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Small Enterprises' Access to Formal Financial Services: A Review and Assessment

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Small Enterprises' Access to Formal Financial Services: A Review and Assessment

Mario B. Lamberte

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Table of Contents

		<u>Page No.</u>
Chapter	1. INTRODUCTION	1
	2. DESCRIPTION OF THE FINANCIAL SYSTEM	3
	A. Overview of the Financial System	3
	B. The Banking System	3
	C. Non-Bank Financial Intermediaries	31
	D. The Cooperative Credit Union System	35
	3. ACCESS TO CREDIT FROM THE FORMAL FINANCIAL SYSTEM	38
	A. Extent of Access to Formal Credit	38
	B. Factors Affecting Access of Small Enterprises to Bank Credit	47
	4. BANKING AND CREDIT POLICIES AND PROGRAMS AFFECTING THE FLOW OF CREDIT TO SMALL BORROWERS	50
	A. Loan Portfolio Regulations	50
	B. Bank Entry and Branching	51
	C. Government's Direct Participation in the Banking System	53
	D. Government's Special Credit Programs	54
	E. NGOs as Credit Conduits	54
	F. Private Banks' Special Credit Programs	60
	5. CONCLUDING REMARKS AND RECOMMENDATIONS	63
	A. Summary	63
	B. Future Direction of the Formal Financial System	65
	C. Recommendations	70
References		74

Small Enterprises' Access to Formal Financial Services: A Review and Assessment*

by

*Dr. Mario B. Lamberte***

Chapter I

INTRODUCTION

The Philippine financial system has grown in size and sophistication in the last decade. The failures of several financial institutions in the 1980s turned out to be a blessing for the financial system because it exposed the weaknesses of many financial institutions and the inadequacies of the prudential and regulatory framework. Although the rehabilitation of some financial institutions is still incomplete, the majority of the remaining financial institutions are strong and are in a better position to operate in a more competitive environment. They certainly set the standards for those that have newly entered the financial system.

Notwithstanding its rapid growth, still the formal financial system rations out a large number of borrowers, particularly small farmers and entrepreneurs. The recent proliferation of special credit programs that are intended to take care of those that are being rationed out by the financial system is a clear testimony to this. This study, therefore, tries to revisit the financial system. The specific objective is to come up with a report that describes and summarizes the banking system in the Philippines - with particular reference to the extent to which the system reaches and provides financial intermediation for the different socio-economic sectors of Philippine society.

To attain this objective, the study has examined: (1) the supply of financial services provided by the formal financial system; (2) extent of access by the different types of socio-economic groups to the formal credit markets; and (3) the banking and credit policies and programs of the government. The data for the study were obtained from published statistics, existing studies and interviews with key informants.

The next chapter describes the Philippine financial system and discusses the authorized functions, total resources, geographical distribution of financial offices, and types of loans and

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**The author is the Vice-President of the Philippine Institute for Development Studies.

borrowers for each of the major financial sub-systems. Chapter 3 discusses the extent to which various socio-economic sectors, particularly small farmers and micro, cottage and small enterprises (MCSEs) have access to credit from the formal financial system and the factors affecting such access. Chapter 4 discusses the various policy instruments adopted by the government and the measures taken by private banks and NGOs to ensure the flow of credit to the small borrowers. The last chapter concludes the study and discusses some recommendations to enhance the financial intermediation services to the different socio-economic sectors of Philippine society.

Chapter 2

DESCRIPTION OF THE FINANCIAL SYSTEM

A. OVERVIEW OF THE FINANCIAL SYSTEM

The Philippine financial system has two sub-systems, namely the formal and informal financial sub-systems. The formal financial system is regulated by regulatory agencies such as the Bangko Sentral ng Pilipinas (BSP), while the informal financial system remains completely unregulated. The informal financial market has remained large and active especially in the last decade, which saw a number of banks that failed. Included in this market are NGOs/PVOs engaged in lending, individual money lenders, traders, etc.

The formal financial system consists of banking institutions and non-banking institutions (Figure 1). The former are allowed to accept traditional deposits, while the latter are not. It is for this reason that banking institutions are more highly regulated and more closely supervised by regulatory agencies than non-banking financial institutions. The BSP regulates and supervises all financial institutions, except insurance companies, which are regulated by the Insurance Commission. The credit union system, which is not included in Figure 1, is regarded as a separate sub-system and is regulated by the Cooperative Development Authority (CDA).

As of December 1993, the total assets of the formal financial system, excluding the credit union system, stood at P1,347 billion, of which 74 percent belonged to the banking system. The financial system had 10,174 offices composed of 5,117 head offices and 5,057 branches, which were almost equally distributed between the banking system and non-bank financial institutions.

B. THE BANKING SYSTEM

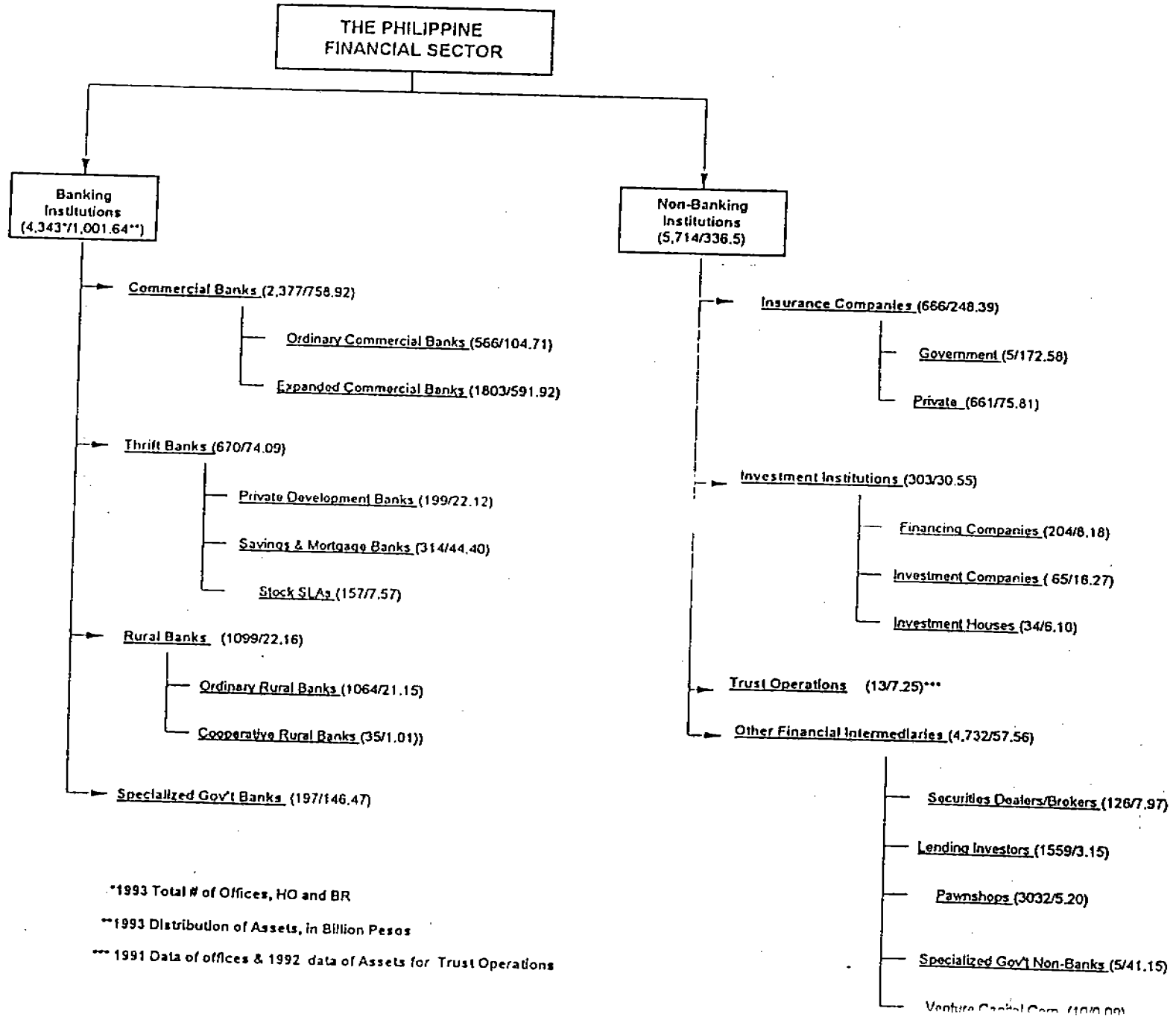
The banking system consists of commercial banks, thrift banks, rural banks and specialized government banks. Table 1 summarizes the authorized functions and activities of the various types of banks, except the specialized government banks. The different bank categories have different required minimum capital requirements commensurate to their authorized functions, i.e., those that are authorized to have more functions (e.g., universal banks) have higher minimum capital requirements than those that have limited functions (e.g., rural banks). These are shown in Table 2.

1. The Commercial Banking System

a. *Authorized Functions and Total Resources*

The commercial banking system is the largest financial sub-system in terms of assets,

Figure 1



**Table 1. AUTHORIZED ACTIVITIES OF VARIOUS BANK CATEGORIES
ON THE AMENDED BANKING LAWS**

Authorized Activities	(1) Expanded Commercial Banks (Unibank)	(2) Commercial Banks (KBs)		(3) Thrift Banks			Rural Banks
		Domestic	Foreign	Savings & Mortgage Banks	Private Dev. Banks	Savings and Loan Association	
A. COMMERCIAL BANKING SERVICES							
1. Accept deposits	1	1	1	1	1	1	1
2. Issue LC's and accept drafts	1	1	1	a/	a/	a/	*
3. Discounting of promissory notes and commercial papers	1	1	1	1	1	1	1
4. Foreign exchange transactions	1	1	1	11	11	11	*
5. Lend money against security	1	1	1	1	1	1	1
B. NATIONWIDE BRANCHING OPERATIONS	1	1	1	1	1	1	1
C. EQUITY INVESTMENTS IN ALLIED UNDERTAKINGS	11	11	11	11	11	11	11
D. EQUITY INVESTMENTS IN NON-ALLIED UNDERTAKINGS	1	*	*	*	*	*	*
E. TRUST OPERATION	11	11	11	11	11	11	11
F. ISSUE REAL ESTATE & CHATTEL MORTGAGE, BONOS BUY AND SELL THESE FOR ITS OWN ACCOUNT, ACCEPT/ RECEIVE IN PAYMENT OR AS AMORTIZATION OF LOAN	1	1	1	1	1	1	1
G. DIRECT BORROWING WITH CENTRAL BANK	1	1	1	1	1	1	1
H. ACTIVITIES OF INVESTMENT HOUSES							
1. Securities underwriting	1	*	*	*	*	*	*
2. Syndication activities	1	1	1	1	1	1	1
3. Business development and project implementation	1	1	1	1	1	1	1
4. Financial Consultancy and Investment	1	1	1	1	1	1	1
5. Mergers and consolidation	1	1	1	1	1	1	1
6. Research and studies	1	1	1	1	1	1	1
7. Lease real and/or personal properties	*	*	*	*	*	*	*
III. MONEY MARKET OPERATION	1	1	1	*	*	*	*

1 - Authorized Activities

11 - Authorized but subjected to Monetary Board Approval

* - Not authorized/prohibited

a/Limited only to domestic LCs and drafts.

b/The lending side may be done by all banks without prior CB. The borrowing side (quasi-banking) may be exercised only with prior CB approval for all bank.

Source: Lamberte, Mario B. (1992), "Assessment of the Financial Market Reforms in the Philippines 1980 - 1992."

Table 2. MINIMUM CAPITALIZATION OF PRIVATE DOMESTIC BANKS AND NON-BANKS AUTHORIZED TO PERFORM QUASI BANKING ACTIVITIES (NBQB)

Type of Institution	Minimum Capitalization (In Million)
1. Universal Banks	₱2,500
2. Commercial Banks with FCDU License	1,250
3. Thrift Banks	
(i) Metro Manila, Cebu City and Davao City	150
(ii) Other Cities and 1st to 3rd class Municipalities	75
(iii) Other areas	50
4. Rural Banks	
(i) Metro Manila	20
(ii) First Class "A" Cities	10
(iii) Other Places	2

Sources: Bangko Sentral ng Pilipinas.

deposits and number of offices. As of December 1993, its assets amounted to ₱759 billion, which constituted 56 percent of the total assets of the financial system (Table 3).

There are two types of commercial banks, namely expanded commercial banks or universal banks and ordinary commercial banks. The creation of universal banks is one of the most important aspects of the 1980 financial reforms. The idea is to make a "one-stop banking facility" which offers clients a broad range of financial services so that they do not have to go to different financial institutions for their various financial needs. Thus, universal banks have been authorized to perform some functions, such as securities underwriting and syndication activities, which before were reserved only to investment houses. Aside from investment functions, they are also allowed to have direct equity investments in allied and non-allied undertakings to ensure the flow of long-term funds into the economy.

As of December 1993, there were 14 universal banks (1 government bank and 13 private banks) with 1,789 branches (Table 4). Their total assets amounted to ₱592 billion, which comprised 44 percent of the total assets of the financial system.

The functions and range of services offered by the ordinary commercial banks have also been broadened under the 1980 financial reforms to include non-traditional functions of a commercial bank. However, unlike universal banks, they have restricted investment functions. More specifically, they are not authorized to perform securities underwriting and syndication activities. In addition, their equity investments in allied undertakings are more restricted compared to universal banks. They are prohibited from investing in non-allied activities.

A commercial bank may graduate into a universal bank upon satisfying some requirements, like minimum capital requirement for a universal bank, and upon securing approval from the BSP. In fact, most of the existing universal banks went through this process.

As of December 1993, there were 18 ordinary commercial banks (4 branches of foreign banks and 14 domestic banks) with 556 branches. Their assets amounted to ₱167 billion, which was equivalent to 13 percent of the total assets of the financial system.

The commercial banking system is the largest mobilizer of deposits. Its deposits stood at ₱515 billion at end-December 1995, which constituted 70 percent of its total resources (i.e., liabilities + equity) and 80 percent of the total deposits of the banking system.

b. Geographical Distribution of Offices

The head offices and almost half of the banking offices of the commercial banking system are in Metro Manila, the National Capital Region or NCR (Table 5).

Table 3
DISTRIBUTION OF ASSETS IN THE FINANCIAL SYSTEM, 1993

	1993 Amount (Billion Pesos)	Percent Distribution
Banking System	1,001.64	74.36
Commercial Banks	<u>758.92</u>	<u>56.34</u>
Private		
Expanded Commercial Banks*	591.92	43.95
Non-Expanded Commercial Banks*	104.71	7.77
Government		
Foreign	62.29	4.62
Thrift Banks	<u>74.09</u>	<u>5.50</u>
Private Dev't Banks	22.12	1.64
Savings & Mortgage Banks	44.40	3.30
Stock SLAs	7.57	0.56
Rural Banks	<u>22.16</u>	<u>1.65</u>
Specialized Gov't. Banks	<u>146.47</u>	<u>10.87</u>
Non-Bank Fin'l. Intermediaries	336.50	24.98
Insurance companies	<u>248.39</u>	<u>18.44</u>
Government	172.58	12.81
Private	75.81	5.63
Investment institutions	<u>30.55</u>	<u>2.27</u>
Investment Houses	6.10	0.45
Financing Companies	8.18	0.61
Investment Companies	16.27	1.21
Trust Operations (Fund Managers)	=	=
Other Financial Intermediaries	<u>57.56</u>	<u>4.27</u>
Securities Dealers/Brokers	7.97	0.59
Lending Investors	3.15	0.23
Pawnshops	5.20	0.39
Specialized Gov't Non-Banks	41.15	3.06
Venture Capital Corp.	0.09	0.01
Non-Bank Thrift Institutions	8.81	0.65
Mutual BLAs	0.11	0.01
Non-Stock SLAs	8.70	0.65
TOTAL	1,346.95	100.00

* 1993 Description

Source: *Bangko Sentral ng Pilipinas (Philippine Financial System Fact Book, 1993)*
Insurance Commission (Key Data Insurance Industry, 1989-1993)

Table 4
Number of Offices by Type and Institutional Group, 1993

	1993			
	TOTAL ¹	(%)	HO	BR
PHILIPPINE FINANCIAL SYSTEM	<u>10174</u>	<u>100.00</u>	<u>5117</u>	<u>5057</u>
Banking System	<u>4343</u>	<u>42.69</u>	<u>912</u>	<u>3431</u>
Commercial Banks	<u>2377</u>	<u>23.36</u>	<u>32</u>	<u>2345</u>
Expanded Commercial Banks	1803	17.72	14	1789
Non-Expanded Commercial Banks	566	5.56	14	552
Foreign	8	0.08	4	4
Thrift banks	<u>670</u>	<u>6.59</u>	<u>97</u>	<u>573</u>
Savings and mortgage banks	314	3.09	8	306
Private development banks	199	1.96	37	162
Stocks savings and loan associations	157	1.54	52	105
Rural banks	<u>1099</u>	<u>10.80</u>	<u>780</u>	<u>319</u>
Specialized government banks	<u>197</u>	<u>1.94</u>	<u>3</u>	<u>194</u>
Nonbank financial intermediaries	<u>5714</u>	<u>56.16</u>	<u>4115</u>	<u>1599</u>
Insurance companies	<u>666</u>	<u>6.55</u>	<u>132</u>	<u>534</u>
Government	5	0.05	5	-
Private	661	6.50	127	534
Investment institutions	<u>303</u>	<u>2.98</u>	<u>212</u>	<u>91</u>
Investment houses	34	0.33	23	11
Finance companies	204	2.01	124	80
Investment companies	65	0.64	65	-
Trust Operations (Fund managers)	<u>13</u>	<u>0.13</u>	<u>13</u>	<u>-</u>
Other financial intermediaries	<u>4732</u>	<u>46.51</u>	<u>3758</u>	<u>974</u>
Securities dealers/brokers	126	1.24	126	-
Pawnshops	3032	29.80	2213	819
Lending investors	1559	15.32	1404	155
Venture capital corp.	10	0.10	10	-
Specialized gov't non-banks	5	0.05	5	-
Nonbank thrift institutions	<u>117</u>	<u>1.15</u>	<u>90</u>	<u>27</u>
Mutual building and loan association	7	0.07	7	-
Non-stock SLAs	110	1.08	83	27

¹ Total includes HO and BR only

Source: *Bangko Sentral ng Pilipinas (Philippine Financial System Fact Book 1993)*

Filename: IIOBR93 (1-18-93)

Table 5
Regional Distribution of Offices by Type and Institutional Group, 1993

	NCR			REGION I ILOCOS			REGION II CAGAYAN VALLEY			REGION III CENTRAL LUZON			REGION IV SOUTHERN TAGALOG			REGION V BICOL		
	TOTAL	HO	BR	TOTAL	HO	BR	TOTAL	HO	BR	TOTAL	HO	BR	TOTAL	HO	BR	TOTAL	HO	BR
GRAND TOTAL	3395	1499	1999	357	166	191	192	95	97	1078	705	373	1628	1007	622	291	184	197
Banking System	1438	72	1364	234	93	141	122	38	84	413	108	305	670	176	494	154	57	97
Commercial Banks	1142	32	1110	88	--	88	46	--	46	175	--	175	202	--	202	60	--	60
Thrift banks	249	22	227	17	6	11	5	2	3	94	21	73	190	24	166	13	4	9
Savings and mortgage banks	178	7	171	4	--	4	1	--	1	19	--	19	52	--	52	7	--	7
Private development banks	54	7	47	5	3	2	1	--	1	20	5	15	60	9	71	4	2	2
Stocks savings and loan associations	17	8	9	8	3	5	3	2	1	55	16	39	58	15	43	2	2	--
Rural banks	16	16	--	118	87	31	61	36	25	132	87	45	258	152	106	71	53	18
Specialized government banks	29	2	27	11	--	11	10	--	10	12	--	12	20	--	20	10	--	10
Nonbank financial intermediaries	1858	1318	540	122	72	50	68	57	11	657	595	62	952	827	125	134	125	9
Insurance companies*																		
Government																		
Private																		
Trust Operations (Fund Managers)*																		
Investment houses	27	23	4	1	--	1	--	--	--	--	--	--	--	--	--	--	--	--
Finance companies	81	74	7	5	1	4	1	--	1	23	14	9	28	12	16	2	1	1
Securities dealers/brokers	126	126	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Investment companies	65	65	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Lending investors	360	330	30	36	2	34	24	18	6	221	213	8	459	433	26	21	20	1
Pawnshops	1184	685	499	80	69	11	43	39	4	413	368	45	465	382	83	111	104	7
Gov't NBFI's	5	5	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Venture capital corp.	10	10	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Nonbank thrift institutions	72	70	2	1	1	--	2	--	2	8	2	6	7	4	3	3	2	1
Mutual building and loan association	5	5	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Non-stock SLAs	67	65	2	1	1	--	2	--	2	8	2	6	7	4	3	3	2	1

Data on regional distribution of offices, not available

Source: Bangko Sentral ng Pilipinas (Philippine Financial System Fact Book 1993)

Regional Distribution of Offices by Type and Institutional Group, 1993

	REGION VI WESTERN VISAYAS			REGION VII CENTRAL VISAYAS			REGION VIII EASTERN VISAYAS			REGION IX WESTERN MINDANAO			REGION X NORTHERN MINDANAO			REGION XI SOUTHERN MINDANAO		
	TOTAL	HO	BR	TOTAL	HO	BR	TOTAL	HO	BR	TOTAL	HO	BR	TOTAL	HO	BR	TOTAL	HO	BR
GRAND TOTAL	498	259	239	932	299	333	162	93	99	163	91	72	361	203	158	460	246	223
Banking System	297	99	198	292	58	234	94	36	58	81	17	64	180	52	128	204	49	155
Commercial Banks	146	=	146	155	=	155	41	=	41	48	=	48	93	=	93	110	=	110
Thrift banks	26	7	19	32	7	25	4	1	3	5	=	5	12	2	10	17	1	16
Savings and mortgage banks	14	=	14	13	1	12	3	=	3	5	=	5	4	=	4	8	=	8
Private development banks	8	5	3	11	3	8	1	1	=	=	=	=	6	1	5	9	1	8
Stocks savings and loan associations	4	2	2	6	3	5	=	=	=	=	=	=	2	1	1	=	=	=
Rural banks	111	92	19	92	51	41	39	35	4	19	16	3	58	50	8	60	48	12
Specialized government banks	14	=	14	13	=	13	10	=	10	11	1	10	17	=	17	17	=	17
Nonbank financial intermediaries	198	158	40	336	236	98	66	57	9	80	74	6	179	150	29	263	196	67
Insurance Companies*																		
Government																		
Private																		
Trust Operations (Fund Managers)*																		
Investment houses	2	=	2	2	=	2	=	=	=	=	=	=	1	=	1	1	=	1
Finance companies	21	11	10	16	7	9	=	=	=	2	1	1	10	2	6	12	1	11
Securities dealers/brokers	=	=	=	=	=	=	=	=	=	=	=	=	=	=	=	=	=	=
Investment companies	=	=	=	=	=	=	=	=	=	=	=	=	=	=	=	=	=	=
Lending investors	67	61	6	146	127	19	16	14	2	21	19	2	66	77	9	68	62	6
Pawnshops	108	86	22	172	104	68	80	43	7	57	54	3	82	71	11	182	133	49
Gov't NBFI's	=	=	=	=	=	=	=	=	=	=	=	=	=	=	=	=	=	=
Venture capital corp.	=	=	=	=	=	=	=	=	=	=	=	=	=	=	=	=	=	=
Nonbank thrift institutions	3	2	1	4	3	1	2	=	2	2	=	2	2	1	1	2	1	1
Mutual building and loan association	=	=	=	1	1	=	=	=	=	=	=	=	=	=	=	1	1	=
Non-stock SLAs	3	2	1	3	2	1	2	=	2	=	=	2	2	1	1	1	=	1

Data on regional distribution of offices, not available

Source: Bangko Sentral ng Pilipinas (Philippine Financial System Fact Book 1993)

Filename: REQ-OFF3 (1-18-93)

Regional Distribution of Offices by Type and Institutional Group, 1993

	REGION XII CENTRAL MINDANAO			REGION XIII CAR			REGION XIV ARMM			GRAND TOTAL		
	TOTAL	HO	BR	TOTAL	HO	BR	TOTAL	HO	BR	TOTAL	HO	BR
PHILIPPINE FINANCIAL SYSTEM	<u>128</u>	<u>71</u>	<u>57</u>	<u>92</u>	<u>47</u>	<u>45</u>	<u>77</u>	<u>46</u>	<u>31</u>	<u>10174</u>	<u>5117</u>	<u>5057</u>
Banking System	<u>62</u>	<u>21</u>	<u>41</u>	<u>59</u>	<u>19</u>	<u>40</u>	<u>45</u>	<u>17</u>	<u>28</u>	<u>4343</u>	<u>912</u>	<u>3431</u>
Commercial Banks	<u>26</u>	<u>=</u>	<u>26</u>	<u>28</u>	<u>=</u>	<u>28</u>	<u>19</u>	<u>=</u>	<u>19</u>	<u>2377</u>	<u>32</u>	<u>2345</u>
Thrift banks	<u>3</u>	<u>=</u>	<u>3</u>	<u>3</u>	<u>=</u>	<u>3</u>	<u>=</u>	<u>=</u>	<u>=</u>	<u>670</u>	<u>97</u>	<u>573</u>
Savings and mortgage banks	<u>3</u>	<u>=</u>	<u>3</u>	<u>3</u>	<u>=</u>	<u>3</u>	<u>=</u>	<u>=</u>	<u>=</u>	<u>314</u>	<u>8</u>	<u>306</u>
Private development banks	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>199</u>	<u>37</u>	<u>162</u>
Stocks savings and loan associations	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>157</u>	<u>52</u>	<u>105</u>
Rural banks	<u>24</u>	<u>21</u>	<u>3</u>	<u>23</u>	<u>19</u>	<u>4</u>	<u>17</u>	<u>17</u>	<u>=</u>	<u>1099</u>	<u>780</u>	<u>319</u>
Specialized government banks	<u>9</u>	<u>=</u>	<u>9</u>	<u>5</u>	<u>=</u>	<u>5</u>	<u>9</u>	<u>=</u>	<u>9</u>	<u>197</u>	<u>3</u>	<u>194</u>
Nonbank financial intermediaries	<u>63</u>	<u>48</u>	<u>15</u>	<u>30</u>	<u>26</u>	<u>4</u>	<u>29</u>	<u>29</u>	<u>=</u>	<u>5714</u>	<u>4115</u>	<u>1599</u>
Insurance Companies*												
Government										<u>668</u>	<u>132</u>	<u>534</u>
Private										<u>5</u>	<u>5</u>	<u>-</u>
Trust Operations (Fund Managers)										<u>661</u>	<u>127</u>	<u>534</u>
Investment houses										<u>13</u>	<u>13</u>	<u>-</u>
Finance companies	<u>1</u>									<u>34</u>	<u>23</u>	<u>11</u>
Securities dealers/brokers			<u>1</u>	<u>2</u>		<u>2</u>				<u>204</u>	<u>124</u>	<u>80</u>
Investment companies										<u>128</u>	<u>128</u>	<u>-</u>
Lending investors										<u>65</u>	<u>65</u>	<u>-</u>
Pawnshops	<u>19</u>	<u>15</u>	<u>4</u>	<u>12</u>	<u>10</u>	<u>2</u>	<u>3</u>	<u>3</u>		<u>1559</u>	<u>1404</u>	<u>155</u>
Gov't NBF's	<u>43</u>	<u>33</u>	<u>10</u>	<u>18</u>	<u>16</u>		<u>26</u>	<u>26</u>		<u>3032</u>	<u>2213</u>	<u>819</u>
Venture capital corp.										<u>5</u>	<u>5</u>	<u>-</u>
Nonbank thrift institutions										<u>10</u>	<u>10</u>	<u>-</u>
Mutual building and loan association												
Non-stock SLAs	<u>3</u>	<u>2</u>	<u>1</u>	<u>3</u>	<u>2</u>	<u>1</u>	<u>3</u>	<u>=</u>	<u>3</u>	<u>117</u>	<u>90</u>	<u>27</u>
										<u>7</u>	<u>7</u>	<u>-</u>
	<u>3</u>	<u>2</u>	<u>1</u>	<u>3</u>	<u>2</u>	<u>1</u>	<u>3</u>	<u>-</u>	<u>3</u>	<u>110</u>	<u>83</u>	<u>27</u>

Data on regional distribution of offices, not available

Source: Bangko Sentral ng Pilipinas (Philippine Financial System Fact Book 1993)

The density ratio (i.e., the ratio of banking offices to total number of cities and municipalities) provides a rough idea of the accessibility of commercial banking services to cities and municipalities within a region. In 1993, Metro-Manila obtains the highest density ratio at 69 (Table 6). It means that each city or municipality in Metro Manila is served by 69 commercial banking offices on the average. Four regions (i.e., Regions III, VI, VII and XI) have density ratios of slightly over 1. The rest have density ratios of less than 1, which means that there are municipalities in these regions that do not have a branch of a commercial bank.

c. Types of Loans and Borrowers

As of December 1993, the loan portfolio of commercial banks stood at P415 billion, which was equivalent to 55 percent of their total assets. Commercial banks have different minimum loan sizes, ranging from P1 million to P2 million, with large banks requiring higher minimum loan size and small banks lower minimum loan size. One of the smallest commercial banks allows its branches to lend as low as P500,000 for business loans. Recently, however, many large commercial banks have gone into the rapidly growing consumer banking market to finance the acquisition of consumer durables such as motor vehicles. They grant loans as low as P100,000. Although many small enterprises were able to purchase small cargo trucks that are used for their business, still these are considered as consumer loans instead of business or commercial loans.

Because of their branching network, commercial banks decentralize their loan decision-making but with certain restrictions. A small commercial bank, for example, authorizes its branch managers to grant a loan to an individual or corporation up to P1 million. Loans more than P1 million but less than P5 million are referred by branch managers to their area heads, who supervise a specified number of branch managers. Loans more than P5 million but less than P10 million are handled by the Credit Committee of the bank. Loans in excess of P10 million are referred to the Executive Committee of the bank for approval.

Commercial banks usually cater to the short-term loans market. Three-fourths of their total loan portfolio are short-term loans, i.e., loans with maturity of one year or less (Table 7). Almost 60 percent of their loan portfolio was meant for working capital (i.e., for production and trade financing) of their borrowers.

Commercial banks normally require collateral for their loans. Of their total loan portfolio, only about one-third were unsecured or clean loans (Table 8). However, this is limited to their highly favored clients with very excellent credit track record. The rest are secured by either real estate, chattel, assignment of deposits, or other acceptable collateral such as bonds, stock certificates or standing crops. Among the different types of acceptable collateral, real estate is the most popular collateral to banks. Loans secured by real estate comprised 50 percent of the total secured loans of commercial banks. Banks may grant loans up to 75 percent of the market value of the collateral.

Table 6
Density Ratios: Ratio of Banking Offices to
Total Cities and Municipalities

Region	DENSITY RATIOS									
	Banking System		Per Banking Group							
			Commercial Banks		Thrift Banks		Rural Banks		Specialized Gov't. Banks	
1992	1993	1992	1993	1992	1993	1992	1993	1992	1993	
NCR - Metro Manila	82.5	87.8	64.3	68.8	15.6	16.2	1.1	1.1	1.6	1.8
I - Ilocos	1.7	2.1	0.6	0.7	0.1	0.2	0.9	1.1	0.1	0.1
II - Cagayan Valley	1.1	1.4	0.4	0.5	0.1	0.1	0.8	0.8	0.1	0.1
III - Central Luzon	3.5	3.9	1.3	1.5	0.9	1.0	1.2	1.3	0.1	0.1
IV - Southern Tagalog	2.9	3.3	0.8	0.9	0.9	1.0	1.2	1.3	0.1	0.1
V - Bicol	1.3	1.4	0.5	0.5	0.1	0.1	0.6	0.6	0.1	0.1
VI - Western Visayas	2.3	2.4	1.1	1.2	0.2	0.2	0.9	0.9	0.1	0.1
VII - Central Visayas	2	2.3	1.1	1.2	0.2	0.3	0.6	0.7	0.1	0.1
VIII - Eastern Visayas	0.6	0.7	0.2	0.3	-	-	0.3	0.3	0.1	0.1
IX - Western Mindanao	0.8	1.1	0.5	0.6	-	0.1	0.2	0.3	0.1	0.1
X - Northern Mindanao	1.5	1.5	0.7	0.8	0.1	0.1	0.5	0.5	0.1	0.1
XI - Southern Mindanao	2.4	2.5	1.2	1.3	0.2	0.2	0.8	0.8	0.2	0.2
XII - Central Mindanao	0.9	1.2	0.3	0.5	-	0.1	0.4	0.5	0.1	0.2
XIII - CAR	-	0.8	-	0.4	-	-	-	0.3	-	0.1
XIV - ARMM	-	0.5	-	0.2	-	-	-	0.2	-	0.1
Highest	82.5	87.8	64.3	68.8	15.6	16.2	1.2	1.3	1.6	1.8
Lowest	0.6	0.5	0.2	0.2	-	0.1	0.2	0.2	0.1	0.1

Source: Bangko Sentral ng Pilipinas (Philippine Financial System Fact Book 1992, 1993)

Filename: DENRAT-912-II-94

Table 7
Loans Outstanding of Commercial Banks Classified
by Maturity, June 1993
(In Million Pesos)

	1993	%
TOTAL ¹	<u>251,708.1</u>	<u>100.00</u>
Demand	29,973.6	11.91
Short-term	159,221.6	63.26
Intermediate-term	50,579.0	20.09
Long-term	11,933.9	4.74

¹ Excluding past due items, items in litigation, domestic and foreign bills, clean .

Source: Central Bank of the Philippines

Filename: COMBANK1 (1-18-95)

Table 8
Loans Outstanding of Commercial Banks Classified
by Type of Security, June 1993
(In Million Pesos)

SECURED		1993	%
TOTAL ¹		<u>251,708.1</u>	<u>100.00</u>
Unsecured		86,639.3	34.42
Total		165,068.8	<u>100.00</u>
Real Estate	92,843.1		56.25
Chattel	11,951.2		7.24
Assignment of Deposit	14,967.0		9.07
Others	45,307.5		27.45

¹ Excluding past due items, items in litigation, domestic and foreign bills, clean.

Source: Central Bank of the Philippines

Filename: COMBANK3 (1-18-95)

The loans of commercial banks were concentrated in the manufacturing sector (42%), wholesale/trade sector (15%) and financing, insurance and business services like hotels, repair shops, etc. (12%) (Table 9). Their loans to the agricultural sector, which comprised 10 percent of their total loan portfolio, went mostly to the multinational and large corporations engaged in producing cash crops for export.

2. The Thrift Banking System

a. *Authorized Functions and Total Resources*

The thrift banking system consists of private development banks, savings and mortgage banks, and stock savings and loan associations. Before the 1980 financial reforms, they were authorized to perform different functions. For instance, private development banks specialized in extending medium- and long-term loans to industrial and commercial enterprises, whereas savings and mortgage banks specialized in providing housing and consumer loans. With the 1980 financial reforms, the functions of these three categories of banks have been broadened and standardized so that they are now formally less specialized, although individual banks falling in any of the three categories may retain their established identity. One of the special privileges of thrift banks is that their reserve requirement on ordinary and special savings and time deposits is lower than that of commercial banks by 2 percentage points.

Thrift banks may secure authority from the BSP to have additional functions, such as demand deposit account operations, issuance of domestic L/Cs, undertaking trust services, etc., after meeting certain requirements prescribed by the BSP for each additional function. In short, thrift banks may have "full domestic banking" functions, which means that they actually operate like a commercial bank but without international banking operations. A thrift bank may be converted into a commercial or universal bank upon satisfying certain conditions like minimum capital requirement with approval by the BSP. To date, two thrift banks graduated into commercial banks.

As of December 1993, there were 97 thrift banks with 573 branches. Their total assets amounted to P74 billion, which was equivalent to 5.5 percent of the total assets of the financial system. Some 13 thrift banks were granted authority to offer checking accounts and 8 were authorized to engage in trust and other fiduciary functions.

Nine thrift banks are subsidiaries of universal banks. One of the reasons why a universal bank maintains a thrift bank is that the latter has a lower reserve requirement ratio on savings and time deposits than a universal bank. Another reason is that a universal bank wants its presence to be strongly felt in the retail loan and deposit markets. Thrift banks have lower overhead cost than commercial banks and therefore they can accommodate small loans and deposits more efficiently than large commercial banks.

Table 9
Loans Outstanding of Commercial Banks Classified
by Industry, June 1993
(In Million Pesos)

	1993	%
TOTAL ¹	<u>251,708.1</u>	<u>100.00</u>
Agriculture, Fishery and Forestry	16,445.4	6.53
Mining & Quarrying	8,427.0	3.35
Manufacturing	105,908.0	42.08
Electricity, Gas and Water	3,903.0	1.55
Construction	6,658.1	2.65
Wholesale and Retail Trade	38,806.4	15.42
Transportation, Storage & Communication	10,917.0	4.34
Financing, Insurance & Business Services	30,569.6	12.14
Real Estate	10,243.1	4.07
Community, Social and Personal Services	19,830.5	7.88

¹ Excluding past due items, items in litigation, domestic and foreign bills, clean.

Source: Central Bank of the Philippines

Filename: COMBANK4 (1-18-95)

As of December 1993, the total deposits of the thrift banking system amounted to P50 billion, which constituted 68 percent of their total resources and 8 percent of the total deposits of the banking system.

b. Geographical Distribution of Offices

Thrift banks may be called regional banks because they tend to operate within a limited geographic area despite being allowed to have a nation-wide branch network. Their branches are usually located near their head offices. Out of 97 thrift banks, only 22 (7 private development banks, 8 stock savings and loan associations, and 7 savings and mortgage banks) have head offices in Metro Manila.

In terms of density ratio for thrift banks, Metro Manila obtained the highest at 16. This is because most thrift banks with head offices in Metro Manila are maintaining several branches, whereas majority of the thrift banks outside Metro Manila do not have branches. Regions III and IV have density ratios of 1, while the rest have density ratios of less than 1.

c. Types of Loans and Borrowers

As of December 1993, the loan portfolio of thrift banks stood at P44 billion, which was about 60 percent of their total assets. About 72 percent of their total loan portfolio were secured loans. Thrift banks prefer real estate (74%) and chattel (17%) as collateral for their loans.

The thrift banking system seems to have carved itself a niche in the loans and deposit markets. More specifically, it specializes in the retail markets, which consist of small loans and deposits that are not being accommodated by commercial banks. The minimum loan size varies across thrift banks and ranges between P20,000 and P100,000. Like commercial banks, thrift banks that have several branches have graduated credit approval authorities. For example, one of the largest thrift banks authorizes its branch managers to approve individual loans up to P1 million and group heads between P1 million and P2 million. Individual loans of more than P2 million need to be approved by the bank's credit committee.

Although the functions of the three categories of thrift banks have been standardized, still they tend to specialize in their traditional line of business. More specifically, private developments provide loans to SMEs to finance both short-term working capital and acquisition of fixed assets. Half their total loan portfolio are medium- and long-term loans (Table 10). A little over one-third of their loans went to the manufacturing sector and one-fourth to the agricultural sector. Financing, insurance & business services and real estate sector had one-tenth each (Table 11). As for savings banks and stock SLAs, at least half their loan portfolio consist of medium- and long-term loans (Tables 12 and 13). They still play a significant role in the housing loans market (Tables 14 and 15).

Table 10
 Loans Outstanding of Private Development Banks Classified
 by Maturity, June 1992
 (In Million Pesos)

	1992	%
TOTAL ¹	<u>7,591.6</u>	<u>100.00</u>
Short-term	3,601.9	47.45
Intermediate-term	2,228.2	29.35
Long-term	1,760.9	23.20

¹ Excluding past due items, items in litigation, domestic and foreign bills, clean.

Source: Central Bank of the Philippines

Filename: PDBANK1 (1-18-95)

Table 11
Loans Outstanding of Private Development Banks Classified
by Industry, June 1992
(In Million Pesos)

	1992	%
TOTAL ¹	<u>7,591.6</u>	<u>100.00</u>
Agriculture, Fishery and Forestry	1,908.6	25.14
Mining & Quarrying	59.7	0.79
Manufacturing	2,594.1	34.17
Electricity, Gas and Water	18.4	0.24
Construction	225.3	2.97
Wholesale and Retail Trade	328.6	4.33
Transportation, Storage & Communication	117.9	1.55
Financing, Insurance & Business Services	876.8	11.55
Real Estate	985.4	12.98
Community, Social and Personal Services	476.8	6.28

¹ Excluding past due items, items in litigation, domestic and foreign bills, clean.

Source: Central Bank of the Philippines

Filename: PDBANKJ (1-18-95)

Table 12
Loans Outstanding of Savings Banks Classified
by Maturity, June 1993
(In Million Pesos)

	1993	%
TOTAL ¹	<u>17,022.1</u>	<u>100.00</u>
Demand	860.7	5.06
Short-term	4,030.9	23.68
Intermediate-term	7,785.2	45.74
Long-term	4,345.3	25.53

¹ Excluding past due items, items in litigation, domestic and foreign bills, clean.

Source: Central Bank of the Philippines

Filename: SAVBANKI (1-18-95)

Table 13
Loans Outstanding of Stock Savings & Loans Associations Classified
by Maturity, June 1993
(In Million Pesos)

	1993	%
TOTAL ¹	<u>1,844.7</u>	<u>100.00</u>
Demand	45.6	2.47
Short-term	880.7	47.74
Intermediate-term	743.2	40.29
Long-term	175.2	9.50

¹ Excluding past due items, items in litigation, domestic and foreign bills, clean.

Source: Central Bank of the Philippines

Filename: SLAsBANK1 (1-18-95)

Table 14
Loans Outstanding of Savings Banks Classified
by Industry, June 1993
(In Million Pesos)

	1993	%
TOTAL ¹	<u>17,022.1</u>	<u>100.00</u>
Agriculture, Fishery and Forestry	340.8	2.00
Mining & Quarrying	21.5	0.13
Manufacturing	1,351.2	7.94
Electricity, Gas and Water	316.9	1.86
Construction	1,893.0	11.12
Wholesale and Retail Trade	800.9	4.71
Transportation, Storage & Communication	459.7	2.70
Financing, Insurance & Business Services	1,433.1	8.42
Real Estate	3,650.7	21.45
Community, Social and Personal Services	6,754.3	39.68

¹ Excluding past due items and items in litigation

Source: Central Bank of the Philippines

Filename: SAVBANK2 (1-18-95)

Table 15
Loans Outstanding of Stock Savings & Loans Associations Classified
by Industry, June 1993
(In Million Pesos)

	1993	%
TOTAL ¹	<u>1,844.7</u>	<u>100.00</u>
Agriculture, Fishery and Forestry	269.6	14.61
Mining & Quarrying	—	0.00
Manufacturing	57.4	3.11
Electricity, Gas and Water	7.6	0.41
Construction	188.8	10.23
Wholesale and Retail Trade	342.3	18.56
Transportation, Storage & Communication	56.3	3.05
Financing, Insurance & Business Services	142.9	7.75
Real Estate	569.0	30.85
Community, Social and Personal Services	210.8	11.43

¹ Excluding past due items, items in litigation, domestic and foreign bills, clean .

Source: Central Bank of the Philippines

Filename: SLAsBNK2 (1-18-95)

3. The Rural Banking System

a. *Authorized Functions and Total Resources*

As part of the 1980 financial reforms, the functions and activities of rural banks have also been broadened to enable them to compete with other types of financial institutions. Whereas before they were merely unit banks (i.e., only one office without any branches), now they are allowed to have branches. They have functions similar to thrift banks except that they are not allowed to open domestic L/Cs. At present, the BSP has not granted them the authority to undertake trust services. But this may be granted by the BSP in the future on a case-by-case basis. They may open demand or checking deposits so long as they satisfy the minimum capital requirement.

Cooperative rural banks, which are owned by farmers or their associations with minor participation from other rural groups, are part of the rural banking system, i.e., they operate under the same charter as the rural banks. However, Republic Act No. 6938 provides that the BSP in consultation with the Cooperative Development Authority and the cooperative movement shall formulate guidelines regarding the operations and banking transactions of cooperatives that take into account the unique characteristics of the cooperative rural banks.

As of December 1993, there were 780 rural banks with 319 branches. Of these, 35 were cooperative rural banks. The rural banks' total assets amounted to P22 billion, which was equivalent to 1.6 percent of the total assets of the financial system. CRBs contributed about P1 billion to the total assets of the rural banking system.

As of December 1993, the total deposits of the rural banking system reached P13 billion, which comprised 60 percent of its total resources and 2 percent of the total deposits of the banking system.

It might be worthwhile to mention here that like rural banks, the CRBs are heavily subsidized by the government. Because a great majority of them encountered financial difficulties in the 1980s and participated in several rehabilitation programs since 1984, the government now partly owns a large chunk of the shares in practically all CRBs.² In particular, the LBP and the Department of Agriculture both hold common stocks in the CRBs that give them minority voting rights.

²LBP's fresh equity infusion to 29 CRBs amounted to P52 million. It also invested P1 million as preferred shares in each of the 6 new CRBs. Likewise, DA implemented its P15.6 million CRB Capital Infusion Program for 29 CRBs. This is over and above the rehabilitation programs participated in by 15 CRBs under which P21 million of BSP arrearage were converted to LBP capital.

b. Distribution of Banking Offices

Rural banks are scattered all over the country in cities and municipalities. There used to be a policy of the government to have a rural bank for every municipality or city. However, many rural banks collapsed in the 1980s. After reaching a peak of about 1,200 in the early 1980s, the number of rural banks head offices declined to 780. Thus, some municipalities in the country today do not have a rural bank.

While rural banks operate within a town, CRBs operate within a province. Thus, the 35 CRBs are distributed to the 34 provinces and one city of the country.

c. Types of Loans and Borrowers

Rural banks, including CRBs, were originally conceived as agricultural unit banks, i.e., they were small banks without branches catering only to small farmers. The 1980 financial reforms allowed them to provide banking services to other sectors in rural areas. Since then, their loan portfolio has been shifting towards non-agricultural loans. More specifically, agricultural loans granted by rural banks comprised 49 percent of their total loan portfolio in 1992, whereas it constituted 75 percent in 1984. CRBs also follow the same trend, with the share of their agricultural loans granted dropping from 70 percent in 1984 to 52 percent in 1992. Indeed, the 1980 financial reforms have given rural banks the opportunity to diversify their loan portfolios. Clearly, small non-agricultural enterprises in the countryside have benefited from this loan portfolio diversification.

Rural banks grant loans between P10,000 and P500,000 per borrower depending on the size of the equity of the rural banks, which determines the single borrower's limit. These are usually short-term, production loans or loans to finance the working capital requirement of borrowers. Since most rural banks are unit banks, credit decisions in a rural bank is concentrated in the manager, who is usually the major stockholder of the rural bank. In the case of CRBs, the manager is given a loan limit authority, which ranges from P10,000 to P50,000. The credit and collection committee approves loan applications ranging from P75,000 to P100,000. Loans beyond P100,000 need the approval of the Board.

4. Specialized Government Banks

a. Authorized Functions and Total Resources

There are three specialized government banks, namely the Philippine Amanah Bank (PAB), the Land Bank of the Philippines (LBP) and the Development Bank of the Philippines (DBP). The PAB provides banking services to the Muslim community. It is basically a commercial bank, but follows the Islamic banking practices, such as charging no interest on its loans.

LBP was established in 1963 to finance the acquisition by the Government of landed estates for division and resale to small landholders, as well as the purchase of landholdings from landowners. After the entire country was declared in 1972 a land reform area, LBP was reorganized and strengthened. More significantly, it was given the authority to engage in commercial banking activities. LBP is legally a universal bank. Since the financial reforms initiated in the mid-1980s, LBP has become the major conduit of government agricultural credit programs.

DBP's original function was to help accelerate the industrialization in the country by providing industries with medium- and long-term funds. It was also given the task to develop the private development banking system in the country through direct equity investments in private development banks and some liquidity windows. DBP encountered acute financial difficulties in the mid-1980s. In 1986, it underwent a rehabilitation program that involved the transfer to the National Government of its non-performing assets totalling P61.4 billion. Under DBP's new charter, its powers have been broadened to take into account the recent financial reforms and to enable it to operate competitively. It is mandated to assist not only private development banks but all private banks under the thrift bank category. DBP remains the major conduit of government credit programs for the industrial sector.

As of December 1993, the specialized government banks had 194 branches (7 for PAB, 59 for DBP and 128 for LBP). Their total assets amounted to P146 billion, which constituted 11 percent of the total assets of the financial system. They had P71 billion deposits, which is equivalent to 49 percent of their total resources and 11 percent of the total deposits of the banking system. Although most of these deposits are those of the national government and government-owned corporations, the share of private sector deposits has been increasing due to the intensive deposit mobilization conducted recently by government banks.

b. Distribution of Banking Offices

The head offices of the three specialized government banks are located in Metro Manila. DBP's branches are spread across 60 provinces. In the case of LBP, 22 of its branches are located in Metro Manila and the rest are distributed to the countryside. PAB's branches are situated in predominantly Muslim provinces in Mindanao.

c. Types of Loans and Borrowers

After being moribund for almost ten years, PAB started operating again recently. It provides all types of loans to their target clientele, who are usually engaged in small- and medium-scale businesses.

DBP used to engage in retail lending. After the change in its charter in the mid-1980s, it started to place greater emphasis on wholesale lending; that is lending huge amount of money to participating financial institutions, which, in turn, retail them to several target beneficiaries.

Presently, its wholesale loan portfolio comprises 63 percent of its total loan portfolio.

DBP has three loan windows. The first two loan windows, respectively, provide short- and medium-/long-term loans to industries included in the Industrial Priority Plan annually drawn up by the government. These are small, medium- and large-sized loans, which are priced at commercial rates, to finance short-term working capital and/or the acquisition of fixed assets of small, medium and large enterprises. Loans by end-users can be as low as ₱50,000. The third window, Window III, provides small loans at concessional terms to finance projects of the so-called "disadvantaged" groups. These projects should have high development impact and are shown to be viable. These loans are charged 2 percentage points above the inflation rate but lower than the interest rates on the first two windows. As of December 1993, the Window III loan portfolio stood at ₱1.26 billion, which is roughly 4 percent of the total loan portfolio of DBP of ₱34.2 billion.

LBP provides both agricultural and commercial loans. As of December 1993, 57 percent of its total loan portfolio of ₱32 billion went to agriculture and agriculture-related livelihood projects. Like DBP, LBP has increasingly emphasized wholesale lending using rural banks, cooperatives and NGOs/PVOs as credit conduits (see Chapter 4 for a related topic).

5. Ownership Structure of Banks

Up until 1989, bank entry regulations were highly restrictive. Because resources were highly concentrated, only very few rich families were able to pool capital together and satisfy the minimum capital requirements needed to set up a bank.

Commercial banks are basically closed, family-owned corporations that are associated with a few Filipino elites (e.g., Ayalas, Madrigals) and Filipino Chinese (e.g., Lucio Tan, Sycip, George Ty).³ Although there were changes in ownership of some banks between 1950 and today, those ownership changes were merely confined to the elite families and Filipino Chinese families. Even those banks that were acquired by the government and recently privatized went to the hands of the elite families (e.g., Aboitiz).

Of the 32 commercial banks, only 8 are listed in the stock exchange. Even these listed banks cannot be said to be widely owned because the shares listed are usually no more than 10 percent of the total outstanding shares of these banks.

Foreign equity has been limited to 40 percent of the total outstanding shares of a commercial bank. At present, 11 commercial banks have foreign equity participation ranging from 1 percent to 40 percent. The recently passed law liberalizing the entry of foreign banks increases the allowable equity participation of foreign banks in domestic banks to 60 percent. To

³This is extensively discussed in Doherty (1982) and Tan (1989).

date, no foreign bank has ever formally applied with the BSP to buy shares of up 60 percent of an existing bank.

Rural banks are basically privately-owned banks. In the 1970s, the government encouraged the establishment of a rural bank in every town of the country by matching every peso infused by private investors into a rural bank. The government's participation was placed in non-voting preferred shares. Naturally, the few more well-off families in a municipalities who could raise capital were able to set up rural banks. Their investment in rural banks were protected by the policy of having only one rural bank per town. This policy was withdrawn in the mid-1980s. Almost all rural banks today are owned and managed by the original owners.

The same was done by the government to encourage the establishment of private development banks. They too are owned by the elite families in the provinces. Of the 37 private development banks, only three have foreign equity participation and one listed in the stock exchange.

Cooperative rural banks (CRBs) were conceived as mass-based banks owned by farmers or their associations, called Samahang Nayan. They were capitalized using the Barrio Savings Fund and Barrio Guarantee Fund of Samahang Nayan. Many of these associations are now moribund, but they have not withdrawn their equity participation in CRBs. Some active Samahang Nayan converted themselves into cooperatives with the approval by the CDA. In view of the need to increase the capitalization of CRBs, many CRBs recently have aggressively sought for new investors including non-agricultural cooperatives. Thus, today many CRBs are not exclusively owned by farmers' cooperatives anymore but also by other cooperatives like market vendors credit cooperatives, marketing cooperatives, etc. It can, therefore, be said that among the existing formal financial institutions, only CRBs are widely owned by non-wealthy members of the Philippine society.

Many raised concerned about the equity implications of the concentration of ownership of banks in the Philippines. The restrictive bank entry regulations already assured bank owners of reaping monopoly profits. In addition, the government encouraged banks to participate in special credit programs by giving them wide spreads ranging from 3 to 10 percentage points. The Central Bank rediscount window also gave banks very generous spreads. In the case of rural banks and private development banks, the very low fixed return (4% vs. 10% on government securities) on preferred shares owned by the government constituted a subsidy to these banks over and above the generous spreads on special credit programs and loans rediscounted by the Central Bank. In the early 1980s, the government suspended its policy of matching every peso invested by owners in rural banks and private development banks.

The concentration of bank ownership reinforces market and political power by a few families or groups, making financial reforms difficult to design and implement (Doherty 1982, Tan 1989). This was recently demonstrated in the case of the move to liberalize entry of foreign banks. Specifically, the Bankers Association of the Philippines (BAP) strongly objected to the

liberalization of the entry of foreign banks. The law that was finally enacted is more restrictive than what was originally proposed by the Senate and House of Representatives to accommodate the concerns of the BAP (e.g., foreign banks preferring to operate as branches are limited to 6 branches only).

What is more worrisome is the widespread interlocking directorates within large financial institutions and between large financial and non-financial corporations. For example, Tan (1989) pointed out that Far East Bank and Trust Co. (FEBTC) is interlocked with four large commercial banks, namely Philippine Commercial International Bank (PCIB), RCBC, China Banking Corp. and Asia Bank. Bank of the Philippine Islands (BPI), which is associated with the Ayala family, is interlocked with 47 companies in the various sectors of the economy; Rizal Commercial Bank Corp. (RCBC), which is associated with the Yuchengco family, with 59 companies; and Union Bank, which is associated with the Aboitiz family, with 54 companies. Tan (1989) further pointed out that these companies belong to sectors of the economy that have been highly protected.⁴ That there has been strong and coordinated resistance from financial and non-financial groups to moves towards greater competition is not surprising at all.

C. NON-BANK FINANCIAL INTERMEDIARIES

Non-bank financial institutions are generally engaged in long-term financing for the expansion and modernization of productive ventures and, to a certain extent, for facilitating short-term placements in other financial institutions. It might be worthwhile to discuss the functions and performance of three groups of non-bank financial intermediaries, namely finance companies, pawnshops, and lending investors because they play an important role in providing credit to the small enterprises, especially those that are not being served by the banking system.

1. Finance Companies

The Financing Company Act (RA 5980), as amended, governs the operations of finance companies. An allied law is the General Banking Act. Finance companies are regulated by the BSP and the Securities and Exchange Commission. They are allowed to engage in (a) receivables financing and (b) financial leasing. There are two types of lease transactions: (a) the "financial lease," which is a non-cancelable contractual arrangement whereby the lessor provides the lessee use of an asset, usually fixed equipment, building or land for the consideration of periodic rental payments, and (b) the "operating lease," which is a cancelable contractual arrangement whereby the lessee makes periodic payments to the lessor over a number of years for the use of an asset. Under the latter type, the usable life of the asset is longer than the term of the lease but because of technological obsolescence, the asset is not leased for a period which is commensurate to its usable life. In the Philippines, leasing is mostly of the financial type.

⁴Earlier, Doherty (1982) did a study on interlocking directorates.

usable life. In the Philippines, leasing is mostly of the financial type.

The Financing Company Act has allowed finance companies to charge any rates even before the de facto abolition of the Anti-Usury Law. A finance company performing quasi-banking functions, that is, borrowing from 20 or more lenders for relending or purchase of receivables, is subject to the BSP rules and regulations on quasi-banking functions. More recently, the single borrower's limit and ceilings on DOSRI loans of finance companies with quasi-banking functions have been imposed while selling of receivables of finance companies has been confined to banks, investment houses and other finance companies. The SEC, on the other hand, regulates the issuance of commercial papers including those issued by finance companies.

Finance companies have emerged as an alternative source of credit facilities for consumers and agricultural, commercial and industrial enterprises. As of December 1993, there were 204 finance companies composed of 124 head offices and 80 branches. Their combined assets reached P8.2 billion on the same year, which was 0.6 percent of the total assets of the financial system. These companies are heavily involved in consumer credit, which enables households to acquire houses and lots, appliances, cars and other consumer durables on installment basis. Through lease financing, commercial enterprises and producers are given the opportunity to use equipment, business and office machines and other fixed assets and at the same time to have more cash flow for other purposes. Trading of securities and residential mortgage finance are the two recent activities where finance companies are active.

Short-term borrowings constituted the major source of funds of finance companies. They average 40 percent of the total sources of funds of finance companies. Own capital and retained earnings account for 23 percent of finance companies' total resources. The rest are other types of liabilities.

Finance companies are heavily involved in receivables financing, direct lending and trading of securities. Receivables financing constituted about one-third of the total business of finance companies. It has grown steadily in importance given the short term orientation of commercial banking and, in general, of financing activities in the economy. Direct lending is another important activity of finance companies second only to receivables financing. It comprises 20 percent of the total business of finance companies. It will continue to be a major source of profits for finance companies given the growth in consumer income and the development of small and medium enterprises.

A few finance companies are subsidiaries of banks. Supply of funds is not much of a problem to them. For the majority, however, which are family-owned, lack of capital is their biggest constraint for expansion. Increasing resources through borrowing is also a fairly limited option since under the law, they are prohibited from borrowing from more than 19 individual/institutional lenders.

2. The Pawnshop Industry

Pawnshops are business establishments engaged in lending money on personal property delivered as security or pledge. It is governed by a special law, the Pawnshop Regulation Act.

With a very low minimum capital requirement of ₱100,000; there is practically free entry and exit in the pawnshop industry. Although the BSP regulates and supervises the pawnshop industry, no prior BSP approval is needed to open a pawnshop. The only requirement is the license of the city or municipality, where operations of a pawnshop are going to be conducted, and registration with the SEC, if corporate and partnership, and with the Bureau of Domestic Trade, if single proprietorship. A pawnshop is usually manned by 3 to 5 people including one appraiser.

As of December 1993, the total assets of the pawnshop industry are placed at ₱5.2 billion. The average asset size of pawnshops is ₱1.7 million. Although they are small in terms of assets, nevertheless they play an important role in the credit markets, particularly in providing credit to small farmers and enterprises. First of all, pawnshops can be found almost every where in the country. Hence, they are very accessible to their clients. The number of pawnshops grew by about 20 percent per year for the last 7 years. As of December 1993, there were already 3,032 pawnshops composed of 2,213 head offices and 819 branches. About 60 percent of these are located outside Metro Manila. Second, transaction cost is low because there is hardly any paper work to be done by borrowers. Loans can be released quickly, usually less than 15 minutes after filing an application. Third, any item of value can serve as collateral. About ten years ago, pawnshops were very selective with regard to the kind of valuable items they accepted as collateral, preferring less bulky, high-valued items such as jewelries. With competition getting stiffer, pawnshops now accept anything of value such as television sets, electric sewing machines, calculators, etc. Fourth, borrowers may use the loans for any purpose they want without being questioned by pawnshops. Fifth, clients can borrow as low as ₱100. In an earlier study, Lamberte (1988) found that about 80 percent of the loans granted by pawnshops were ₱500 and below. Even if the concentration of the loans has now shifted to the ₱500-₱1,000 bracket, still it is much lower than the minimum loan requirement of rural banks. Sixth, pawnshops charge interest of 4 percent to 5 percent per month, sometimes without any service charges. This is considerably lower than what informal money lenders charge.

Accordingly, an average size pawnshop in Metro Manila, Cebu City, Davao City and Cagayan de Oro City accommodates about 20-25 clients a day, while an average size pawnshop in other cities and municipalities accommodates about 8-12 clients a day.

Since pawnshops are prohibited from mobilizing deposits, they rely mainly on their own funds. Borrowing from other financial institutions was less than 20 percent of the total resources of pawnshops.

3. Lending Investors

Unlike finance companies and pawnshops, lending investors are a recent phenomenon that emerged in the mid-1970s. They are in the business of extending secured or unsecured small loans at interest. They are not covered by a special law. But since they extend credit, the BSP is responsible for regulating and supervising them. Lending investors have the same registration requirement as pawnshops, but they do not have any minimum capital requirement.

As of December 1993, there were 1,559 lending investors composed of 1,436 head offices and 123 branches. This is five times the number of lending investors that existed in 1986. The number of lending investors per region ranges from 15 to 360. Many of them can be found in Metro Manila (22%) and its two adjoining regions, namely Region III (15%) and Region IV (29%). Their total assets stood at P3.2 billion. They employ 2 to 5 staff to run their lending operations.

Like pawnshops, lending investors are not allowed to accept deposits. Thus, their resources mainly come from owners' equity (43%) and short-term borrowing from other financial institutions and individuals (56%). Their loan portfolio comprises 70 percent of their total assets.

Lending investors are active in public market places and offices, providing business and consumption loans to small enterprises and employees. Lending investors in rural areas very seldom lend to farmers. They prefer to lend to salaried employees and small enterprises. Salary loans, i.e., loans computed on the basis of the monthly net take-home pay of borrowers, range from P3,000 to P20,000. Loans secured by real estate could go as high as P1 million.

In their case study of four lending investors, Peñalba et al. (1994) obtained the following results:

1. maturity period of the loans provided by lending investors ranges from 100 days to 1 year;
2. except for real estate and chattel loans, no collateral is required for any types of loans such as salary loans and loans for working capital;
3. interest rate charged by lending investors ranges from 36 percent to 45 percent per annum, which is lower than the interest rate charged by informal money lenders and pawnshops;
4. the frequency of loan repayment could be daily, bi-monthly or monthly;
5. lending investors have simple and minimal documentary requirements such as loan application and business permit or certificate of registration;

6. although loan processing is done quickly (1 day to 1 week depending on the type of security being offered by borrowers), disbursement of the loan could be delayed due to lack of funds;
7. lending investors send collectors to borrowers to collect loan repayment and deliver notices of delayed payments;
8. repayment rates are generally high: 98 percent for three lending investors and 80 percent for one lending investor; and
9. the number of borrowers of lending investors ranges from 80 to 200.

Lending investors are competing with informal lenders, finance companies, pawnshops and other lenders to small borrowers. Accordingly, some lending investors accept pledged articles delivered to them as collateral (Dominise 1993), which pawnshops do. Since there is no special law governing lending investors, they can practically do what an ordinary money lender does. Indeed, it has been pointed out that a number of informal money lenders registered themselves with the BSP as lending investors (Agabin *et al.* 1989). The advantage of being registered is that they can take legal actions against defaulting borrowers.

D. THE COOPERATIVE CREDIT UNION SYSTEM

The cooperative credit union (CCU) system is an important source of credit especially to those who have no access to bank credit. Although it is engaged in lending, it is not supervised by the BSP. The Cooperative Development Authority (CDA) regulates and supervises CCUs as well as other types of cooperatives. Presently, regulations on CCUs are less restrictive than those on banks, and the CDA has not done any meaningful supervision of CCUs. To be registered with the CDA, the CCU must have at least 15 members. There is no minimum capital requirement for a CCU to be registered with the CDA.

CCUs enjoy some special privileges not accorded to banks and non-bank financial intermediaries. There is no reserve requirement imposed on deposit liabilities of CCUs. They are exempted from taxes imposed on financial institutions such as withholding tax on interest income from deposits, gross receipts tax on interest income from loans and income tax.

Because the Catholic hierarchy has been promoting credit unions as part of their social functions, almost every town in the country today has a credit union. CCUs can also be found in public market places, large companies and schools.

Per record of the CDA, there are 2,500 registered CCUs, of which 1,500 are active. This is not an exhaustive list of the number of CCUs operating in the country because the CDA has not been actively campaigning for registration of CCUs. Unlike the BSP, it does not impose any

sanction on unregistered CCUs or on registered CCUs that habitually fail to submit financial reports. Thus, it is difficult to come up with a good picture of the overall performance of the CCUs. There are several federations of CCUs (e.g., CUP, PFCCI, NATCCO, NAMVESCO) that can provide a list of their CCU members. However, some federations have overlapping membership. Also, newly formed CCUs are not likely members of any federation of CCUs. Thus, a discussion of the performance of CCUs will have to be based on existing studies that used survey data (e.g., Lamberte and Balbosa 1988, Relampagos *et al.* 1990, Lamberte 1994, Llanto 1994).

CCUs provide financial services only to their members. Membership in some CCUs is open to all, while in others, membership is limited to a few such as employees of the same firm or agency, registered market vendors, etc. Each member is required to subscribe to a minimum fixed share or fixed deposit, which ranges from P25 to P1,000. The average number of members per CCU is 1,151 (Llanto 1994). One of the largest CCUs has 8,000 members.

Total assets considerably vary among CCUs. Newly established CCUs could have assets as low as P5,000. One of the largest CCUs in the country has assets of more than P70 million. In fact, many CCUs in the countryside have assets that are much larger than rural banks. CCUs initially rely only on fixed deposits for on-lending. As they mature, they are able to mobilize deposits. Savings and time deposits constitute at least 30 percent of the total resources of more mature CCUs.

Small CCUs usually have part-time staff including the manager and treasurer, while medium- and large-sized CCUs have full-time staff of 5 to 15.

Loan portfolio of CCUs usually comprises 80 percent of their total assets. CCUs provide both regular loans typically with one year maturity period and emergency loans (one to three months) that can be simultaneously availed of by members. Any member with good standing record is qualified to borrow from his/her CCU usually up to 2 - 3 times his/her fixed deposits. Some CCUs apply a single borrower's limit, ranging from P4,000, especially for newly established CCUs, to P100,000 for large CCUs (Relampagos *et al.* 1990). The average loan size per member in a CCU is estimated to be P10,300 (Llanto 1994). For CCUs, the purpose of regular loans is not a determining factor for approving a loan application. However, survey results showed that the purpose for borrowing from a CCU is primarily for business, and secondarily for household needs. Although the documentary requirements are few, still it takes a CCU 1 to 7 days to process a loan application due to lack of full-time personnel. Like lending investors, many CCUs have insufficient funds to meet credit demands. Thus, actual disbursement of approved loans could be delayed if funds are not available. Peñalba *et al.* (1994) found that 20 percent of coop borrowers had to wait for 1 to 3 months before their loans were released.

Some CCUs align their lending rates with the prevailing market rates, while others have fixed them to 12 percent per annum or 1 percent per month regardless of the maturity of the loan. Some CCUs, such as market vendors credit unions, have mimicked informal lenders in that they

grant loans that have a daily repayment schedule and charge very high interest rates, sometimes 15 percentage points above the prevailing lending rates of banks.

Some federations have established a central liquidity fund, which comes from the contributions of their member-CCUs. A deficit CCU may borrow from the central liquidity fund to augment their loanable funds. Some federations have thought of establishing a bank. However, aside from being able to mobilize deposits from the public and having access to the rediscounting window, a bank does not have the same privileges as those being enjoyed by CCUs as mentioned above. There were proposals to establish an apex bank for cooperatives. One of the proposals recommends the conversion of LBP into an apex bank for cooperatives. However, there was no consensus reached among the various cooperative groups.

The discussions above clearly show that there exist in the Philippines a wide array of formal financial institutions providing a variety of financial services to various sectors of the Philippine society.

Chapter 3

ACCESS TO CREDIT FROM THE FORMAL FINANCIAL SYSTEM

The previous chapter focuses on the supply side of the financial system. This chapter deals with the demand side. In particular, it discusses the extent to which various socio-economic sectors, particularly small borrowers such as small farmers and micro, cottage and small enterprises (MCSEs), have access to credit from the formal financial system. The factors that affect access to credit from the formal financial system are also discussed.

A. EXTENT OF ACCESS TO FORMAL CREDIT

There is no systematic information about the credit access of various sectors of Philippine society to the formal financial system. The BSP and the National Statistics Office (NSO) do not collect such information. However, some studies using survey data could give a rough idea of the extent of credit access of various sectors of Philippine society to formal financial system.

The Social Weather Stations (SWS) and the Ateneo University (AU) conducted a nationwide survey in 1986 and 1987 on peoples' access to credit using a sampling technique that can provide population estimates. The sampling frame is based on the voting age population, which was about 25 million. The results showed that about one-third of the total voting age population borrowed those years (Table 16). Among those who borrowed, about one-third did borrow from the formal and mixed sources, i.e., formal and informal sources. In Metro Manila, about 40 percent of the voting age population had borrowed from the formal sources, while in other urban areas, between 38 percent to 55 percent borrowed from formal sources. In rural areas, those who have access to credit from formal sources comprised between 26 percent and 33 percent.

In terms of amount borrowed, 37 percent came from formal sources and 7 percent from mixed sources (Table 17). The rest came from informal sources of credit. In Metro Manila, 42 percent of the total amount borrowed came from formal sources and in other urban areas, 52 percent from formal sources and 10 percent from mixed sources. In rural areas, however, only 23 percent came from formal sources and 10 percent from mixed sources of credit.

It is to be noted that the survey did not include corporations, which have different juridical personalities. If they were included, the distribution of borrowers would not change dramatically but the amount of loans would change substantially because corporate loans tend to be large. For instance, of the total loan portfolio of commercial banks in 1993, 71 percent went to corporations.

Table 16
**Distribution of Borrowers in Metro Manila, Urban and Rural
 Philippines, By Source of Credit, 1986 & 1987**
 (In Percent)

	All Philippines		Metro Manila		Urban		Rural	
	1986	1987	1986	1987	1986	1987	1986	1987
I. Borrowers as % of total population in locale	32.0	35.0	33.0	36.0	31.0	33.0	33.0	36.0
Formal	10.0	10.0	11.0	13.0	10.0	16.0	10.0	7.0
Informal	21.0	23.0	20.0	22.0	20.0	15.0	22.0	27.0
Mixed	1.0	2.0	2.0	1.0	1.0	2.0	1.0	2.0
II. Percent distribution of borrowers in locale								
Formal	32.0	28.0	34.0	36.0	34.0	48.0	31.0	20.0
Informal	65.0	66.0	61.0	62.0	62.0	45.0	67.0	74.0
Mixed	3.0	6.0	5.0	2.0	4.0	7.0	2.0	6.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

39

Source: SWS-Ateneo University. Public Opinion Report Surveys, October 1986 and October 1987

Note: In the 1987 survey, "borrowers" are identified as those having borrowed at least P/1,000 in the past 12 months. In the 1986 survey, there is no minimum amount specified

Table 17
 Amount of Borrowings & Percent Distribution By Source, Philippines,
 Metro Manila, Urban & Rural, 1987 Survey
 (Amount in Million Pesos)

	All Philippines		Metro Manila		Balance Urban		Rural	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Formal	15,241	34.0	2,932	42.0	6,551	52.0	5,758	23.0
Informal	26,482	59.0	4,011	57.5	4,745	38.0	17,726	70.0
Mixed	3,165	7.0	34	0.5	1,249	10.0	1,882	7.0
Total	44,888	100.0	6,977	100.0	12,545	100.0	25,366	100.0
% Share		100.0		16.0		28.0		56.0

Source: SWS-Ateneo University. Public Opinion Report Survey Data, October 1987

Peoples' access to credit from the formal sources may have improved in the last five years especially after the bank entry and branching deregulation in 1989. However, the improvement may not yet be substantial. It may be safe to say that the percentage of the population that have access to credit from formal sources has increased from one-third to two-fifths of the total number of borrowers. Still, small farm and non-farm enterprises may have the same degree of difficulty in accessing credit from the formal credit institutions. Before turning to this issue, it would be worthwhile to have a clearer understanding of what small farm and non-farm enterprises are in the context of this report.

When dealing with the farm sector, there is a common understanding of what constitutes a small farm enterprise because of the comprehensive agricultural reform law. According to that law, the retention limit for agricultural lands is 7 hectares. Thus, small farm enterprises refer to those that are farming 7 hectares or less.

In the case of the non-farm sector, there seems to be no common agreement on how to define small non-farm enterprises. The definition may be based on assets, sales turnover, number of employees, or some combination of these. In the Philippines, some analysts define small non-farm enterprises in terms of the number of workers, i.e., those with less than 10 workers. Based on this definition, the 1988 Census of Establishments shows that small non-farm enterprises comprised 89.4 percent of the total number of non-agricultural establishments, contributed 33 percent to the total employment and added 8 percent to the total census value added of the non-agricultural sector.

On the other hand, the Magna Carta for Small and Medium Enterprises defines small and medium enterprises as any business activity or enterprise engaged in industry, agribusiness and/or services, whether single proprietorship, cooperative, partnership or corporation whose total assets, inclusive of those arising from loans but exclusive of the land on which the particular business entity's office, plant and equipment are situated, must have value falling under the following categories:⁵

Micro	-	P100,000 and below.
Cottage	-	above P100,000 - P1,000,000
Small	-	above P1,000,000 - P10,000,000
Medium	-	above P10,000,000 - P40,000,000

Thus, for purposes of complying with the mandatory credit allocation to small non-farm enterprises (see next chapter for a detailed discussion on this issue), small enterprises are defined

⁵This is the latest revision made by the Small and Medium Enterprises Development Council as of November 1992.

as those whose assets are P10 million or less. This is the definition of small non-farm enterprises that this report has adopted, taking into account that they include three groups of firms of different asset sizes.

There is no systematic information about the small farm enterprises' access to formal sources of credit. However, a rough idea of it can be culled from cross-section surveys done by individual researchers and research institutions. Table 18 shows the extent of farmers' access to the formal and informal sources of credit from 1954 to 1991. Although the survey results are not directly comparable because they had different sampling frames and sample areas, nevertheless they consistently show that access to formal sources of credit by farmers has been very little ranging from 0.9 percent to 55 percent. As expected, large farmers tend to have more access to formal loans than small farmers. For instance, 55 percent of the sample cattle raisers and 71 percent of the fishpond operators borrowed from banks. In contrast, only 21 percent of the agrarian reform beneficiaries, who by definition are small farmers, borrowed from formal credit institutions - mainly the LBP and credit cooperatives.

Israel (1994) and Orbeta (1994), respectively, estimated the demand for and supply of formal credit to small farmers for the period 1993-1998. Israel used a production cost method to estimate demand, while Orbeta applied an econometric technique. Israel estimated credit requirement (based on cash costs) of small farmers to be P41 billion in 1993, which will rise to P88 billion in 1998. Orbeta, on the other hand, estimated the supply of credit to the small farmers by the banking system including specialized government banks to be P16 billion in 1993 and rising to P47 billion in 1998. Indeed, the implied credit gap is huge, which means that the small farmers will have to rely substantially on the informal credit markets. Interestingly, the credit gap is projected to narrow down from 61 percent to 39 percent during the indicated period. This is due to the expected expansion of banking services in the countryside, which already began in the last five years.

There is also no systematic information about small non-farm enterprises' access to the formal credit markets. Secondary data and results from some small cross-section surveys can throw some light into this issue. Table 19 shows the loans outstanding of commercial banks by type of borrower. About 71 percent of the total loans of commercial banks went to corporations. These are usually large corporations, most of which belong to the top 1,000 corporations of the country and subsidiaries of multinational corporations. Although 20 percent of the total loan portfolio of commercial banks went to individuals, some of these individuals have high net worth, and therefore, they can easily access loans from commercial banks. It has been estimated that about 40 percent of the loans to individuals are actually large loans (Agabin *et al.* 1989). Only 9 percent of the total loan portfolio of commercial banks went to cooperatives, single proprietorships and partnerships/associations. So, all in all, about 20 percent of the loan portfolio of commercial banks went to the small enterprises. Although this is a small proportion, nevertheless it can be said that commercial banks have accommodated quite a significant number of small enterprises considering the fact that small enterprises demand small loans.

Table 18
Summary of Studies Indicating Extent of Borrowing from Formal and Informal Sources ^w
(In % of Total Number of Loans or Borrowers)

Period Covered	Author/Year of Publication or Release	Number of Loans/ Borrower-Respondents	Credit Source (%)		
			Formal	Informal	Mixed
1954-55	de Guzman (1957)	2,411 loans	12.0	88.0	
1957-58	Gapud (1958)	256 loans	10.0	90.0	
1957-58	Sacay (1961)	916 loans	13.0	87.0	
1960-61	BCS (1963)	1,679,000 loans	7.8	92.2	
1967-70	Mangahas (1975)	151 borrowers	11.9	88.1	
1970-71	Mangahas (1975)	297 borrowers	20.9	79.1	
1969-70	Almario (1970)	138 loans	37.7	62.3	
1969-70	Balagot (1974)	134 borrowers	21.6	78.4	
1973	DA (1974)	620 loans	51.3	48.7	
1976	DA (1976)	268 farmers	17.2	82.8	
1977	UPBRF (1977)	1,079 loans	36.9	63.1	
1977	DA (1977)	405 farmers	5.2	94.8	
1977	TBAC (1978)	656 borrowers	25.8	74.2	
1977-78	Laopao & Latorre (1979)	41 fisherman	29.3	70.7	
1978	DA (1978)	338 farmers	3.8	96.2	
1978	TBAC (1981)	2,110 loans	17.4	82.6	
1979	Manalo (1979)	203 cattle raisers	54.7	45.3	
1979-80	NIA-SGV (1980)	299 farmers	20.0	80.0	
1980	Capistrano (1982)	41 village households	2.1 ^w	97.9 ^w	
1981-82	TBAC (1982)	871,600 loans	40.2	59.8	
		626,300 farmers	34.0	58.7	7.3
1983-84	Floro (1986)	111 farm households ^d	0.9	99.1	
		448 loans	8.0	92.0	
1987	Geron (1988)	1,790 farmer-borrowers	3.0	97.0	
1985-1989	Casuga & Morte (1992)	3,575 agrarian reform beneficiaries	21.0	79.0	
1991	Llanto & Magno (1994)	52 fishponds operations	71.0	29.0	

^w Data comparability is limited by differences in sampling.

^w Out of 48 responses. Some borrowers had more than one source of credit.

^d The respondents were all borrowers

Sources:

1. Adapted from: Sacay, Agabin, & Tanchoco. *Small Farmer Credit Dilemma*, 1985.
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Table 19
**Loans Outstanding of Commercial Banks Classified
 by Type of Borrower, June 1993
 (In Million Pesos)**

		1993	%
GRAND TOTAL:		<u>251,708.1</u>	<u>100.00</u>
<u>Private Sector</u>		240,692.7	<u>100.00</u> 95.62
Individuals	49,098.5		20.40
Single Proprietorships	12,915.2		5.37
Partnerships and Associations	4,916.1		2.04
Cooperatives	2,739.2		1.14
Corporations	171,023.7		71.05
<u>Public Sector Corp.</u>		11,015.4	<u>100.00</u> 4.38
National Government	471.8		4.28
Local Government	284.9		2.59
Government Corporation	10,258.7		93.13

1 Excluding past due items, items in litigation, domestic and foreign bills, clean .

In the case of thrift banks, data on loans outstanding by type of borrower are available only for savings banks (Table 20). It shows that only 38 percent of their total loan portfolio went to corporations, and the rest to individuals, single proprietorships, partnerships/associations and cooperatives. Private development banks and stock SLAs must have the same profile of loan portfolio as savings banks. Even if the proportion of loans going to corporations is sizeable, it may be safe to say that most of the clients of thrift banks are small enterprises, considering the size of individual thrift and rural banks and the single borrower's limit, which is equivalent to 25 percent of their total unimpaired capital.

Given the evidence shown above, it can be said that the perception that small enterprises do not have access to bank credit is exaggerated. The data, however, did not distinguish among micro, cottage and small enterprises. It is likely that the perception mentioned above applies very well to the micro and cottage enterprises. Results from some survey data could clarify this.

One of the recent surveys on small enterprises was done by Lapar (1994a). The sample consisted of 400 rural non-farm enterprises in Bohol, Iloilo, Negros Occidental and Cebu. Only 8.5 percent of the total sample had assets of P1 million or more. Thus, it can be said that the sample firms are mainly micro and cottage enterprises. Of the total sample, only 54 percent availed themselves of loans from the credit markets. Among those who borrowed, 25 percent obtained loans from formal credit institutions including credit unions and cooperatives and 23 percent, from both formal and informal institutions. The rest borrowed from the informal credit markets. In other words, about one-fourth of the sample firms have access to the formal credit markets.

Lapar also tried to verify the existence of unmet credit demand for formal credit by those who borrowed from the formal credit markets. She found that 60 percent of them do not have any plan of borrowing more money from the formal credit markets at the prevailing interest rates.

Earlier, Lamberte (1990) conducted a similar study using the NEDA-UPISSI survey data on 600 micro, cottage and small firms.⁶ His results showed that only 14 percent of the sample borrowed from banks for their start-up capital and 13 percent for the expansion of their business.

The results discussed above suggest that a large proportion of micro and cottage enterprises do not have access to the formal credit markets. The micro and cottage enterprises that had access to bank credit must have obtained them from small financial institutions, such as thrift banks, rural banks and credit cooperatives. On the other hand, commercial banks' lending to small enterprises must have gone to the more credit-worthy among small enterprises with assets of P5 million to P10 million.

⁶During the survey period, micro, cottage and small enterprises were defined as those with assets of less than P50,000, P50,000 to P499,999 and P500,000 to P5 million, respectively.

Table 20
**Loans Outstanding of Savings Banks Classified
 by Type of Borrower, June 1993
 (In Million Pesos)**

	1993	%
GRAND TOTAL¹	<u>17,022.1</u>	<u>100.00</u>
<u>Private Sector</u>	17,022.1	<u>100.00</u> 100.00
Individuals	3,832.3	22.51
Single Proprietorships	4,672.7	27.45
Partnerships and Associations	1,417.2	8.33
Cooperatives	545.8	3.21
Corporations	6,554.1	38.50
<u>Public Sector Corp.</u>		-
National Government	-	-
Local Government	-	-
Government Corporation	-	-

¹ Excluding past due items and items in litigation.

It is interesting to note that a sizeable proportion in Lapar's sample firms (46%) did not avail of credit from the credit markets. Lamberte also found that 54 percent of the sample firms financed their start-up capital from their savings. For business expansion, 62 percent preferred to use their own savings. In the survey of agrarian reform beneficiaries reported by Casuga and Morte (1992), 41 percent of the respondents preferred to finance their enterprise by themselves. The SWS-AU nationwide survey showed that two-thirds of the voting age population were non-borrowers.

There are several explanations why a large number of small firms did not make use of external financing either from formal or informal credit markets to start or expand their business. One is that firms are risk-averse and, therefore, they would rather grow slowly using their own resources. Another explanation is that firms decided not to borrow knowing that they will be rationed out by the credit markets (self-selection credit rationing) because they have not yet established a good credit track record with potential lenders and have very little collateral to offer. This means that the proportion of those who do not have access to credit from the formal credit markets could have been higher than what existing studies have suggested.

Not accessing bank credit has some disadvantages. As Lamberte (1990) had found out, those that had access to bank credit had been growing faster in terms of assets and employment than those that did not have access. Lapar's (1994b) findings corroborated this. That is, she found that firms that are unable to access external financing tend to operate at sub-optimal level of production, whereas those that have access to external finance were able to relax their liquidity constraint and, therefore, were able to operate at optimal levels of production.

B. FACTORS AFFECTING ACCESS OF SMALL ENTERPRISES TO BANK CREDIT

There are competing views that try to explain why banks, particularly large commercial banks, ration out small borrowers. One view adheres to the classical transaction costs approach. According to this view, big banks shy away from small loans because of high transaction costs. The following statements represent well this view:

"An average loan officer can perhaps handle a portfolio of P80 million to P100 million. If his clients are medium-sized commercial or industrial companies with loans averaging about P5 million, the officer would be handling between 16 to 20 accounts. To reach the same loan volume, for sugar producers who average 25 hectares and who each require about P200,000 per year, the same loan officer would have to handle about 400 accounts. When one considers corn producers, who average perhaps 10 hectares and require about P50,000 per crop cycle in loans, the officer would have to handle as many as 1,600 individual accounts to achieve a volume of P80 million. Clearly, these numbers of agricultural clients to be adequately serviced require a greater number of staff, meaning

more overhead for the bank. The bank considering making agricultural loans therefore would either shy away or have to be satisfied with a lower margin per peso loaned due to the higher overhead." (Dominguez 1985).

The situation is, however, different for small banks whose cost structure is geared towards small borrowers. For instance, they do not hire highly paid bank managers/officers as big banks do. In most cases, small banks operate in a small area or in a limited market. Their managers know well their clients, which would reduce the need to have intensive credit investigation of their clients. All this helps to bring down the transaction costs of small banks in lending to small borrowers and increase repayment rates.

Empirical studies that examined transaction costs of different types of banks seem to support the transaction cost approach. Untalan and Cuevas (1988), for example, found that the total cost per loan account outstanding was P14,500 for commercial banks, P1,839 for private development banks and P473 for rural banks. These explain why the different types of banks have established different minimum loan sizes as discussed in the preceding chapter.

If lending rates were administratively set, the transaction costs approach can satisfactorily explain the lending behaviour of different banks. Under a liberalized interest rate regime, however, banks especially under an oligopolistic market structure, could be compensated for their high transaction costs for lending to small borrowers by charging higher interest rates. However, this is not the case in reality as was discussed above that commercial banks still ration out a large number of small borrowers. As an alternative to the classical transaction costs approach, the imperfect information view has been advanced to explain the existence of credit rationing in a liberalized interest rate policy regime. According to this view, there exists asymmetric information between lenders and borrowers. In particular, borrowers know very well the degree of their riskiness while the banks have imperfect information about their borrowers. Gathering more information about the borrowers could be more costly to the lender.

The two main types of information problem are adverse selection and moral hazard. In adverse selection, only more risky borrowers come forward to borrow from a bank as interest rate is increased beyond a certain point, while less risky borrowers who will likely repay their loans tend to shy away from borrowing to avoid subsidizing the more risky borrowers. In other words, the expected return on the loans is not a linear function of the rate of interest. Beyond a certain level, the bank's expected return on its loans declines as interest rate increases. Thus, the bank will be better off rationing access to credit at lower interest rate rather than raising the interest rate further. In moral hazard, the bank is unable to discern borrowers' action. In particular, an increase in interest rate could affect the behaviour of borrowers negatively, reducing their incentive to take the necessary steps so that they could repay their loans. Thus, again, the bank is better off rationing access to credit at lower interest rate. That banks do not charge interest rate as high as they can, perhaps the same as those charged by money lenders, seems to confirm the plausibility of this view to explain the existence of credit rationing under a liberalized interest rate policy regime.

Unlike other markets, credit markets do not have simultaneity of exchange of goods transacted. This can give rise to the problem of noncompliance of the loan contract on the part of the borrower. In other words, a bank's problem is not limited only to screening carefully borrowers. In fact, its real problem starts only after granting the loan; hence, it also has to continuously monitor the borrower and ensure that the loan contracts are enforced. It must do it at the least cost possible.

The adverse selection problem encourages banks to sort out more risky borrowers from less risky borrowers. One screening device usually used by banks is collateral requirement. If the bank requires that each borrower put up a collateral, the more risky borrowers will be the least likely to comply because they know that they are likely to lose the collateral, whose value is usually greater than the amount of the loan.

In developing countries, hard collateral, such as real estate, is scarce. In particular, small borrowers can hardly present a collateral for their loans. In the absence of a collateral, collateral substitutes have been created. One example of a collateral substitute is credit tying, such as linking loans to marketing arrangements, which is prevalent both in rural agricultural areas (e.g., Esguerra 1993) and urban manufacturing sector (e.g., Lamberte 1988). But if foreclosure of collateral is difficult to enforce, as is often the case in developing countries, then the bank has no way of sorting out risky borrowers from less risky borrowers on the basis of a collateral.

To recapitulate, this alternative view emphasizes imperfect information and credit rationing and loan contract enforcement problems as key factors that explain why banks, particularly large commercial banks, ration out small borrowers. It is, therefore, important to understand these problems so that a credit policy could be designed to encourage large banks to lend to small borrowers. This issue will be revisited in the last chapter.

Chapter 4

BANKING AND CREDIT POLICIES AND PROGRAMS AFFECTING THE FLOW OF CREDIT TO THE SMALL-BORROWERS

Recognizing the lack of access of small farm and non-farm enterprises to the formal credit markets, the government has instituted certain policies and programs to push credit to these groups. In response to the criticisms against them for not accommodating small borrowers, commercial banks have also created special credit programs for those that cannot qualify under their regular credit windows. This chapter discusses the different policy instruments and measures applied by the government and the private sector to increase the flow of credit to the small borrowers.

A. LOAN PORTFOLIO REGULATIONS

Loan portfolio regulations pertain to those regulations that require banks to allocate a certain proportion of their loanable funds to a specific sector. This policy instrument has been widely used in developing economies including Korea and Malaysia.

There are three existing loan portfolio regulations. First is the deposit retention scheme. Under this scheme, at least 75 percent of the total deposits, net of required reserves against deposit liabilities and total amount of cash in vault, accumulated by branches, agencies, extension officers, units and/or head offices of specialized government banks, in a particular regional grouping outside the National Capital Region, shall be invested therein as a means to develop that region. For purposes of this regulation, the country used to be divided into thirteen regions.

This particular policy is used to deal with the problem of funds diversion; that is, banks mobilize deposits in rural areas and lend them to large firms in urban areas. This is considered detrimental to the development of rural areas because they are denied of badly needed funds. Commercial banks are particularly hard hit by this policy because they have nation-wide branch networks. Their reason for transferring funds from rural areas to urban areas is that they could hardly find any credit-worthy borrowers or bankable projects in rural areas.

One drawback to this measure is that it prevents banks from efficiently allocating bank-wide resources from surplus to deficit branches, thereby discouraging them from intensively mobilizing deposits. Borrowers and depositors ultimately stand to lose from this regulation in terms of higher interest rate for the loans and lower interest rates for the deposits. Some banks found a way of circumventing the regulation by booking a loan of a large borrower in Metro Manila in one of their branches in the province.

In 1990, the thirteen regional groupings were reduced to three, which effectively relaxed the regulation since banks can now transfer funds to their branches in a much wider geographical area.

The second is the agri/agra law that mandates all banking institutions to set aside 25 percent of their net incremental loanable funds for agricultural lending, 10 percent of which is to be lent to agrarian reform beneficiaries and 15 percent for general agricultural lending. Commercial and thrift banks have not found any difficulty in complying with the latter because there is a good number of credit-worthy agri-business corporations, some of which are multinational firms and corporate giants. However, they have difficulty complying with the former simply because their operations are not structured to provide credit to the widely dispersed agrarian reform beneficiaries. In other words, they face severe information problem, aside from high transaction costs, when it comes to lending to agrarian reform beneficiaries.

As at end-1993, the required loanable funds of the banking system for general agriculture and agrarian reform beneficiaries were P37.3 billion and P24.9 billion, respectively. The actual loan portfolio of the banking system exceeded the former by 42 percent but fell short of the latter by 43 percent. However, they were able to make up for the shortfall by investing the required amount in instruments eligible as substitutes for the loans to agrarian reform beneficiaries.

The third and most recent loan portfolio regulation is the mandatory credit to the small enterprises. Under the Magna Carta for Small Enterprises, all lending institutions are mandated to lend at least 10 percent of their total loan portfolio to small enterprises whose total assets, inclusive of those arising from loans but exclusive of the land on which the particular business entity's office, plant and equipment are situated, amount to P10 million and below. Unlike the agri/agra law, this requirement is tiered and has a time bound: 5 percent of the total loan portfolio by the end of 1991 to rise to 10 percent by end-1992 through 1995 and to decline to 5 percent by the end of 1996 and to zero by the end of the 7th year. Commercial and large thrift banks are adversely affected by this law, since they do not possess adequate information about the credit worthiness of small enterprises and their structure is not designed to service small borrowers.

Given the loan portfolio of commercial banks as of March 1994, P25.9 billion should have been set aside by them for on-lending to small enterprises. In actuality, their loan exposure to small enterprises for the same period amounted to P22.9 billion, which is P3 billion short of the required loan allocation to small enterprises. As mentioned above, most of these loans must have gone to the more credit-worthy small borrowers with assets of P5 million or more. For the shortfall, commercial banks were able to comply with the law because they invested the balance in eligible instruments (Table 21).

B. BANK ENTRY AND BRANCHING

The existence of adequate banking offices in all areas of the country can improve access

Table 21
 Banking System
 Summary Report on Compliance With Small Enterprises
 Credit required Under R.A. 8977
 As of March 31, 1994

Industry	No. of Operating Banks	No. of Reporting Banks	Actual Investment				Funds Set Aside		Loan Portfolio (G)	Total Funds Set Aside (Sum of Columns A to F) (H)	Minimum Amount Required to be Set Aside (I)	Excess/ (Deficiency) (H-I) (J)
			Net Eligible Loans (A)	SBGFC Instruments (B)	Excess Compliance In Subsidiary bank (C)	Equity Investment BAP CGC (D)	Cash On Hand (E)	Due from BSP (F)				
A. Commercial Banks	32	32	22,918	741	3,118	73	111	1,674	258,976	26,635	25,898	2,737
1. EKBs	15	15	20,380	0	3,118	73	0	348	215,428	23,889	21,543	2,356
2. Non-EKBs	13	13	2,160	470		0	111	525	31,557	3,266	3,156	110
3. Branches of FK Banks	4	4	398	271		0	0	801	11,993	1,470	1,199	271
B. SGBs	3	3	2,280	0		4	0	2,218	34,041	4,482	3,405	1,077

of small borrowers to bank credit. The Central Bank used to be overly concerned about the viability of banks that it limited entry of new banks and imposed a very restrictive bank branching policy. Beginning in 1989, the regulation on bank entry has been relaxed. Since then, the Central Bank approved the conversion of two thrift banks into commercial banks and one application for a commercial bank.

The regulations on bank branching have been substantially relaxed in the last three years. Unlike before when the Central Bank designated areas which were overbanked and therefore opening of branches was prohibited, the recent rules allow commercial and thrift banks to open branches anywhere they like provided they meet certain capital requirement. This liberalized branching policy has encouraged several banks to open branches in areas where they think they can operate viably. In 1992 alone, 194 bank branches were opened.

Recently, a law was passed liberalizing the entry and scope of operations of foreign banks. A maximum of ten foreign banks will be allowed to open up to 6 branches each in the country. The four existing foreign banks are each allowed to increase their branches by 6. In addition, foreign banks may opt to establish subsidiaries with equity participation of up to 60 percent of the total outstanding shares of the subsidiaries. The new foreign bank entrants are expected to concentrate in the wholesale and foreign exchange markets, providing stiffer competition with domestic banks in servicing prime corporate clients.

C. GOVERNMENT'S DIRECT PARTICIPATION IN THE BANKING SYSTEM

Towards the second half of the 1980s, the government adopted a policy of reducing its direct participation in the banking system. Except for one commercial bank, all banks acquired by the government in the early 1980s have already been privatized. The Philippine National Bank (PNB), which does commercial banking only, is now partly owned by the private sector. Plans to fully transfer ownership of this bank to the private sector are underway.

Because they perform special functions, the Land Bank of the Philippines (LBP) and the Development Bank of the Philippines (DBP) remain with the hands of the government. They are main conduits of special credit programs for the agricultural and industrial sector that are mostly funded by multilateral agencies. Both banks have substantially reduced their retail lending activities and increased their wholesale lending so as to reduce their transaction costs. With the newly opened rediscounting facility for rural banks, LBP has become a *de facto* apex bank for the agricultural sector. DBP is far from this situation because of the very active participation of commercial and thrift banks in industrial lending.

D. GOVERNMENT'S SPECIAL CREDIT PROGRAMS

To respond directly to the credit demand of those sectors of the society that are rationed out by the banking system, the government has established numerous special (or directed) credit programs for specific groups. The number of special credit programs reached its peak in the early 1980s. Towards the second half of the 1980s, the government started consolidating some of them. Recently, however, several special credit programs has been created, thereby increasing again the number of government-sponsored special credit programs. This effectively reverses the policy of consolidating special credit programs.

Table 22 shows a summary of special credit programs compiled by the National Credit Council. There are 111 special credit programs implemented by 19 government agencies, some of which are non-bank government institutions. Their combined resources amounted to P31 billion. Funds for these special credit programs come from various sources, i.e., national budget, surplus government financial institutions such as the GSIS and SSS, and official development assistance. Some programs have very concessional interest rates; others charge market rates of interest. Repayment rates of these special credit programs are high compared to those introduced in the past (e.g., Masagana 99).

Figure 2 depicts the different modes of implementing the various special credit programs. The implementing institutions/agencies may be grouped into three: non-financial government agencies such as the Department of Trade and Industry (DTI); non-bank government financial institutions such as the GSIS and SSS; and government banks such as the DBP and LBP. They may do retail lending, wholesale lending or both. In the case of retail lending, the implementing government institutions lend directly to the targeted clientele, whereas in wholesale lending, the implementing government institutions lend a block of funds to credit conduits, which, in turn, do retail lending. The implementing institutions bear the credit risk of their wholesale loans, while the credit conduits bear the credit risk of their retail loans. The credit conduits may be private banks, credit cooperatives or non-bank private institutions such as NGOs/PVOs engaged in lending. Two examples of a wholesale lending program using NGOs as conduits are discussed in the next section.

E. NGOs as CREDIT CONDUITS

While the banking system was still in the process of recovering from the 1983-1984 crisis and of adjusting to a liberal policy regime initiated in the second half of the 1980s, the non-bank informal lending institutions, such as credit cooperatives and some NGOs with credit programs, had been doing well in terms of providing credit to small borrowers and repayment rates. Their good credit performance could be attributed to the following factors: (1) they are mass-based, have adequate information about the credit worthiness of their borrowers and can monitor their borrowers at least cost; (2) they have built-in mechanism for continuous savings mobilization; (3) they can exert strong social pressure on borrowers which is important in securing prompt

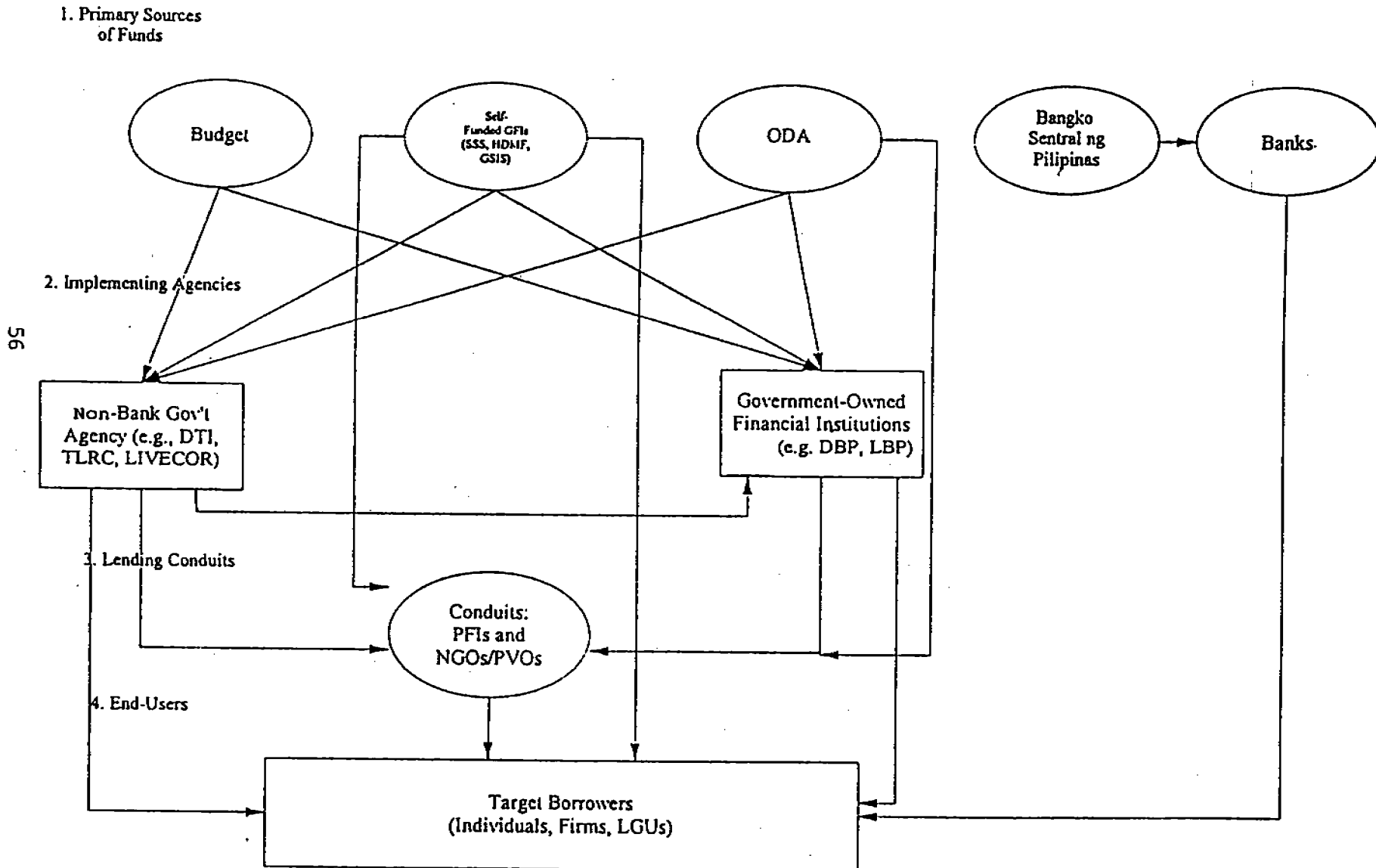
Table 22. SUMMARY OF GOVERNMENT LENDING PROGRAMS

	AGRI		LIVELIHOOD		TOTAL
		Ultra-Poor	Salaried & Self-Employed	SHEs	
No. of Programs	39	13	21	38	111
No. of Implementing Agencies	19	4	12	9	
Estimated Funds Available	More than P11.064 B	No data Available	More than P3.160 B	More than P16.675 B	More than P30.899 B
Interest Rate Range (To Conduits)	From 6% p.a. to 14% p.a.	Ranging from interest free to a minimum rate of 6% p.a. to market rate.	3 - 18%	7% - 24%	

Source: National Credit Council.

Figure 2

EXISTING ADMINISTRATIVE ARRANGEMENTS OF DIRECTED CREDIT PROGRAMS IN THE PHILIPPINES



repayment; and (4) most of them have very dedicated leaders. Recognizing the problem of the banking system and the good performance of non-bank credit institutions, the government therefore changed its strategy of delivering credit its priority sectors (e.g., small exporters, small farmers, etc.). Instead of coursing credit solely through banks, the government currently has made use of NGOs as credit conduits. The following discusses two examples of these special credit programs: one for the non-agricultural sector implemented by a non-financial government agency and the other for the agricultural sector implemented by a government bank.

1. Tulong Sa Tao Self-Employment Loan Assistance (TST-SELA) Program

The TST-SELA Program is a special credit program for the non-agricultural rural sector started in April 1987. It is being implemented by the Bureau of Small and Medium Business Development (BSMBD), a non-financial government agency under the Department of Trade (DTI), with an initial funding from the government of P30 million.

The TST-SELA is different from previous credit programs in that it uses NGOs as conduits, instead of the banking system. The NGOs are believed to have some advantages in delivering small credit to those who do not have access to the formal banking system. Their long association with their clients in non-credit services provides them with ample information about the credit risk of clients. NGO accreditation criteria utilized by the Program were very liberal. The program abides by the prevailing interest rate policy of the government by not putting a cap on the end-user lending rate. NGOs may charge sub-borrowers whatever is the prevailing commercial rate in the area. But DTI charged a fixed 7 percent for its loans to NGOs. This gives NGOs reasonable spread to cover their administrative cost and credit risk since they bear the credit risk of subloans.

The TST-SELA Program quickly became popular as can be gathered from the number of NGOs across the country that participated in the program. Because of this, it quickly ran out of funds, prompting the government to tap the Asian Development Bank (ADB) for additional funds. This paved the way for the successor of the TST-SELA, the NGO-Microcredit Project (MCP) I.

The target beneficiaries of the Project were basically the same as those of the original TST-SELA Program, i.e., microenterprises including cottage industries, which are group-based in nature, require modest capital, are labor-intensive, and use low technology and local raw materials. Since this was the first time ADB was involved in such a project, it was decided to make it a pilot project, limiting the number of regions to be targeted to six instead of all the regions as in the TST-SELA Program. The six regions were selected based upon the following criteria: high incidence of poverty, existence of viable NGOs that would act as the credit and technical assistance intermediaries for the target groups under the Project, and equitable geographical distribution.

Under the NGO-MCP I, the scope of the TST-SELA Program was expanded to all sectors, i.e., agroprocessing, manufacturing, cottage, handicraft, trade, transport and services, excluding

agricultural production since there were already credit programs supporting this activity. It emphasize lending to self-help groups in preference to individuals. The intermediary NGOs would offer the beneficiaries a package of services which would include general capacity-building of beneficiary self-help groups, assistance in the institution of savings schemes, technical and project management training, and services related to procurement and marketing. The TST-SELA Program delegates decision-making to the regional level, and the TST-SELA Program gives NGO representation in the national and regional policy and decision-making bodies of the Program.

The approval of the subsidiary loans to the NGOs is facilitated by the establishment of Provincial Fund Management Committees (PFMCs) with a loan approval authority of less than P150,000 and the Regional Fund Management Committees (RFMCs) with a loan approval authority of P150,000 to P500,000. The Committees are composed of the Regional Director of DTI for RFMC or Provincial Director of DTI for PFMC, a representative of the local banking community and a representative of a local NGO network. DTI hired 76 financial analysts who processed loan applications of NGOs.

Only NGOs including credit unions that met the required accreditation criteria are qualified to participate in the Project, effectively screening out weak NGOs.

Processing and approval of subloans to final beneficiaries are the responsibility of participating NGOs. Accredited NGOs may onlend to beneficiaries through non-accredited smaller NGOs.

Accredited NGOs are eligible for lines of credit up to a maximum of P2 million at a time for onlending. Repayment periods of NGO loans may not exceed five years inclusive of a grace period.

Microenterprises and cottage industries, either owned by individuals or self-help groups, in rural areas may qualify for this credit program. Subloans to individual borrowers would be made in amounts of up to P25,000 at an annual interest rate not exceeding the commercial bank interest rate prevailing in the area, with fixed repayment periods of up to two years. On the other hand, subloans to self-help groups would be made in amounts of up to P200,000, at an annual interest rate not exceeding the commercial bank interest rate in the area, with fixed repayments periods of up to five years. Final subborrowers may use the loan for business expansion or start-up business. The NGO and the final subborrowers would execute an onlending agreement upon approval of the subloan, which the NGO can use in legal action to enforce compliance of subborrowers with the terms of the onlending agreement.

The Project became operational in April 1989 and was completed in August 1991, 15 months ahead of schedule because the NGOs were able to disburse all the funds to subborrowers. Benefitted from the projects were 278 NGOs, of which 60 percent were credit cooperatives, which onlent the funds to 21,100 microenterprises and self-help groups. The size of the loans to NGOs averaged P775,000 and to final beneficiaries, P11,000. The project final beneficiaries were

mostly of the "non-bankable" types with limited mortgageable assets and household income of below P2,500. Accordingly, the loans from the Project were able to increase the beneficiaries' income by 50 percent to 200 percent.

The past due loans of NGOs with the Program were estimated at 15 percent and default rate at 2 percent. Default rates of subsidiary loans were more or less the same. Accordingly, credit cooperatives have a better repayment record than other types of NGOs because of their long experience in lending and credit collection. Most of them strived hard to repay the Program promptly and fully to maintain their good credit track record even if some of their subloans were past due.

The loan collection rate of NGOs from their borrowers averaged 81 percent. Of course, this varied by region from a low of 67 percent to a high of 92 percent. Regions that were struck by natural calamities, such as devastating typhoons and the eruption of Mt. Pinatubo experienced lower collection rates. NGOs restructured loans in these areas but did not yet feel the need to write them off. Again, credit cooperatives showed a better collection rate than other types of NGOs.

While NGOs paid DTI 7 percent on subsidiary loans, they charged final beneficiaries for their loans an average of 18 percent per annum, leaving them a spread of 11 percentage points. This is more than enough to cover their administrative cost in handling small loans and the risk involved in lending to "non bankable" borrowers.

Encouraged by the success of the first program, the government requested ADB for another assistance to the TST-SELA Program. The ADB responded favorably to this request by providing the government with another loan of US\$35 million with the same terms as in the previous project. This Project was prepared with the active involvement of NGOs and beneficiaries of the previous project.

The features of the NGO-MCP I were carried to the NGO-MCP II with some modifications such as extending the program to all regions of the country and increasing DTI's lending rate to NGOs to 12 percent per annum to allow the government to cover its costs related to foreign exchange risk, DTI's administrative overhead cost and provisions for loan losses.

The NGO-MCP II started in April 1992. As of December 31, 1993, the number of approved loan applications of NGOs reached 589 with a total value of P352 million. Again, credit cooperatives comprised about 60 percent of the total number of NGO-beneficiaries. Assuming an average loan size of P11,000 per end user, then this second project must have benefitted about 32,000 borrowers.

2. The Development Assistance Program for Cooperatives and People's Organization (DAPCOPO)

DAPCOPO is a special credit program for the agriculture sector with practically the same rationale and major features as the TST-SELA. It was established in May 1990 by the Agricultural Credit Policy Council (ACPC) using the funds of the Comprehensive Agricultural Loan Fund.

The program has three components, namely: (1) the **credit component** which addresses the credit needs of the non-bankable farmers' groups and their members; (2) the **institution-building component** which provides financial assistance to farmers' groups for their capability-building efforts; and (3) **savings mobilization component** which encourages beneficiaries to increase their savings and link up with banking institutions.

Unlike the TST-SELA which deals directly with primary cooperatives, DAPCOPO deals only with federations which, in turn, lend to their member primary cooperatives, which, in turn, lend to their members. The federations are to assume the credit risk.

A committee composed of representatives from the cooperative and NGO community sector, the Land Bank of the Philippines and Agricultural Credit Policy Council screens and accredits eligible cooperatives.

DAPCOPO's loans to federations could be as long as five years with interest rate pegged at the prevailing Land Bank's rediscount rate on its loans to banks. Since the start of the project, the rediscount rate of Land Bank has ranged between 11 percent and 15 percent. There is no cap on the interest rate on sub-loans. Accordingly, interest rates on loans by final borrowers ranged from 18 percent to 21 percent. To realize the objective of savings mobilization, the federations are required to put up a deposit fund equivalent to 15 percent of the requested loan fund.

As of December 1993, 14 federations participated in the program, of which 4 federations operate on a nation-wide basis and 10 on a region-wide basis. The program granted P24.1 million loans to these federations benefiting 119 primary cooperatives and 10,551 individual borrowers. Repayment rate was 97 percent at the federation level and 100 percent at the program level because as mentioned earlier, federations are to assume the credit risk. Savings generated by the federations amounted to only P2.2 million.

F. PRIVATE BANKS' SPECIAL CREDIT PROGRAMS

In 1991, the Bankers Association of the Philippines (BAP) established the BAP Credit Guaranty Corporation (BCGC) funded by contributions of their members. At present, its paid-up capital amounted to P100 million. Legally, BCGC is considered as a lending investor, not a

bank. Its head office is located in Metro Manila with 24 staff. So far, it has only one branch located in Mindanao.

The BCGC provides loans to those that do not normally qualify under the regular loan windows of the individual member-commercial banks, i.e., small enterprises with inadequate collateral to offer. It has greater flexibility than commercial banks in that it grants loans not on the basis of the quantity and quality of the collateral and established credit track record of borrowers but on the basis of the viability of the projects to be funded and the potential repayment capacity of borrowers. Loans are mostly for short-term working capital of small firms. Its minimum loan size is P50,000. Thus, small borrowers, who have no track record with any bank and have very little collateral to offer, can have access to the BCGC loan facility. It charges the usual commercial bank rate on its loans, which is much lower than the interest rate charged by lending investors, pawnshops and money lenders.

BCGC is still in the process of accumulating its expertise in lending to small borrowers who do not have established banking track record. Since its establishment, it already granted loans to borrowers amounting to P400 million in all. The average loan size was a little over P200,000. Ten of the BCGC borrowers have already graduated to the regular lending window of banks.

BCGC recognizes that its present coverage is still small relative to the number of small borrowers with credit demand. It has difficulty in reaching out to small borrowers in rural areas because it has only one office. More recently, it has decided to go into wholesale lending to reduce risk and transaction costs by tapping existing NGOs that have a good credit track record. It is now in the process of training six NGOs to improve their management of credit programs including accounting system.

BCGC will soon face the problem of lack of funds. Being classified as a lending investor, it is not allowed to mobilized deposits nor to borrow from more than 19 individuals/corporations including BAP members.

Aside from the BCGC, which is a collaborative effort among commercial banks, some commercial banks came up with certain initiatives on their own to meet the credit demands of small borrowers who do not have access to their regular lending facilities. These special lending windows are funded out of the banks' own resources.⁷ One example is the Philippine Commercial International Bank (PCIB) lending program to small footwear manufacturers in Marikina. When a wholesaler places an order of shoes from a footwear manufacturer, he usually issues post-dated checks. Small footwear manufacturers, who are short of capital, usually sell their post-dated checks to input suppliers and/or money lenders at a discount, say 3 percent per month. PCIB set

⁷Some commercial banks serve as credit conduits of the government's special credit programs to small borrowers. The initiatives referred to here are those solely funded by the banks themselves.

up a desk in their branch in Marikina to compete with input suppliers and money lenders in discounting post-dated checks. It entertains loan requests as low as P3,000 and processes them within 7 days. In lieu of audited financial statements and income tax returns, PCIB requires only a valid business license and a credible character reference from reputable individuals in the community.

PCIB considers its lending program to the small footwear manufacturers in Marikina very successful. Despite its liberal credit facility for small borrowers, still many small footwear manufacturers in Marikina could not access loans from PCIB. One of the reasons is that PCIB accepts only post-dated checks issued by well-known department stores in the country (e.g., Shoemart, Landmark, etc.). Many small footwear manufacturers that cater to relatively unknown small retailers are rationed out by PCIB.

Another initiative is the Export Dragon Fund of the Rizal Commercial Banking Corporation (RCBC). This facility provides loans for working capital to small exporters, who have little or no collateral at all to offer to banks. Under this facility, RCBC requires only an irrevocable L/C issued by a foreign buyer to back up the order as collateral. It does not require borrowers to present hard collateral, such as real estate. Loan application procedures have been greatly simplified. The facility also accommodates small indirect exporters provided they obtain a guarantee from their respective direct exporters. The commercial bank rate has been applied to the loans made under this facility.

A significant number of small direct exporters borrowed from this facility. The loan size averaged P150,000, which is RCBC's break-even loan size. However, many of the loans became past due. Instead of closing this facility, RCBC opted to retain it but it started requiring their borrowers to obtain a guarantee for their subsequent loans. This, of course, is an additional hurdle that small exporters must pass to obtain a loan from the RCBC's Export Dragon Fund.

The discussions above demonstrate that commercial banks are now beginning to formulate innovative lending programs to address the credit needs of small borrowers who have very little or no collateral at all to offer to banks. They are moving very cautiously since they are going into an area that is new to them. Naturally, they confine themselves at this initial stage to the more credit-worthy among small borrowers, usually those that have assets of P5 million or more. Thus, many small borrowers are still rationed out by the commercial banking system, especially since commercial banks have allocated very little resources to their special credit programs for small borrowers.

Chapter 5

CONCLUDING REMARKS AND RECOMMENDATIONS

A. SUMMARY

This study describes the Philippine formal financial system, especially the banking system, with particular reference to the extent to which the system reaches and provides financial intermediation for the different socio-economic sectors of Philippine society.

The Philippine formal financial system has grown in size and sophistication in the last decade. As of December 1993, its total assets stood at P1,347 billion, three-fourths of which belong to the banking system. It has 10,174 offices that are almost equally distributed between the banking system and non-bank financial intermediaries. One-third of the total number of offices are located in Metro Manila.

There exists a variety of financial institutions in the Philippines that provides an array of financial services to different clientele (Table 23). In particular, the commercial banking system, which is composed of large banks, focuses itself on large corporate borrowers and high net-worth individuals. The smallest business loan that a small commercial bank entertains is P500,000. Medium and large banks have higher minimum loan sizes, ranging from P1 million to P2 million. The high minimum loan requirement of commercial banks effectively screens out small borrowers. On the other hand, small banks cater to small borrowers. Their cost structure and informational advantages allow them to provide financial services to small borrowers. The minimum loan sizes for thrift banks and rural banks are P20,000 and P10,000, respectively.

In general, banks provide short-term loans for working capital and require a collateral for their loans. The most popular collateral is real estate.

Non-bank financial institutions are also active in the credit markets. Many of them cater to small borrowers, especially those that are rationed out by the banking system. They grant short-term small loans as low as P100, in the case of pawnshops, and P3,000, in the case of lending investors. They have simpler loan documentation requirements than banks and accept movable collateral, such as jewelries or anything of value in the case of pawnshops. Some of them, like lending investors, grant loans without collateral.

The cooperative credit union (CCU) system also plays a vital role in mobilizing deposits and providing small borrowers with access to credit, especially those that do not have collateral to offer. The individual loans of CCUs averaged P10,300. CCUs generally do not require hard collateral from their borrowers.

Table 23
Financial Services and Markets of Various Financial Institutions

Financial Institution	Minimum Loan size	Type of Borrower	Type of Loans	Type of Collateral
1. Commercial Banks	Business loans—P0.5 M Consumer loans—P0.1M	Predominantly large corporate enterprises and high net-worth individuals	Predominantly short-term loans for working capital	Predominantly real estate
2. Thrift Banks	P20,000 to 100,000	Non-farm SMEs	Short/medium/long-term loans for working capital and fixed asset acquisition	Real estate and others
3. Rural Banks (including CRBs)	P10,000	Small farm and non-farm enterprises	Predominantly for short-term production loans	Real Estate, standing crops and others
4. Credit Cooperatives	None	Small farm and non-farm enterprises. Salaried employee	Short-term production and consumption loans	Predominantly unsecured
5. Finance Companies	None	Non-farm SMEs	Medium and long-term loans for fixed asset acquisition	Secured by acquired fixed assets
6. Pawnshops	None	Small farm and non-farm enterprises; individuals	Short-term loans for working capital and consumption	Pledges
7. Lending Investors	P3,000	Small farm and non-farm enterprises. Salaried employee	Short-term loans for working capital and consumption	Predominantly unsecured

Despite the existence of an array of financial institutions providing a variety of financial services to various clientele, still a large number of the population is rationed out by the formal financial system. Survey results show that about one-third of the voting age population of the Philippines borrowed from various sources of credit, of which only one-third obtained loans from the formal credit markets; the rest borrowed from the informal credit markets (Table 24). As expected, people in rural areas have less access to the formal credit markets than those in Metro Manila and other urban areas of the country.

Given the recent expansion of the formal financial markets, it might be reasonable to say that about 40 percent of the voting age population who are borrowers have access to the formal credit markets today. Assuming further that only one-third of the voting age population are borrowers, then it can be said that there were 3.8 million individuals out of the 35 million registered voters in 1994 who have access to the formal credit markets. Of course, this number increases slightly if corporations, which have separate juridical personalities, were included.

In general, farm enterprises have very little access to the formal credit markets. Credit access, however, greatly varies among farm enterprises of different sizes, with small farm enterprises having less access than large enterprises (Table 25). Specifically, 21 percent of the small farmer-borrowers, who are represented by agrarian reform beneficiaries, obtained loans from the formal credit markets. In terms of absolute number of agrarian reform beneficiaries, this constitutes about 20 thousand out of about 200 thousand agrarian reform beneficiaries (both borrowers and non-borrowers). With respect to small fishermen, only 29 percent of the fishermen-borrowers borrowed from the formal credit markets. If we were to apply this to the estimated 581 thousand municipal fishing operators, then it can be said that about 168 thousand municipal fishing operators have access to the formal credit markets. In contrast, large farmers, who are represented by cattle raisers and fishpond operators, have greater access to the formal credit markets: 55 percent among the cattle raiser-borrowers and 71 percent among the fishpond operator-borrowers.

The non-farm enterprises, especially the cottage and micro enterprises, have also great difficulty accessing credit from the formal credit markets. Survey results showed that about one-fourth of micro and cottage non-farm enterprises have access to credit from the formal institutions including cooperatives. There is no information on the total number of micro and cottage enterprises in the country. However, if we were to use the 1988 Census of Establishment which estimated that there were 317,490 small non-agricultural establishments in the country, then it can be said that there were almost 80 thousand small non-agricultural establishments that have access to the formal credit markets.

B. FUTURE DIRECTION OF THE FORMAL FINANCIAL SYSTEM

The financial system today has substantially been liberalized compared to the situation before 1989. As a result of the bank entry and branching liberalization, new domestic banks have

Table 24
 Distribution of Borrowers in Metro Manila, Urban and Rural
 Philippines, By Source of Credit, 1986 & 1987
 (In Percent)

	All Philippines		Metro Manila		Urban		Rural	
	1986	1987	1986	1987	1986	1987	1986	1987
Formal	32.0	28.0	34.0	36.0	34.0	48.0	31.0	20.0
Informal	65.0	66.0	61.0	62.0	62.0	45.0	67.0	74.0
Mixed	3.0	6.0	5.0	2.0	4.0	7.0	2.0	6.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: SWS-Ateneo University. Public Opinion Report Surveys, October 1986 and October 1987

Note: In the 1987 survey, "borrowers" are identified as those having borrowed at least P/1,000 in the past 12 months. In the 1986 survey, there is no minimum amount specified

Table 25
 Extent of Borrowing from Formal and Informal Sources,
 by Type of Agricultural Activities

	Credit Source (%)	
	Formal	Informal
Fishermen (Laopao & Latorre, 1979)	29.3	70.7
Cattle Raisers (Manalo, 1974)	54.7	45.3
Fishpond Operators (Lianto & Magno, 1994)	71.0	29.0
Agrarian Reform Beneficiaries (Casuga & Morte, 1992)	21.0	79.0

entered the market and bank branches and non-bank financial intermediaries have rapidly proliferated both in Metro Manila and in the countryside. All this have already enhanced competition in the financial system as can be gathered from the rapid pace of financial innovations, which financial institutions are doing now. For instance, interest-bearing demand deposits are now being offered by commercial banks. Also, new high-yielding savings deposits are now being marketed by banks. Several banks have recently introduced telebanking, i.e., banking by phone or by fax. Most commercial banks are now going into the lucrative consumer banking and housing finance, which before were considered areas of specialization of some thrift banks and finance companies. These are small loans by commercial banks' standards.

Large thrift banks are catching up fast on the new developments in the financial sector. A number of them including those in the provinces are now hooked up with the automatic teller machines set up by commercial banks.

The competition is expected to intensify further once the 10 new foreign banks start to operate in 1995. Under the newly enacted law on foreign banks, the ten new foreign banks together with the existing four foreign banks will be permitted to have up to 6 branches each.

Foreign banks are expected to compete with the domestic banks in the wholesale market, i.e., accounts of multinational corporations and top 1,000 corporations. Because of this, most domestic commercial banks are now re-structuring their organization to make them lean and efficient so that they can be competitive in both the wholesale and retail markets. Their expansion into the retail market is intended to make up partly for the expected reduction in their business in the wholesale market. Many of them, through their branches, are now seriously looking for new credit-worthy clients including successful medium- and small-sized enterprises. This has put pressure on small financial institutions, like thrift banks, to shape up to stay competitive. With the rapid expansion of commercial and thrift bank branches and other types of financial institutions, rural banks, especially those in large towns, are anticipating competition to become stiffer. They too are now under pressure to innovate and make their banking operations efficient. In some small towns, however, competition will be less intense and it will be among small financial institutions such as rural banks, credit unions, lending investors and pawnshops, and informal lenders.

Despite commercial banks' going into the retail market, still they are not expected to cater to the numerous and widely dispersed small farmers and micro and cottage enterprises with assets of P1 million or less simply because it will not be cost-effective for them to do it and because they do not have informational advantages to assess the credit worthiness of this group of borrowers. They will stick to their minimum retail loan size of P500,000 (for small commercial banks) to P1 million (for large commercial banks) and still will require hard collateral from their borrowers, which many micro and cottage industries can hardly present. The large thrift banks will also do the same. Thus, only the small thrift banks, rural banks, cooperative rural banks, credit unions, lending investors and pawnshops have the potential to extend their financial services to small farm and non-farm enterprises.

Presently, however, these small financial institutions are not adequately meeting the credit demand of small borrowers, as may be gathered from the results discussed above. The question, therefore, is what could be done to expand further their financial services to those that are currently rationed out by the formal credit institutions without sacrificing their viability. To answer this question, it is necessary to discuss first the favorable policy environment and constraints facing small financial institutions.

a. Favorable Policy Environment

The current policy environment (i.e., entry and branching, interest rate policy) is already conducive for banks to expand their services. In fact, there are already signs that small banks are responding favorably to this environment. For instance, although the number of head offices of thrift banks went down from 106 in 1989 to 97 in 1993 as a result of closure, consolidation and conversion of two large thrift banks into commercial banks, the number of branches of the remaining thrift banks increased from 403 to 573 during the same period. The same can be said of rural banks; that is, the number of rural bank branches more than doubled from 118 in 1989 to 319 in 1993 despite the decline in the number of head offices from 824 to 780 during the same period. Even the number of CRBs, which stayed at 28 for quite a long time, increased to 35 during the same period. Considering that the banks went through a difficult period in the 1980s and that, except for the CRBs, there was no fresh capital infused by the government into these banks, the growth in the number of bank offices since 1989 is by no means insignificant.

The same can be said of pawnshops, which grew from 2,324 in 1989 to 3,032 in 1993; and lending investors, from 811 to 1,559. The number of credit cooperatives must have also increased significantly during the same period.

The expansion of financial institutions that cater to small farm and non-farm enterprises will likely accelerate in the next five years for several reasons. One is that there are still several areas in the country that are not being served by banks or other formal financial institutions. Another reason is that after more than a decade of low growth, the economy is expected to have a sustained growth, at least in the next five years. The economic reforms instituted by the government in the last five years are consistent with the overall policy of economic liberalization and are credible. As is well known, the increase in economic activity would lead to greater demand for financial services by all sectors of Philippine society. Given the increasingly competitive environment in the market for medium- and large-sized loans, small financial institutions are going to remain in the market for small loans, benefitting more small borrowers in the medium-term.

b. Some Constraints

There are, however, some factors that will constrain small financial institutions from expanding their services to a greater number of small farm and non-farm enterprises. These are:

1. Capitalization. Most of the small financial institutions are family-owned, and the growth of their capital will be constrained by the financial resources these families have. In the case of credit cooperatives, the growth of their capitalization will depend on the extent to which they can increase their membership, which is hard to do after reaching a certain size. CCUs capability to raise more resources through savings mobilization is limited by the fact that they are not allowed to accept deposits from non-members without securing authorization from the BSP and that their deposits are not insured unlike those of banks.
2. Competition from government banks. From 1989 to 1993, the number of government bank offices expanded from 76 to 205. Because of the policy of the government to make these banks self-sufficient, these banks are directly competing with private banks in mobilizing deposits. Although these banks are engaged in wholesale lending, they are also engaged in retail lending, which directly competes with private financial institutions.
3. Special credit programs. The existence of 111 special credit programs, some of which are managed by non-financial government agencies and charge substantially below-market rates of interest, crowd out small financial institutions that have the same clientele as those credit programs, except those that are being coursed through lending conduits.

Relaxing these constraints would require some policy changes and changes in the way the government intervenes in the credit markets.

C. RECOMMENDATIONS

The government should recognize that the private financial institutions have the primary role of providing financial services to all socio-economic sectors of Philippine society including small farm and non-farm enterprises. Many small enterprises are found to be viable and provide modest income to small entrepreneurs. There should be no reason why private financial enterprises providing financial services to small viable enterprises cannot be viable. Small financial institutions have cost structure and informational advantages that make the provision of financial services to small enterprises viable. The government, therefore, should play a secondary role to private financial institutions.

To encourage private financial institutions to expand further their financial services to a greater number of small farm and non-farm enterprises, the following are, therefore, recommended:

1. The government should have a clearer policy of not directly competing with private financial institutions. As a first step, the government should rationalize its credit

programs, consolidate them under the appropriate government financial institutions and withdraw the interest rate subsidies in these programs. Corollarily, the government financial institutions should concentrate on wholesale lending and close completely their retail lending programs. This will not only eliminate competition between government and private financial institutions but will also strengthen the complementarity between them. While it reduces the exposure of the government financial institutions to credit risks, the focus on wholesale lending by government financial institutions will relax the liquidity constraints of many small financial institutions including NGOs that have good credit programs. As already mentioned above, many small financial institutions and NGOs are unable to respond quickly to the credit demands of their clientele because of lack of funds.

2. The need to have a credit coordinating body is long overdue and the National Credit Council (NCC) has a potential to become that body. First of all, it has the mandate to coordinate, review and, if necessary, to consolidate credit programs. Secondly, being chaired by the Secretary of Finance, the NCC will have a direct link to the President, which is important in quickly coming up with firm decisions about the credit programs in the country. Thirdly, the NCC has direct linkage with the key economic agencies of the government. This is important because the key government agencies can give the NCC a broader perspective of the role of each special credit program in the entire economic program of the government. Thus, credit programs will not be evaluated only on the basis of outreach and viability but also on their implications on the overall economic development program of the government. Fourthly, the presence of private sector representatives in the Council provides the NCC with a mechanism for consultation with and quickly soliciting feedback from the private sector concerning the effectiveness of special credit programs.

Apart from these, the NCC needs more clout by giving it the responsibility not only to review existing credit program but also to screen and approve all special credit programs and scrap those that are found to be poorly performing. It implies that the NCC has the capability to evaluate the merits of proposed and existing credit programs and to closely monitor them. Given the sensitivity of government agencies managing several credit programs, it is necessary that the NCC be viewed as an independent body so that its analysis and decisions be respected and carried out by concerned agencies. This requires the NCC to be a distinct body from credit implementing agencies.

Having the LBP as the Secretariat for the NCC could undermine the NCC's independence. LBP is managing several special credit programs and the Secretariat's evaluation of LBP's credit programs may not be considered objective by others. Also, the Secretariat's recommendations regarding consolidation of special credit programs under the government financial institutions, specifically

LBP, might be viewed by other agencies as self-serving. Thus, it is necessary that the NCC's Secretariat is not one of the credit implementing agencies. Perhaps, NEDA or a small staff of DOF can play that role.

3. The government should avoid infusing capital into small private financial institutions just to encourage them to expand their financial services to small farm and non-farm enterprises. This creates dependency on the part of private sector investors and, as mentioned in Chapter 2, confers undue benefits to private owners of banks. Instead, the government should provide incentives to large private banks to encourage them to invest in the small financial institutions by treating their equity investments in these institutions as eligible instruments for complying with the various loan portfolio requirements.
4. Some non-bank financial intermediaries such as finance companies, pawnshops and lending investors have already demonstrated their potential to provide credit to small entrepreneurs with very little collateral to offer. However, many of them face the problem of lack of funds, which have reduced their ability to reach out a greater number of small borrowers. One way of relaxing their liquidity constraint is to increase the maximum number of lenders they could borrow from 19 individuals/corporations, the existing ceiling, to say 40. There is no solid basis for imposing the ceiling of 19 individuals/corporations even for prudential purposes. In rural areas, only a few people have large excess funds, but there are many who have modest amount of excess funds that could be pooled together by these non-bank financial intermediaries so that they can have more resources for on-lending and, hence, they can reduce the delay in disbursing approved loans to small borrowers.

One of the potential beneficiaries of this policy change is the BCGC, which presently could not borrow from more than 19 commercial banks because it is treated like any other non-bank financial intermediary. With the liberalization of bank entry, more banks including foreign banks are expected to enter the commercial banking system and become members of the BAP. BCGC then could tap more funds from a larger number of banks to beef up its resources for on-lending to those that could not be accommodated to the regular lending windows of commercial banks.

5. The government has yet to realize the full potential of BCGC in extending credit to a great number of small enterprises. BCGC began with retail lending. Given its limited branches and its desire to reach more small enterprises, BCGC is now exploring the possibility of going into wholesale lending using NGOs as conduits. NGOs have cost and informational advantages over BCGC in reaching out to small borrowers. The government has similar efforts embodied in several special credit programs (e.g., TST-SELA, DAPCOPO). The government and BCGC, therefore,

should work together and complement each other instead of competing each other. A program should be worked out in which some of the NGOs now serving as conduits of government funds could migrate to the BCGC.

Some NGOs need technical assistance to enhance their capability to manage a credit. Both the BCGC and the government should jointly develop a program of technical assistance and extend it to the NGOs.

6. An interesting development in the last few years is the increase in the number and the broadening in the ownership of CRBs, i.e., CRBs are no longer exclusively owned by farmer associations but also by other types of non-farm associations, such as market vendors. This could be accelerated by encouraging credit cooperatives to form more CRBs. The assistance that the government could provide to credit cooperatives wanting to form a cooperative bank may be in the form of technical assistance, such as feasibility study, bank management training and bank accounting. Although unlike credit cooperatives CRBs are subject to the usual reserve requirement ratio, nevertheless they are authorized to mobilize deposits from the public. The CRBs could use member associations as conduits for their loans to small borrowers.

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