programs provide both short-term (6 months to 1 year) and term loans (more than 1 year) except for Sikat Saka and APCP which provide only short-term loans. Production loans are usually short-term while loans for other purposes such as fixed assets and working capital are term loans.

With respect to collateral, real estate mortgage or REM is one form of collateral required or accepted by most programs except Sikat Saka, AFFP and APCP. Since the clients of these programs are mostly small farmers who do not qualify based on bank standards, collateral substitutes in lieu of REM are allowed as well. Examples of collateral substitutes are promissory notes (PNs) from cooperatives and farmers' organizations, assignment of crop insurance, guarantee coverage, chattel mortgage and/or hold-out deposits and purchase orders, among others. Programs that accept promissory notes from cooperatives and farmers organizations are the MILK program of Land Bank, Sikat Saka, Kawayan, AFFP, CAP-PBD, APCP and FCSP. Another common collateral substitute is the chattel mortgage which is accepted by all programs. It is interesting to note that there are programs that accept guarantee as a substitute to collateral. This guarantee is

provided under the Agricultural Guarantee Fund Pool of the Department of Agriculture and Land Bank of the Philippines. Table 4 presents the different types of collateral substitutes accepted under each program.

Table 4. Key features of Various Credit Programs

	Commodity Based Programs					Programs for SFF and ARBs			Other Agri Credit Program	
	MILK	CACAO -100	ISDA	SIKAT SAKA (Rice)	KA WA YAN	AFFP	CAP - PBD	APCP	Step-Up Loan	FCSP
Eligible Borrowers										
Small farmers and fishers (SFF)				X		X				
ARBs /ARBOs							X	X		
SFF Organizations	X	X								X
Coops/NGOs/Federations	X	X	X		X				X	X
SMEs/Large ABEs	X	X	X		X					X
LGUs		X			X					
Countyside Financial Institutions (CFIs)	X		X						X	
Loan Purpose							X	X		
Production loan					X	X				X
Rice				X						
HVCC		X								
Livestock and Poultry	X					X				
Fisheries			X			X				
Fixed Assets						X	X	X		X
Working Capital	X	X	X		X	X	X	X		X
Rehab/Restoration of damage facilities										
Loan take out from CFIs										
Relending	X	X	X		X					
Rediscounting	X	X	X		X				X	
Collateral Requirements										
PN	X			X	X	X	X	X		X
Assignment of Crop Insurance	X			X	X	X		X		X
Chattel Mortgage	X	X	X	X	X	X	X	X		X

	Commodity Based Programs					Programs for SFF and ARBs			Other Agri Credit Program	
	MILK	CACAO -100	ISDA	SIKAT SAKA (Rice)	KA WA YAN	AFFP	CAP - PBD	APCP	Step-Up Loan	FCSP
Guarantee Coverage/AGFP	X		X						X	X
REM	X	X	X		X		X			X
Assignment of portion of LGU's IRA					X					
Credit Surety Fund			X						X	X
Comprehensive Surety Agreement and/or Joint and Several Signatures (JSS)										X
Continuing Assignments of Receivables									X	
Hold-out Deposit										X
Deed of Assignments										X
Fishery Trust Fund			X							
Purchase Order/Marketing Agreement				X			X			
Post Dated Checks										
Loan Maturity										
Short-term (6 mos to 1 year)	X	X	X	X	X	X	X	X		X
Term-Loan	X	X	X		X	X	X		X	X
Fund Source										
LBP's Own Fund		X			X				X	
DA				X		X		X		
DAR							X	X		
DA-NDA	X									
DA-BFAR			X							
JBIC										X
Area Coverage										
Nationwide	X	X	X	41 PROV	X	14 PROV	X	X	X	X

Some Comments and Observations on the Smallholder Credit Programs. The foregoing shows that there is a variety of credit programs targeted towards small farmers with almost very similar features. Basic difference lies in the source of funds

which essentially determines the purpose and the specific target clientele, e.g. irrigated rice farmers for Sikat Saka, RSBSA farmers for AFFP, ARBs for APCP etc.

Given the multiplicity of programs catering to smallholders, it is not clear whether multiple borrowings across program happens. LBP, however, claims that their monitoring system is able to verify borrower credit information across programs and prevents a farmer from borrowing from more than two programs. It is also observed that after the consolidation of agricultural credit programs into the AMCFP sometime in the late 90s, there seem to be a tendency to go back to commodity specific credit programs. These credit programs are implemented through the same conduit (LBP), and cater to the same small farmer with almost the same terms and conditions. These are also credit programs funded and implemented by either the DA or the DAR. As several studies have observed, the overlap reflect the observation that there seem to be some disconnect between and among line agencies dealing with farmers. As with the other rural development programs, there is weak coordination between and among agencies assisting small farmers. This leads to duplication or at times even conflicting signals.

To avoid this, there is a need to rationalize these credit programs particularly those that cater to small farmers. Stronger coordination between DA and DAR is needed.

5.4. Performance of Smallholder Credit Programs

Discussion on the performance of smallholder credit programs is focused on three programs that directly target small farmers, agrarian reform beneficiaries and small fishers, particularly, the AFFP, Sikat Saka and the APCP.

Table 5 shows that the AFFP-PCFC has a 100% repayment rate as of December 31, 2015; followed by Sikat Saka at 92% as of December 31, 2015; APCP at 89.46% as of Feb. 29, 2016 and the AFFP-LBP at 78.47% as of December 31, 2015. On the other hand, AFFP-Land Bank and the APCP have repayment rates of 78.47% and 89.68%, respectively. The program with the highest past due ratio is AFFP-Land Bank at 21.53%, followed by APCP at 10.54% and Sikat Saka at 7.78%.

With respect to amount of loans granted, programs that reached the billion mark include Sikat Saka and APCP at P2.2 billion and P2 billion, respectively.

Meanwhile, APCP posted the greatest number of individual borrowers at 31,036 followed by AFFP-PCFC at 16,458; Sikat Saka at 9,413 and AFFP-LBP at 1,231 (Table 5).

The foregoing shows that in terms of outreach, programs that were channeled through cooperatives and farmers' organizationS (e.g. ARBOs) have greater outreach (e.g. AFFP-PCFC and APCP) than those that were directly lent out to clients (AFFP and Sikat-Saka).

Table 5. Comparative Performance Review of Smallholder Programs

Name of Program	Amount of Loans Granted (in million)	Number of Individual Borrowers Reached	Repayment Rate (%)	Past Due Rate (%)
AFFP-LBP/1	119.39	1,231	78.47	21.53
AFFP-PCFC/1	259.20	16,458	100% MFI to PCFC	0
SIKAT SAKA/1	2,158.15	9,413	92.22	7.78
APCP/2	1,948.78	31,036	89.46	10.54

Source: ACPC, DAR, Land Bank

/1 As of December 31, 2015

/2 As of Feb. 29, 2016

5.5. State of Smallholder Financing

The proportion of smallholders that borrowed from formal sources increased from 2006 to 2014. According to the Small Farm Indebtedness Survey²⁴ which is regularly conducted by the ACPC, about two-thirds of small farmers borrowed in 2014. More than half of small farmers borrowed from formal sources and about 40% of smallholders borrowing from informal sources in 2014. Seven percent borrowed from both formal and informal sources.

Informal sources of financing remain an important source of financing among smallholders. The proportion of those who borrowed from informal sources declined from 52% in 2006 to only 40% in 2014. Informal sources such as family, friends, relatives, traders, input dealers and moneylenders continue to serve a sizable proportion of small farmers.

Table 6. Profile of Small Farmers' Borrowing

	2006	2008	2014
Proportion of small farmer borrowers	68%	63%	60%
Proportion of small farmers borrowing from formal sources	48%	52%	53%
Proportion of small farmers borrowing	52%	41%	40%

²⁴ Small Farm Indebtedness Survey is an annual survey conducted by ACPC.

from informal sources			
Proportion of small farmers that borrowed from both formal and informal sources		7%	7%

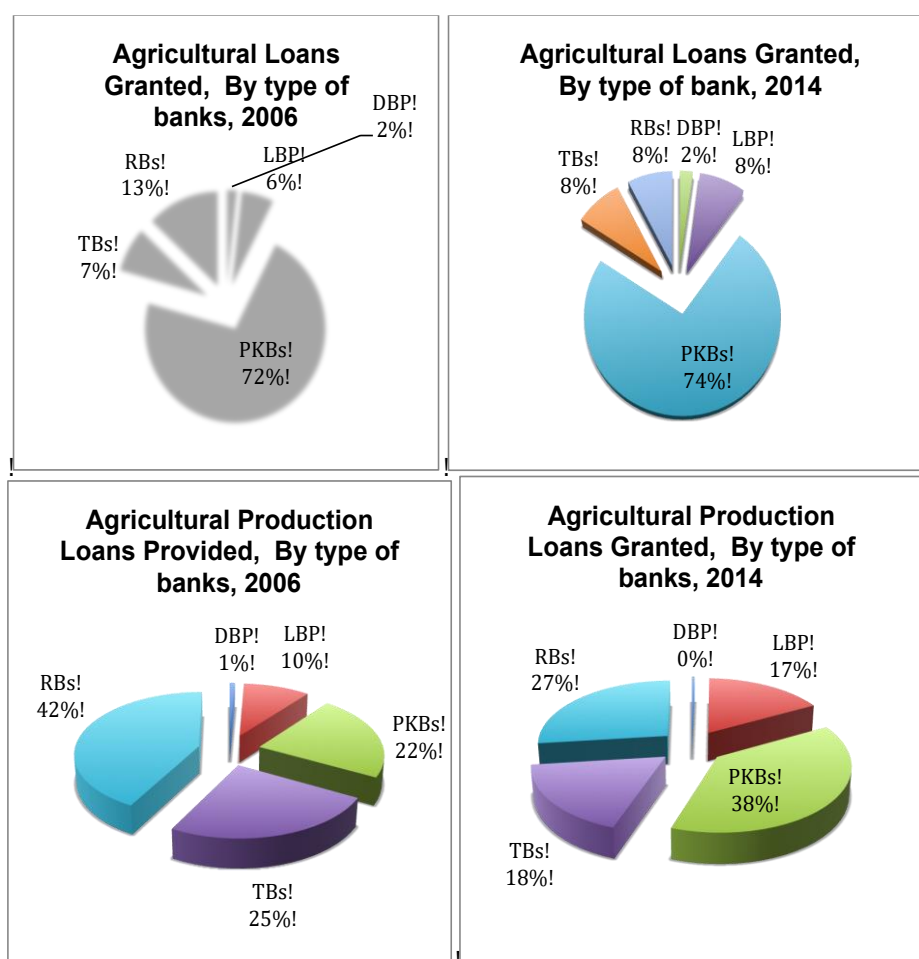
Source: ACPC Small Farm Indebtedness Survey

Despite the increase in the proportion of small farmers who borrowed from formal sources, total production loans released by all banks remained small. In 2014, total amount of agricultural production loans released by banks amounted to only Php246.7 billion pesos²⁵. This amount represents almost a third of total agricultural loans granted and only 2 percent of the total loans granted by the whole banking system. Estimated total credit demand of small farmers and fisherfolk for 2014 was P524.9 of which P82.1 billion are from ARBs.

Private commercial banks provided a substantial portion of the total agricultural loans from the banking system. Figure 3 below shows that private banks provided 90% of the total agricultural loans in 2014. About 70 percent of these loans were from private commercial banks and only 10% came from government financial institutions. In terms of agricultural production loans, 17% were released by LBP (almost equal to the total amount provided by thrift banks) while 38% came from private commercial banks in 2014. Almost the same pattern was observed in 2006 for total agricultural loans. For agricultural production loans, the share of thrift banks and rural banks substantially declined from 2006 to 2014 while that of LBP and other private commercial banks increased.

²⁵ Data from Bangko Sentral ng Pilipinas and Agricultural Credit and Policy Council (ACPC)

Figure 3. Agricultural Loans and Production Loans, by type of banks,



Source of Basic Data: BSP-DER, SRSO, Statistical Bulletin, RB System Annual Reports, LBP and DBP.

LBP, RBs' and TBs' agricultural loan portfolio are largely production loans. Table 7 below shows that in 2014, about two-thirds of the LBP's agriculture loan portfolio is production loans while all the loans granted by thrift banks and rural banks to the agriculture sector were production loans to smallholders. Only 15 percent of the agriculture loans extended by commercial banks were lent for agricultural production.

Table 7. Status of Smallholder Financing

	2006	2008	2014
Amount of agriculture loans granted (in Pmillion)	302,162.20	482,473.70	778,250.00
Amount of agricultural production loans granted (in Pmillion)	93,227.96	162,829.07	246,663.77
Proportion of agri loans to total loans granted (in%)	1.7	2.6	1.9
Proportion of agri production loans to total agri loans (in%)			
All Banks	30.9	33.7	31.7
Government Financial Institutions			
LBP	53.4	64.5	60.1
DBP	14.2	2.1	5.1
Commercial banks	9.6	17.3	14.7
Thrift banks	100.0	48.7	100.0
Rural banks	100.0	100.0	99.0

Source of basic data: BSP-DER/SRSO/Statistical Bulletin, RB System annual reports, LBP and DBP.

The foregoing information implies that while agricultural loans comprise only a measly 2% of the total loans granted by the banking system, data shows that private banks (except for RBs) have increased their share of total agricultural lending from 2006 to 2014 (see figure 3). In terms of agricultural production, private banks have also stepped up. This can partly be attributed to the government's deliberate shift to a market-based and demand-driven approach to agricultural lending.

Microfinance and micro-finance oriented appetite micro-agri loans seem to be waning. Using microfinance technology, banks also provide microfinance loans for the agricultural sector. These are called micro-agri loans. Data shows that the number of banks with micro-agri loans went down from 39 in 2012 to 32 in 2014. On the other hand, the amount of micro-agri loans provided by these banks also decreased significantly from about P496 million in 2012 to P295 million in 2013 and went down further to P278 million in 2014.

Table 8. Micro-agri loans from Private Banks

	2012	2013	2014 (Q2)
Number of Banks with Micro-Agri Loans	39	33	32
Amount of Micro-Agri Loan Portfolio(in million pesos)	496	295	278

Source: Bangko Sentral ng Pilipinas

Weak compliance of banks to the Agra requirement under the Agri-Agra Law.

Under the Agri-agra Reform Credit Act of 2009 (RA 10000), all banks are mandated to set aside 25 percent of their loanable funds for agriculture and fisheries, of which the 10 percent is to be appropriated exclusively for agrarian reform beneficiaries. Aside from directly lending to agri and agra borrowers, banks are allowed to comply using alternative forms of compliance.²⁶

In 2014, the total loanable funds of banks were P2.13 trillion. Following the mandated quota allocation, P527.93 billion should have been channeled to agriculture broken down into: P322.8 billion for agri and P215.2 billion for agra. Compliance data shows that there was over-compliance in the agri requirement (15.2) and an under compliance in the agra requirement (1.5%). Table 8 below shows that more than half of the banks' agri compliance is through alternative forms. ACPC reported that banks prefer the alternative mode for the following reasons: 1) banks still prefer to comply through less risky modes; and 2) banks have difficulty finding qualified ARBs. Because of the risks associated with agri and agra lending, some commercial banks prefer to pay penalties than lend to the sector.

²⁶ Following are the alternative forms of compliance: i) Investments in bonds issued by the DBP and the LBP that have been expressly declared as eligible by the DA, or by an agency duly-authorized by the DA; ii. Investments in other debt securities that have been declared as eligible by the DA, or by an agency duly-authorized by the DA; iii. Paid subscription of shares of stock in the following institutions, such as Accredited rural financial institutions (preferred shares only), Quedan and Rural Credit Guarantee Corporation (Quedancor), or (3) Philippine Crop Insurance Corporation (PCIC); Investments in SDAs of BSP-accredited rural financial institutions; iv. Wholesale lending granted to accredited rural financial institutions for the exclusive purpose of on-lending to the agriculture and agrarian reform sector; v. Rediscounting facility granted by UBs/KBs to other banks covering eligible agricultural and agrarian reform credits, including loans covered by guarantees of the Quedancor or the PCIC; vi. Actual extension of loans intended for the construction and upgrading of infrastructure, including, but not limited to, farm-to-market roads, as well as the provision of post harvest facilities and other public infrastructure; vii. Loans to NFA-registered warehousemen/millers/wholesalers for purposes of financing activities; viii. Loan to NFA provided that the NFA shall not use the proceeds of said loans for relending; ix. Purchase of eligible loans that are not rediscounted with universal banks or commercial banks;

**Table 9. Bank Compliance to the Agri-Agra Law
(in billion pesos)**

	2014	
	Amount	Compliance Rate
Banks' Total Loanable Funds	2151.71	
Amount of Loan Quota Requirement		
15% Agri Requirement	322.76	
10% Agra Requirement	215.17	
Actual Compliance to 15% Agri		
Direct Compliance	149.55	6.95%
Alternative Compliance	176.99	8.26%
Total Agri Compliance	326.54	15.21%
Actual Compliance to 10% Agra		
Direct Compliance	26.84	1.25%
Alternative Compliance	5.31	0.24%
Total Agra Compliance	32.15	1.49%

6. Assessing the Agrarian Production Credit Program (APCP)

To enhance the productivity of the agrarian reform lands, DAR provides organizational development interventions alongside the land distribution process. ARBs are organized into Agrarian Reform Beneficiaries Organization (ARBOs) through which government support services and assistance is channeled. Most of these organizations, particularly the new ones are credit constrained and do not qualify under the LBP's regular lending program and under the Credit Assistance Program for Program Beneficiaries' Development (CAP-PBD).²⁷ Because of this, the DA, DAR, DENR and the Land Bank pooled resources and expertise to provide credit, development assistance and marketing support to ARBs

6.1. Scope of the Program

The APCP is a P2 billion-credit facility, which was designed to meet the credit needs of Agrarian Reform Beneficiaries (ARBs). The program provides credit assistance to newly organized ARBOs, FOs and POs or existing ARBOs that are generally not qualified under the regular lending program of LBP. Following are the terms and conditions of loans under the program:

²⁷ CAP-PBD is a credit program that provides credit assistance to non-bank eligible ARB cooperatives and farmers' associations and assists them to become bank-eligible organizations. Interventions include institutional and enterprise development coupled with provision of small loans.

Table 10. APCP Loan Terms and Conditions

Eligible borrowers	<ul style="list-style-type: none"> • ARB Organizations with ARB members (<i>Coops and Farmers Organizations</i>) • Other conduits such as Coops, RBs and NGOs with ARB or ARB household members or ARBOs that are not qualified under the regular lending program of LBP.
Eligibility criteria for borrowers	<ul style="list-style-type: none"> • Duly registered with CDA or SEC • Operational for the past 6 months • With ARB members • With core management team • With systems and procedures in place particularly on lending
Projects that can be financed	<ul style="list-style-type: none"> • Crop Production • Agri-enterprise • Livelihood Projects
Loan amount limit	<ul style="list-style-type: none"> • Up to 80% of the total project cost • For agri-enterprise and livelihood projects: <ul style="list-style-type: none"> - For those with existing production loans, up to 10% of the outstanding loan portfolio - For those without existing production loans, not to exceed Php 1 million per ARBO
Interest rate	<ul style="list-style-type: none"> • 8.5%* p.a. for short term loans • 9.5%* p.a. for term loans <p><i>*inclusive of 2% p.a. incentives for service conduit</i></p>
Loan terms	<ul style="list-style-type: none"> • Short term loans – term of not more than 1 year • Term loans – term of up to 7 years inclusive of 3-year grace period
Loan repayment scheme	Based on crop cycle, cash flow and/or remaining useful life of the asset financed
Collateral requirement	<ul style="list-style-type: none"> • Deed of Assignment (D/A) of promissory notes and underlying collaterals • D/A of proceeds of market contracts • D/A of crop insurance proceeds (if any) • Chattel Mortgage

Aside from the lending facility, the program also provides capacity building assistance to the ARBO/PO/FO borrower. The assistance is focused on strengthening the ARBOs/POs/FOs and/or enhancing the capacities of the organization to eventually qualify under the regular lending program of the LBP. As such, capacity building assistance include among other things, the deployment of experts who will assist borrowers (ARBOs, FOs and POs) in the following:

- Setting up of loan disbursement and repayment system within the APCP eligible conduit;
- Establishment of appropriate financial control measures to ensure the timely release of loans to and collection from end-borrowers;
- Institutional strengthening to ensure the viability and sustainability of the ARBO/FO/PO
- Developing organizational vision and development of relevant operational policies, systems and procedures.
- Developing the business enterprise of the organization to ensure viability and sustainability.

Aside from the capacity building component of APCP, the program also provides mandatory crop insurance coverage of all APCP borrowers. Crop insurance premiums of APCP-farmer-borrowers are paid for by the program.

6.2. Performance assessment

6.2.1. Program performance

As of February 29,,2016, a total amount of 1.95 billion pesos have been released to 526 ARBOs providing credit access to 31,036 ARBs. Of the amount released, P953.96 million is still outstanding of which 10.54% was registered as past due. Repayment rate of the program was 89. 68%. Some ARBOs are not able to pay their loan due to their inability to collect from **all** of their sub-borrowers. Because most of the ARBOs are small and do not have buffer funds for relending, ARBOs choose to default on their loans when some of the sub-borrowers are not able to pay. Recognizing that because of non-payment of some borrowers, the whole ARBO is not qualified for a re-loan, some ARBOs opt to default on their loan to be able to provide loans to the good-paying borrowers. Loans collected are used to provide re-loans to good paying borrowers.

While the past due rate may not yet be considered very high, it is prudent to still lower the past due rate considering that past due ratio is based on amortization past due. Since APCP loans are relatively small, one missed payment may result in an increasing rate of default as the loan approaches maturity.

Table 11. Program Status as of February 29, 2016

	No. of ARBs	2016 Releases	Cumulative Amount of Loan Releases (Pmillion)
Rice	12,797	4.83	764.32
Corn	3,036	6.32	154.81
Sugarcane	9,778	3.77	752.11
Corn and Sugar	1,126	-	125.50
Palay and Sugar	32	-	2.10
Corn and Palay	28	-	1.51
Coconut	2	-	0.40
HVCC	2,656	0.12	80.39
Fisheries	140	-	0.36
Livestock and Poultry	242	0.10	13.11
Agri-enterprise	762	-	1.00
Others	437		53.17
Total *	31,036	15.14	1,948.78

Source: Land Bank

6.2.2. Program design

As discussed in the program scope, APCP is designed to provide credit assistance to ARB organization that does not qualify under the regular lending window of LBP for smallholders. As such, ***the documentary requirements are less tedious and the lending procedures adopted under the program are relatively simpler compared to the requirements and procedures under the LBP regular lending program.*** Table 11 below shows a comparison of the documentary requirements of the APCP and the LBP regular lending program.

Table 12. Documentary Requirements under the LBP Regular Lending Program and the APCP: A Comparison

LBP Regular Lending Window	APCP
To be eligible under the LBP regular lending window, a cooperative needs to qualify under the Enhanced Cooperative Accreditation Criteria (ECAC). The ECAC has two parts:	To qualify as an eligible borrower under APCP, the ARBO has to submit the following: 1. Endorsement by DAR of eligible conduits with certified list of eligible ARBs or ARB household members.

<p>Part I - submission of the following pre-qualification requirements:</p> <ol style="list-style-type: none"> 1. Must be duly registered with the Cooperative Development Authority (CDA) 2. Must have a minimum of 60 regular members; 3. With a minimum paid-up share capital of P30,000.00; provided that for NACs with more than 60 members, an average of P500.00 per regular member is required. 4. All members have undergone pre-membership education seminar; 5. With updated and audited financial statement 6. With a Core Management Team (COMAT) composed of qualified, duly designated full/part time Manager, bonded full/part time Cashier/Treasurer and full time Bookkeeper <p>Part II - passing the performance indicators under each of the following categories to determine the coop's maturity level</p> <ul style="list-style-type: none"> • Organization and Management - measures the size of membership, patronage of business, participation of members in CBU and SM programs, leadership and management, continuing education and skills development, policies, systems and procedures, book of accounts. • Business Operation – measures the livelihood enterprises, volume of business, market linkaging. • Financial and Loan Portfolio – refers to the profitability, liquidity and the coop relationship with LANDBANK in terms of loan repayment, deposits and investments. 	<ol style="list-style-type: none"> 2. Endorsement by DENR of certified people's organization 3. Certification from ARBO that their eligible members/clients have no outstanding loans with any financing institutions for the same project being applied for, and that their members are actual cultivators of the land 4. Photocopy of Registration Certificate and Articles of Cooperation/incorporation/By-laws duly authenticated by DAR/DENR or LBP 5. Audited Financial Statements for the preceding year and interim FS for the current year, if applicable 6. Copy of the lending policy or project policy for block farming/collective farming/joint venture/contract growing with the corresponding agreement between the ARBO and the member duly concurred by the PARPO/MARPO/PENRO/CENRO 7. Copy of marketing contract between the conduit and market provider 8. Notarized General Assembly Resolution authorizing the BOD to borrow 9. Notarized BOD Resolution applying for loan and designating authorized signatories 10. List of members with their corresponding address, work area, farm location and paid-up share capital duly certified by its secretary and attested by the chairperson 11. Certified list of officers and Core Management Team 12. Farm plan and budget, and/or business plan, if applicable 13. Milling report for sugarcane for the last 3 years, if applicable 14. Photocopy of systems and procedures and minutes of the meeting.
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The lending process adopted is simpler and has fewer procedural steps.
The DAR field staff assists prospective APCP borrowers in making sure that

the borrower's documentary requirements are complete. DAR assistance facilitates loan approval and evaluation since documentary requirements are mostly complete when loan applications are submitted to the LBP lending center. Also, loan approval is relatively faster because APCP loan limits are within the approval authority of the local lending centers. With the DAR assistance in documentary submissions and with relatively few steps, almost all borrowers endorsed by DAR are approved and loans are released accordingly. With relatively simple documentary requirements, easy lending procedures and lower interest rates, it is no surprise that most ARBs prefer APCP over other lending programs of DAR.

It was also reported during the FGDs conducted that some APCP ARBO borrowers were former CAP-PBD borrowers. Instead of graduating from CAP-PBD to the regular lending program of LBP, some ARBOs opted to borrow under APCP particularly those with past due loans. It was also noted that some ARBOs who are already qualified in the regular lending program of LBP still borrow from the APCP. The ARBOs, DAR and LBP lending centers argue that these ARBOs are still qualified under APCP because they have members who just got their CLOAs and therefore are still qualified as end-borrowers under APCP.

6.2.3. Lending Policies and Procedures

The program lending policies and procedures adopted under the APCP facilitate ARBs' access to credit particularly those that are not eligible under the regular lending window of LBP or other private financial institutions. Following are some observations:

- i. For newly registered ARBOs to qualify as APCP borrower, the APCP lending guidelines requires that it should i) be operational for at least six (6) months, ii) have lending systems and procedures in place and iii) have a management team with at least a manager, a cashier and a bookkeeper. While these requirements are meant to facilitate lending to new ARBOs, these are not sufficient foundation for an ARBO to become viable during the life of the program. A newly registered ARBO with only six months of operation may not have the necessary equity needed to have viable and sustainable operations.
- ii. The requirement of six-month operational period is too short to determine if the prospective ARBO borrower is ready and has the potential to grow. Given the size of the ARBOs, the required period is not sufficient for an ARBO to put operating system and procedures in place and to have a trained management team.
- iii. The debt to equity ratio is waived for ARBO borrowers. As such, most of the ARBO borrowers are too small with very limited amount of capital for operations. In view of this, ARBOs have difficulty paying the loan when one of the member ARB borrower defaults on their individual loan. These ARBOs do not have buffer fund for their lending operations and merely acts as cashier to the program. If the intention of the APCP is to prepare the ARBOs/POs to become bankable and pass the regular lending criteria of LBP, at least 10% equity or a 90:10 debt-equity ratio must be required.

- iv. LBP does not seem to conduct any rigorous credit screening of APCP borrowers. Provided documentary requirements are complete, LBP lending centers usually approves the loan endorsed by the DAR personnel. In all the provinces visited, all the lending centers indicated loan approvals for all borrowers endorsed by the DAR. This seeming leniency on the part of LBP may be attributed to the incentives associated with APCP product design, i.e. lending centers can call on the guarantee fund to cover any loan default after 30 days.
- v. Lending procedures and guidelines do not entice nor encourage participation from private financial institutions (e.g. rural banks). For instance, the imposition of a cap on the on-lending interest rate discourages rural banks to borrow from the APCP because transaction cost of lending to ARBs is relatively high. Also, the 8.5% interest rate on wholesale loans is relatively high for rural banks, particularly those that already qualify under the regular lending program of LBP²⁸.
- vi. To encourage rural banks, program design may need to be amended to induce them to be conduits of APCP and lend to ARBs within their area of operation. For instance, if the purpose of the loan is for agricultural production, rural banks may be allowed to require the assignment of the standing crops as part of the collateral.
- vii. The short timeline of the program (initially for 3 years but was extended to 5 years) may be counterproductive and may encourage default. Lessons from microfinance programs show that borrowers continue to pay their loans when they are assured that they are able to borrow continuously on a sustainable basis. Having a 5-year timeline without any assurance of graduating into the LBP regular lending program may therefore be counterproductive and defeat the program purpose of enabling the borrowers to access credit on a sustainable basis.

6.2.4. Program Implementation

The LBP and the DAR jointly implements the APCP with support from the DA and DENR. A project management committee (PMC) comprised of high-level officials from the DA, DAR, DENR, LBP, DOF and a farmer representative. The PMC is tasked to: i) provide direction and formulate policies for the program; ii) monitor program implementation; iii) act on issues related to program implementation and iv) conduct program evaluation. The PMC is supported by a technical working group comprised of technical staff from each of the agencies represented in the PMC. A secretariat headed by the APCP supports both the TWG and the PMC.

Land Bank of the Philippines. LBP, as the lending institution, screens and evaluates the prospective borrower using credit evaluation criteria that are more relaxed than the criteria used in its regular lending window for agriculture. Unlike borrowers under the regular lending window of LBP, borrowers are not required to pass the LBP Enhanced Coop Accreditation

²⁸ Under the LBP RAAC system, a rural bank with a good risk rating is able to borrow at a rate lower than 8.5%.

Criteria²⁹ to be eligible. Borrowers are also not risk rated using the LBP's RAAC system.³⁰ They are only required to comply and submit the basic documentary requirements shown in Table 9.

Under the APCP, loan approval limit of the LBP lending center head is higher (P5 million) than that of the regular lending program (only P1million). The higher loan approval limit is expected to facilitate loan approval and ensure timely loan releases. Since DAR field staff is responsible for the solicitation and submission of required loan application and other documentary requirements, LBP officers and staff only meet with the ARBO borrower when the loan is released. During this time, LBP explains and clarifies the loan terms and conditions of the APCP loan including the role and responsibility of the ARBO and the member ARBs.

LBP uses its own funds for APCP lending. In view of this, APCP program targets are included in the LBP lending centers' key result areas and performance targets. The Php 2 billion APCP fund facility is deposited in a trust account with LBP and is used to guarantee APCP loans extended by LBP. Within 30 days upon loan default, LBP lending centers can immediately draw on the APCP guarantee facility thereby protecting its bottom line.

Department of Agrarian Reform. DAR acts as the marketing and facilitating agent of the APCP. As marketing agent of the program, DAR disseminates information on the APCP to all prospective ARBOs through the conduct of seminars and/or symposium. When an ARBO signifies interest in the program, DAR assists the ARBO in the preparation and submission of the required documents including the certification from the Municipal Agrarian Reform Officer (MARO) that a specific borrower is an ARB recipient of a CLOA. DAR also closely coordinates and liaises with LBP on the status of loan approval and loan releases. In some cases, DAR also assists LBP in following up repayment of loans.

The APCP program design stipulates that DAR shall provide capacity building support to the ARBOs. Interviews with DAR field staff and LBP account officers revealed that during the conduct of capacity building activities, LBP acts as one of the resource persons particularly on topics related to credit discipline. LBP also explains the terms and conditions of the loan as well as the role and responsibility of the borrowers during these activities. Most of the capacity building activities cited were focused on providing information to ARBO-borrowers on their responsibilities as borrower and on familiarizing the ARBO-borrower with bank processes and procedures.

Some observations on program implementation: Designed as a credit facility to cater to ARBs who are not qualified under any formal lending institution, program implementation does not follow the usual credit screening processes of the LBP. While LBP program officers consider APCP a priority

²⁹ The ECAC is a tool to measure the maturity level of the organization, particularly on financial, business operation, organization and management. Passing the ECAC does not guarantee passing the RAAC.

³⁰ The RAAC is a tool used by LBP to assess the viability of the project and the creditworthiness of the borrower. The RAAC also includes information on whether the organization/management/BOD have adverse findings on character i.e. no payment of loans, court cases, etc. The RAAC also determines the amount of loan that can be extended to the borrower using the coop's debt-equity ratio. The borrower may also negotiate for a lower interest rate given its RAAC rating.

inasmuch as program targets are included in their own targets and key result areas, credit processes and procedures employed differ from that of the regular lending window of LBP.

- LBP credit evaluation and screening seem limited to checking compliance to documentary requirements. Thus far, no lending center interviewed recalls of denying the loan of an ARBO that was recommended by a DAR program officer provided the ARBO complies with all the documentary requirements of the program.
- The recommendation of the DAR program officer (who ensures submission of documentary requirements) as well as the endorsement of the MARO facilitates loan approvals. The standard accreditation criteria and risk rating assessment of LBP are not used in evaluating the ARBO borrower. In view of this, the performance and capacity of the ARBO borrower relative to the LBP's standard criteria for credit assessment is not assessed. Limitations of the ARBO in meeting bank credit criteria are not identified. As such, capacity building support under the program is not designed to enable the ARBO-borrower to meet the LBP standard criteria for loan evaluation.
- LBP does not bear any credit risk. While LBP uses its own fund for the program and APCP loans are considered part of the LBP loan portfolio, the APCP fund is immediately called upon as a guarantee for any loan default. The LBP lending center can immediately call on the guarantee for full coverage within 30 days upon default. Because of this, there are very limited incentives for serious credit screening and evaluation.
- LPMC, which is supposed to meet regularly to address program implementation issues rarely meets at the local level particularly in the provinces covered in the FGDs³¹.

6.2.5. Capacity Building Component

For the year 2014, DAR allotted P72.5 million to support the various capacity development activities of targeted agrarian reform beneficiary organizations (ARBOs). However, only 27.5 million was utilized to fund 31% (161 ARBOs) of the 523 ARBOs targeted for capacity development in 2014. For newly accessing ARBOs, CAP DEV assistance focused on the following: conduct of program orientations, facilitating compliance to loan fund documentary requirements such as assistance in securing tax identification number (TIN), preparation of farm plan and budget, and other loan documentation. For ARBOs re-availing loans under the program, CAP DEV interventions were geared towards organizational strengthening and management of the funded projects. Organizational development trainings provided include conduct of strategic planning sessions, business planning, leadership and values formation, simple bookkeeping, and financial management, among others. To support the ARBO funded projects, the following trainings were provided: conduct of farmer field school for rice producers, cacao production technologies, vermi composting, and organic farming. For ARBOs with problematic accounts or are in past due status, trainings focused on loan delinquency management.

³¹ Among the 6 provinces in which FGDs were conducted, it is only the Bukidnon DAR office reported that the provincial PMC was convened to discuss related to APCP implementation.

As designed, the APCP is designed to lend to ARBOs and cooperatives and their members who do not yet qualify under the LBP regular lending window. One of the program goals is to ensure that the APCP borrowers can eventually graduate into the regular lending window of the LBP. In view of this, it is expected that the capacity building component of the program should be geared towards building the capacities of the APCP borrowers to meet the lending criteria under the LBP regular lending window.

While training and capacity building activities were provided, it seems that these were not designed to systematically build and strengthen the capacities of the ARBOs to become viable institutions that can eventually qualify and graduate into the LBP regular lending program. Mentoring and handholding activities were rarely conducted and if they were, these were not done on a sustained basis until specific performance targets are met. Also, capacity building support towards enabling the ARBO-borrowers to meet the standard accreditation and risk rating criteria of the LBP are not provided.

To ensure that capacity building support is geared towards meeting program objectives, it is important to institute a metrics and/or evaluation system that will determine whether the activities conducted under the capacity building component results in an improved and better performance of the ARBOs leading to their graduation into the LBP's regular lending window. To facilitate this, it is suggested that the ARBO-borrowers still be subjected to the ECAC and RAAC system of LBP but with lower hurdles. The results of the evaluation can then be used to determine specific support for capacity enhancements.

Table 13. Trainings and Capacity Building Activities conducted under the APCP, as of December 31, 2015

Specific Areas	No. of Coops/ARBOs	No. of ARBs
Preparatory Activities	592	9956
Organizational Development	570	7038
Agri-business Development	212	3952
Monitoring	485	10473

Source: DAR-BARBD

6.2.6. Response from ARBs

ARBs that participated in the FGDs indicated satisfaction on the program due mostly to the following:

- Low interest rate. APCP interest rate on end borrower (15%) is deemed lower than the 2 to 3% per month charged by cooperatives on their members' loans. Most ARBs also indicated that the APCP rate is also way lower than the rates

provided by informal moneylenders such as traders and input suppliers.

- Less tedious documentary requirements
- Assistance from DAR program officer in accomplishing and completing required documents

A few ARBs expressed some concern on the late release of loans particularly when loan proceeds are earmarked for the application of required inputs such as fertilizers. Delay in loan releases prompt them to borrow from informal sources, which sometimes are the cause of non-repayment of APCP loans. ARBs opt to pay the informal sources of loans first before paying the ARBO resulting in non-repayment and eventually inability to renew ARBO's loan due to loan defaults.

There were also some ARBO members and ARBO officers who expressed concern on the implementation period of the APCP. While program implementation has been extended from 2013 to 2015, most of them are clamoring for longer implementation period for the program.

6.3. Effectiveness of the program

APCP has twin objectives. Aside from providing ARBs and newly registered ARBOs access to credit, APCP also aims to build and enhance the capacities of these organizations through appropriate development assistance, marketing support and credit.

6.3.1. *Providing access to credit*

In terms of providing access to credit, APCP was seemingly able to accomplish its objectives. As of February 29, 2016, a total amount of **1.95 billion pesos** have been released to **526 ARBOs** providing credit access to **31,036 ARBs.**) Majority of APCP borrowers (ARBOs and member-ARBs) are those that have not or are not able to borrow from the banks/financial institutions due to lack of acceptable collateral and tedious documentary requirements of banks. Several ARBOs whose members used to borrow from informal sources (i.e. moneylenders, traders, family and relatives) were able to provide an alternative source of financing through the ARBO's loan from APCP. The table below shows that none of the FGD participants were able to get bank financing prior to APCP.

Table 14. ARBs' Sources of Funds prior to APCP

	Negros Occ	Negros Oriental	North Cotabato	Quezon	Nueva Ecija	Bukidnon
Own funds	✓	✓	✓	✓	✓	✓
Loans from family and friends	✓	✓	✓	✓	✓	✓
Loans from coop	✓	✓	✓			
Loans from MFIs/NGOs	✓		✓		✓	
Loans from moneylender	✓					

APCP is a preferred program among ARBOs because of the less tedious documentary requirements and the low interest rates. Under APCP, ARBO borrows at 8,5% and relends to members at a maximum interest rate of 15%. Because of this, it was observed that there were a few APCP borrowers/ARBOs that are already able to borrow under the regular lending window of LBP. The APCP loan was used to finance the ARB borrowers who would otherwise be able to access the ARBO's regular lending facility at higher interest rates.

6.3.2. Enhancing Capacities of ARBOs

Many of the APCP-ARBO borrowers are very small. Average membership size of the ARBO borrowers is less than 100. ARBOs collect only a minimal amount of share capital from its members. Most of them do not have sufficient working capital or revolving loan fund. As such, the APCP ARBO borrower is not able to fully pay its APCP loan when one of the member-ARB borrowers defaults. This results in non-repayment for some ARBOs. Instead of partially paying the loan using the amounts collected, the ARBOs opt to use the money to lend to those who have fully paid their loan to the organization.

With very limited capital, these ARBOs act as cashier of loans borrowed under APCP. This shows the ARBOs' level of organizational development. If the intent is to graduate the ARBOs into the regular lending window of LBP or enable them to access lending windows of private financial institutions, capacity building activities should be more

intentional in meeting the desired objectives. Handholding and mentoring activities that are focused on specific weak areas of the ARBOs operations are needed. For instance, as cooperatives, ARBOs need appropriate assistance to enable them to function as a true cooperative where the importance of savings among members is highlighted. At present, capacity building assistance received from APCP are mostly random, sporadic and not systematic. While most of the trainings maybe considered demand based, they do not seem to lead towards the development of the ARBO as a viable organization that could access funds from formal financial institutions. As mentioned earlier, the current standards and criteria of LBP in evaluating its regular coop clients may be used in determining the level of development of an ARBO. The evaluation results should then be used in determining the kind of assistance that should be provided. In this way, the capacity building support that will be provided is intended to enable to ARBO to qualify under the regular lending window of the LBP and eventually the lending window of other financial institutions.

The foregoing observation on capacity enhancing activities seems to also be applicable to other capacity building activities of DAR. LBP reported that as of August, 2015, only 16 of the 86 ARBO borrowers that were provided capacity building assistance under the CAP-PBD program of DAR were able to graduate to the regular lending program of LBP. This is something worth looking into considering that the CAP-PBD program has been implemented for about 10 years now.

7. Financing Smallholders in the Philippines: Emerging issues

7.1. Access to Finance Barriers: Results of Focus Group Discussion

Focus group discussions (FGDs) were conducted to validate constraints to the demand for and supply of smallholder finance. Using information on ARBO- borrowers from the APCP, six FGD sites were selected

As borrowers of APCP, the ARBOs, FOs and POs were classified into provinces within each island grouping (Luzon, Visayas, Mindanao). The list was further categorized into two: those with high repayment rates (equal to or greater than 90%) and those with low repayment rates (less than 90%). Within each island grouping, the province with the highest proportion of ARBOs, FOs and POs that reported high repayment rates and those that reported the highest proportion with low repayment rates were selected. FGDs were conducted in the following provinces: Negros Occidental, Negros Oriental, North Cotabato, Quezon, Nueva Ecija and Bukidnon. FGDs with APCP ARBO borrowers, APCP sub-borrowers, Non-APCP borrowers and non-ARBs were conducted in each of the selected provinces.

7.1.1. Demand Side

7.1.1.1. Sources of Financing and Use of Funds

APCP Borrowers. Results from the FGDs indicate that for APCP borrowers, the major sources of financing include Land Bank or the APCP, cooperatives and farmers organizations, CARD Bank, personal funds, private moneylenders and from family, relatives and friends. The most convenient sources are cooperatives, the APCP or Land Bank, microfinance institution and personal or own funds. Some of the respondents in Quezon explained that the microfinance institution in their area provided higher interest rates, released loans immediately and was easier to talk to, meaning, a representative from the institution met with them regularly.

On the use of funds, participants from all areas specified farm production as the primary purpose while there are others who cited non-farm business projects such as sari-sari stores. Funds were also used for immediate family or personal needs such as food, educational expenses, payment for utilities and health or medicine expenses, among others. Responses by area are shown below:

Sources of Financing	Quezon	Nueva Ecija	Negros Oriental	Negros Occ	North Cotabato	Bukidnon
Land Bank/APCP			/	/	/	
Cooperatives/Farmers Organizations	/	/		/	/	/
Rural Bank/CARD Bank	/	/		/	/	/
Government Programs	/					
Personal Funds	/			/	/	/
Private Moneylenders/Traders				/	/	
Family/Relatives/Friends	/		/	/	/	
Most Convenient Source						
Cooperatives	/		/	/	/	/
MFI	/					
Land Bank/APCP				/	/	/
Personal Funds	/			/	/	
Private Moneylenders/Traders						/
Use of Funds						
Farm Production	/	/	/	/	/	/
Livelihood/Business			/			
Personal/Family	/	/	/	/	/	/

Non-APCP Borrowers. Non-APCP borrowers are ARBs who have not borrowed from the APCP. Except for Landbank, these farmers borrow from the same sources that APCP borrowers borrow from (i.e. cooperatives, banks, private moneylenders, family, other relatives and friends). also use their own personal funds to finance their farm operations. While all areas

cited personal funds as their major source of fund and 4 of the 6 provinces cited 'cooperative', it is interesting to note that many of those from Negros Oriental and Negros Occidental cited 'bank' as their major source of financing. It is only in Negros Occidental that respondents cited 'bank' as their most convenient source, particularly, Bank Dungganon. Bank Dungganon is an active microfinance institution in the area. In contrast, respondents from Quezon indicated private moneylenders or traders as their most convenient source of fund. Below are the results, by province:

Sources of Financing	Quezon	Nueva Ecija	Negros Oriental	Negros Occ	North Cotabato	Bukidnon
Land Bank/APCP						
Cooperatives/Farmers Organizations	/	/	/	/		
Rural Bank/CARD Bank			/	/		
Govt Programs						
Personal Funds	/	/	/	/	/	/
Private Moneylenders/Traders	/			/	/	
Family/Relatives/Friends				/		/
Most Convenient Source						
Cooperatives	/		/	/		/
MFI						
Land Bank/APCP				/		
Personal Funds				/	/	/
Private Moneylenders/Traders	/					
Use of Funds						
Farm Production	/	/	/			
Livelihood/Business			/			
Personal/Family	/	/	/			

Non-Agrarian Reform Beneficiaries (Non-ARBs). Among Non-ARBs, cooperatives, family and relatives and personal funds are the common major sources of financing. Some respondents in North Cotabato cited bank as a major fund source while the sole respondent in Bukidnon answered 'personal funds'. On the use of funds, most of the respondents cited 'farm production' and 'personal or family needs' as the common purpose while farmers in North Cotabato also utilize funds for livelihood or non-farm business projects.

Sources of Financing	Quezon	Nueva Ecija	Negros Oriental	Negros Occ	North Cotabato	Bukidnon
Land Bank/APCP						
Cooperatives/ARBOS*	/		/		/	
Bank/CARD Bank					/	
Personal Funds	/	/	/			/
Family/Relatives/Friends			/		/	

Private Company (San Miguel Corporation)						/
Most Convenient Source						
Cooperatives/MFI	/	/	/			
Bank						
Personal Funds						/
Use of Funds						
Farm Production	/	/	/		/	
Livelihood/Business					/	
Personal/Family	/	/			/	

*There are non-ARBs who are members of ARB organizations or ARBOs

6.1.1.2 Borrowing Constraints

APCP Borrowers. When asked about the constraints that hinder them from getting bank loans, farmers in all the areas replied ‘having no collateral’ and the ‘many and tedious requirements’ as primary factors. There are also those from Nueva Ecija and Bukidnon who indicated ‘having existing past due loans with banks’ as a major factor that stops them from sourcing funds from banks. On the other hand, farmers from Quezon and Nueva Ecija cited ‘fear of not being able to pay’ while some farmers from Negros Occidental cited ‘lack or no access to information on bank lending programs’. Fear of non-repayment is largely due to the farmers’ inability at times to generate the income needed to pay for the loan and take care of the household needs.

Along with farmers from North Cotabato, Negros Occidental farmers also noted their ‘preference for cooperatives’ because of lower interest rates and lesser documents. Similarly, Bukidnon farmers mentioned that unlike banks which take a long time to process and approve loans, cooperatives release loans faster. Some farmers in North Cotabato also indicated ‘inaccessibility of banks relative to their municipalities’ as a major hindrance.

With regards to assistance they need so they can borrow from a bank, majority of the farmers in Negros Oriental, Negros Occidental and North Cotabato cited ‘help in acquiring land title for their land’ while farmers in Bukidnon expressed the need for either Land Bank or DAR to help them complete documentary requirements.

Constraints in Getting a Loan from Banks	Quezon	Nueva Ecija	Negros Oriental	Negros Occ	North Cotabato	Bukidnon
No collateral	/	/	/	/	/	/
Have existing bad loans with banks		/				/
Many/Tedious Requirements/slow approval of loans	/	/	/	/	/	/
No info on bank lending programs				/		

Prefer coops because of lower interest rates and lesser documents				/	/	
Fear of not being able to pay due to calamities, etc.	/	/				
Slow approval of loans relative to cooperative, private moneylenders						/
Inaccessibility of banks					/	
Assistance Needed to be able to Get a Bank Loan						
Acquire land title			/	/	/	
Assistance from Land Bank or DAR in completing bank requirements						/

Non-APCP Borrowers. Like their APCP counterparts, non-APCP borrowers also cited ‘having no collateral’, the ‘many and tedious requirements’ as well as ‘their preference for cooperatives’ as primary reasons why they do not borrow from banks. Others indicated ‘having no information on bank lending programs’; ‘not understanding the process that it entails’; ‘having had a bad or difficult experience in the past on getting a loan from a bank’; and ‘fear of not being able to pay due to force majeure’. Farmers also noted the inaccessibility of banks given the distance of their municipalities to the poblacion where banks are located as well as poor road conditions and lack of transportation, prevent them from getting bank loans.

When asked about the assistance they require in order to enable them to borrow from a bank, their answers include ‘access to information’ especially with regards to loan procedures, lending programs and collateral substitutes acceptable to banks; ‘group organizing’; ‘training on the procedures in getting bank loans including the completion of bank requirements’

Constraints in Getting a Loan from Banks	Quezon	Nueva Ecija	Negros Oriental	Negros Occ	North Cotabato	Bukidnon
No collateral	/		/	/	/	/
Have existing bad loans with banks/previous bad experience				/		
Many/Tedious Requirements/slow approval of loans	/		/	/	/	/
No info on bank lending programs/do not understand process			/	/		

Prefer coops because of lower interest rates and lesser documents	/	/	/	/	/	/
Fear of not being able to pay due to calamities/force majeure	/					/
Inaccessibility of banks			/		/	
Assistance Needed to be able to Get a Bank Loan						
Access to info			/			
Group Organizing			/			
Training on how to avail of a bank loan			/			
Assistance from Land Bank or DAR in completing bank requirements						/

Non-ARBs. Non-Agrarian Reform Beneficiaries also mentioned the tedious requirements of banks, having no info on bank lending programs, high bank interest rates as well as their preference for cooperatives as the major factors that hinder them from borrowing from banks

Constraints in Getting a Loan from Banks	Quezon	Nueva Ecija	Negros Oriental	Negros Occ	North Cotabato	Bukidnon
Many/Tedious Requirements/difficult process			/		/	
No info on bank lending programs			/			
High interest rates			/			
Prefer coops, not banks		/				/

7.1.2 Supply Side

Based on the interview results, the rural banks were found to be non-APCP conduits and not lending to small farmers. Those who lend only do so in compliance with the Agri-agra law or RA 10000 and they require collateral for the said loans. One bank indicated that in addition to requiring collateral, the farmer-borrower should not be more than 60 years old. These rural banks prefer to lend to big borrowers, usually those with large agricultural projects. According to them, a large bulk of their loan portfolio consists of loans to small and medium enterprises. One rural bank related that when agrarian reform beneficiaries approach their banks, they refer them to cooperatives. Another rural bank mentioned their participation in the Agricultural Guarantee Fund Pool (AGFP) which was established by the government to encourage banks to lend to small farmers since the program guarantees payment of 85% of the loans granted to the target sector in case of default. However, the bank said they still require collateral for the remaining 15%. According to this bank, they are not sure if they are willing

to participate in the APCP since AGFP is already too big to handle for a small bank like them.

When asked about the issues or challenges they face when lending to small farmers, the banks explained that lending to agriculture, particularly to small farmers remains very risky not only because of climate change but also because support services from the government are not yet fully in place including farm-to-market roads, post-harvest facilities, capacity-building, technology and marketing opportunities, among others. Small farmers especially those in remote areas find it difficult to transport, sell their produce and get a good price. Small farmers need to improve their creditworthiness and to be educated further on financial management. These banks also mentioned that while they are aware that small farmers find the documentary requirements quite cumbersome, they, according to the banks, cannot release the loan if such requirements are incomplete in compliance with Bangko Sentral ng Pilipinas policies. They may also require additional documents should they see the need to do so after analysis of the applicants' capacity to pay. These banks reiterated that when small farmers become viable and creditworthy, banks will be encouraged to lend to them even without risk-reducing mechanisms such as guarantee facility. These banks also added that farmers put greater premium on the amount of loan that banks can provide and how fast the loan processing is. They also emphasized the importance of crop insurance in further reducing the risk of agricultural lending.

8. Enhancing smallholders' access to financial services: Some imperatives

8.1. Addressing Barriers

8.1.1. Demand side

FGD results confirm that smallholders need credit not only for their farm operations but also for consumption smoothing. Aside from using their own funds, smallholders borrow from either formal (banks, coops) or informal sources (friend, family, relatives, input dealers and traders). Effective demand for smallholder credit depends on their ability and willingness to access and use credit services. Some may have access but prefer to use their own funds or borrow funds from family and friends to finance their operations.

About 2/3 of smallholders borrow and about 53 percent of these, borrow from formal sources (ACPC, 2014). Because of this and recognizing that smallholders need credit, DAR and DA designed and formulated credit programs that cater to the credit needs of their clientele. Table 14 shows the features of the credit programs implemented and how these programs address the perceived demand side access barriers.

Table 15. Demand side barriers and features of credit programs

Perceived demand side barriers to credit access	Features of credit programs implemented	Credit programs
Tedious documentary requirements	Simplified documentary requirements Provision of assistance from line agencies to comply with the prescribed documentary requirements	APCP, CAP-PBD
Lack of or inadequacy of collateral	Acceptance of innovative collateral substitutes such as standing crops, marketing contracts, assignment of crop insurance, chattel mortgage, guarantee and use of credit surety fund.	All credit programs
Unaware of the presence of an accessible financial institution	Conduct of information dissemination Use of local cooperatives and farmers' organization as conduits of credit programs (LBP provide wholesale funds to these institutions)	All credit programs
Lack of information on the lending processes and procedures for accessing formal credit	Conduct of information dissemination Conduct of credit seminars to explain the loan terms and conditions	All credit programs
Perceived high interest rates on bank loans	Lower interest rate on wholesale loans and prescribing a cap on the pass-on rate of retail financial institutions	APCP, AFFP, Sikat-Saka
Non-repayment of previous loans	Restructuring allowed	

The foregoing shows that credit programs implemented by the government through LBP address some of the demand side barriers to credit access by smallholders. Most of these credit programs are implemented by the LBP using funds of the line agencies. In particular, these credit programs address the tedious documentary and collateral requirements that are usually imposed by private financial institutions. In the case of the APCP, a certification from the Municipal or Provincial Agrarian Reform Officer that a smallholder is an ARB replaces the collateral requirement. This, however does not address the problem of non-ARB borrowers who also do not have any collateral to offer.

The transaction cost barrier is addressed by using cooperatives and farmers' organization as conduits of LBP funds. It should be noted that for most of these credit programs, no private financial institutions participated. The prescribed cap on interest rates discouraged banks from participating.

Other demand side barriers that were raised are: low farm productivity and insufficient cash flows to service the loans. Market uncertainty that results in low prices of produce also prevents some smallholders from accessing formal finance. These barriers are best addressed by other types of support services highlighting the need for a coordinated development assistance for smallholders.

8.1.2. Supply side

Private financial institutions are constrained to lend to agriculture because of the risks and costs associated with agriculture lending. To address these, PFIs require collateral (e.g. REM) and documentary requirements that are considered tedious by smallholders. Private financial institutions rarely accept marketing contracts and standing crops as collateral. PFIs prefer to lend to agricultural enterprises or to smallholders with landholdings or properties that are acceptable as collateral. Because of this, growth of smallholder finance, particularly financing from private financial institutions has relatively been slow.

Aside from the risks arising from climate changes and bad weather condition, banks are also reluctant to lend to small farmers due to the lack of information about the risk profile of the prospective borrower. This increases both the risk and cost of lending to agriculture inasmuch as banks are not able to design appropriate risk management measures. Also, the lack of support services needed by farmers to improve and enhance their income also constrain PFIs to lend to smallholders. With low incomes, the risk of loan defaults is high.

Table 15 below shows some perceived barriers of PFIs in providing agricultural loans and the measures implemented to address the barriers.

Table 16. Perceived supply side barriers to smallholder finance

Perceived supply side barriers to credit access	Measures implemented to address the barrier	Credit programs
Perception or actual experience of high default rates among smallholders	Implementation of guarantee and crop insurance programs	AGFP, PCIC
Smallholders lack collateral that is deemed acceptable by banks		
Smallholders are located in areas where banks do not have office or transaction offices resulting in high lending and transaction costs	Use of conduits such as cooperatives and farmers' organization	APCP, CAP-PBD, Sikat Saka, AFFP
Lack of financial capacity and capability among organization that lend to smallholders (e.g. ARBOs, cooperatives or farmers' organization)	Provision of capacity building and capacity enhancing programs for cooperatives and farmers' organization	CAP-PBD, APCP

One way by which risks associated with agriculture lending is addressed is through the use of insurance. Crop insurance³² is used to protect farmers against loss of crops due to risks associated with natural disasters such as typhoon, flood, earthquake etc. The current crop insurance is an indemnity-based insurance where insurance pay-outs are based on actual damage. More recently, index-based or parametric insurance is also used where pay-outs are based on an objectively measured index correlated with farmers' losses but not necessarily actual losses. Indexes are used to represent agricultural risks³³ such that when an index exceeds a certain threshold, farmers receive immediate pay-outs without the need for adjusters.

To entice banks to lend to agriculture, particularly the smallholders, guarantee mechanisms were also put in place. Participating banks and private financial institutions are allowed to call on the guarantee fund when there is a loan default.

³² The crop insurance program in the Philippines was evaluated in another PIDS study. The study provides insights on how to improve the program to make it more responsive to the needs of smallholders.

³³ Indexes include any of the following: rainfall, wind speed, area average yield statistics, and vegetation conditions measured by satellites.

While the implementation of guarantee and crop insurance programs may help in reducing risks in lending to agriculture, banks and other formal financial institutions interested in lending to agriculture may also need to design products and adapt lending methodologies that are tailor-fitted to the needs and circumstances of smallholders. New and/or different lending processes and procedures may be designed and adopted. For instance, specific agricultural expertise and skills are needed in assessing smallholder loans and in designing appropriate financial products. Use of a conduit that are familiar and located closely with smallholders is also important (e.g. coops and ARBOs).

8.2. Policy imperatives for Government

Demand and supply side constraints to smallholder finance show that it is unique, costly and risky. As such, very few private financial institutions are interested in lending to smallholders or if they lend, they impose stringent requirements that smallholders find hard to comply with. Because of this, there is always a tendency for government to intervene in the credit market by directly providing credit at low-cost subsidized interest rates. However, empirical and theoretical evidences from previous studies and experience show that the government, particularly government non-financial agencies, is a poor creditor. The provision of financial services is best done by financial institutions, which have the necessary expertise and required infrastructure for lending.

Government has a distinctive role in smallholder finance. Learning from the lessons of previous subsidized directed credit programs in agriculture, results of various studies show that government's role in smallholder finance should be focused on i) establishment of the appropriate policy and regulatory environment and ii) provision of the necessary basic and support infrastructure that will reduce the costs and risks associated with agricultural lending in general and smallholder finance in particular.

In providing the appropriate environment for increased private sector participation in smallholder finance, government should adopt and consider the following policy measures.

- Reducing costs of agricultural lending and smallholder finance. Smallholder finance is considered more costly by banks because smallholders live in hard to reach areas with dispersed population and low literacy rates. Banks and formal financial institutions, on the other hand, are located in the towns and cities. Also, smallholders require relatively smaller amount of loans resulting in higher transaction cost per borrower. Because of these, extending loans to smallholders entail additional transaction costs for the banks.

To reduce the cost of lending, Government can:

In the short-term:

- Strengthen and build capacities of smallholders' and/or farmers' organization as viable and sustainable conduits of financial services in rural areas, in particular cooperatives. Capacity building support should focus on enabling and

strengthening these smallholder organizations (e.g. coops) to meet banks' criteria for credit screening. For instance, LBP criteria for coops and farmers' organization should be used as benchmark in evaluating the performance of an organization and use the results to determine specific capacity building assistance that should be provided to a specific coop or a farmers' organization. To further strengthen cooperatives, CDA, as the institution mandated to oversee cooperatives should strengthen its regulatory functions and implement its supervisory mandate, particularly for cooperatives engaged in savings and credit operations.

- Allow banks to use innovative means of delivering financial services to the rural areas (e.g. use of agents such as farmer's cooperatives and organizations) within a reasonable risk management framework
- Promote the use of mobile technology that will allow roaming agents to distribute finance and collect information from smallholders. The current framework of the BSP in the use of digital finance for reaching far-flung rural areas would help in reducing the banks' transaction cost in lending to small farmers in these locations.

Medium-term

- Build the required support infrastructure (e.g. farm-to-market roads) that will reduce the costs of reaching the small farmers.
- Reducing risks associated with agricultural lending and smallholder finance. Risks in agricultural lending comes from any of the following: climate change and weather disturbances; constrained economic opportunities due to inadequate transportation and communication infrastructure; income variability and price volatility; seasonality of crop and production schedules; poor market linkages and lack of adequate market information. A smallholder is usually exposed to a variety of these risks.

To reduce the risks associated with smallholder lending, Government can adopt the following policy strategies:

Short-term

- Support the collection of systematic set of smallholder information that can be used by relevant financial institutions in determining the credit risk profile of a smallholder³⁴. The government may provide specific support to coops and farmer's organization that provides credit to small farmers to submit the required credit information on individual borrowers to the Credit Information Corporation³⁵.
- Strengthen and link farmer producer organization to structured value chains for effective market linkages. Government can facilitate linkages between small farmer organizations and

³⁴ With the establishment and operation of the Credit Information Corporation (CIC), the collection of credit information of small farmers is now feasible. All banks and credit granting institutions are required to submit borrower information to the CIC.

³⁵ At present, no single organization has credit information on small farmers. LBP provides wholesale loans to cooperatives and farmers' organization and does not have individual farmer data.

private business corporations that require a steady supply of quality agricultural products;

- Implement a systematic, sustained and demand-driven capacity building program that will strengthen and build viable and sustainable cooperatives and farmers' organization. Specific capacity building support should be tailored to the needs of the organization. Metrics on determining organizational and operational weaknesses should be established on which assessment of capacity building support should be based.
- Conduct Information, Education and Communication (IEC) activities among small farmers on the Crop Insurance Program highlighting specific roles and responsibilities of both farmers (as insured) and the Philippine Crop Insurance Corporation (PCIC) (as the insurer)

Medium Term

- Implement an effective and responsive crop insurance program that pays out claims immediately. Parametric or index-based insurance products that allow immediate claims payment may be provided.
- Implement an effective guarantee program for smallholder financing. In particular, the government may consider the provision of relevant guarantee mechanism for cooperatives that are lending to smallholders.
- Provide the necessary rural infrastructure support (e.g. farm to market roads, irrigation, post-harvest facilities, farm technology) that will open up economic opportunities of smallholders.

8.3. Imperatives for the private sector

Recognizing the constraints to agriculture lending, banks can overcome the barriers by employing innovative lending schemes. A few banks³⁶ have done this through a mix of product, distribution and collateral customization that serves the financing needs of smallholders effectively. These include the following:

- Use of agents in distributing finance and in collecting relevant information about smallholders
- Collaborating with agricultural experts to design loans with flexible repayment terms that are linked to actual crop cycle. This can help improve the farmers' ability to pay on time.
- Use of farmers' organization as hub for loan distribution and collection
- Use of warehouse receipts and equipment leasing as collateral substitutes
- Understanding the value chains and buyer relationships to determine future cash flows and improve the credit assessments of smallholders.

- Product innovations (e.g. Credit card concept, with accredited input dealers and suppliers).
- Use of mobile/electronic banking for farmers --- also to provide digital footprints for smallholders.

8.4. Imperatives for development organization

Donors can help both the government and the private sector in unlocking demand and supply side constraints to smallholder financing. On the demand side, donors can provide support in reducing the riskiness of smallholders as borrowers by helping them acquire skills in financial literacy (e.g. focus budgeting, roles and responsibilities as borrowers) and in improving their farm productivity. On the supply side, donors can provide technical assistance to financial service providers in assessing the risks associated with smallholders and using the results in designing and customizing appropriate agricultural financial products. Some donors³⁷ are willing to make equity investments in banks that have showed interest and commitment to smallholder finance. They provide equity investments and offer training and technical support in adopting specific lending methodologies as well as in establishing relevant lending procedures, systems and processes for effective and efficient smallholder financing.

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³⁷ Examples of these donors are: Rabo Development and Grameen Credit Agricole

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