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"The Market-Based Road to the Bank"

A Policy Study on the Philippine Regulatory Framework for Microfinance

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List of Acronyms

ACPC	Agricultural Credit Policy Council
BSP	Bangko Sentral ng Pilipinas
CALF	Comprehensive Agricultural Loan Fund
CDA	Cooperative Development Authority
CPIP	Credit Policy Improvement Program
DA	Department of Agriculture
DCP	Direct Credit Programs
DOF	Department of Finance
GNFA	Government Non-Financial Agency
GFI	Government Financial Institution
LBP	Land Bank of the Philippines
MFI	Microfinance Institution
NAPC	National Anti-Poverty Commission
NATCCO	National Confederation of Cooperatives
NBFI	Non-Bank Financial Institutions
NCC	National Credit Council
NGO	Non-Government Organization
NPO	Not for Profit Organization
PCFC	Peoples Credit and Finance Corporation
PDIC	Philippine Deposit Insurance Corporation
PIDS	Philippine Institute of Development Studies
SPC	Social Pact on Credit
SRA	Social Reform Agenda
USAID	United States Agency for International Development

Abstract[1]

This study is interested in tracing the process of financial reforms in the Philippines. Starting from the financial liberalization reforms implemented during the 1980s, the research mainly looks at the institutions and organizations involved in the series of events that led to the issuance of the National Strategy for Microfinance, which also led to the creation of the Microfinance Regulatory Framework.

The study posits that the Philippine Regulatory Framework for Microfinance was shaped and remains to be guided by market-driven principles of financial liberalization, and as such, the banks are the ones greatly encouraged to develop and grow as microfinance actors in the country's growing microfinance industry.

Relevance to Development Studies

While most available literature written about the Philippine microfinance regulation make normative recommendations, this research tries to analyze real-life policymaking in order to identify empirical constraints in microfinance policy that will be useful in coming up with more realistic types of policy recommendations.

Also, as microfinance continues to be acknowledged as the government's tool for poverty alleviation, microfinance institutions can easily claim legitimacy to deliver financial services at the expense of the poor clients. On one hand, it is important that these organizations be regulated to be held more accountable for their actions, and on the other, a discussion on how regulation is serving the poor's interest that it rightly claims to do so also lend relevance to the study as a whole.

Keywords

Philippines
Microfinance
Regulation
Commercialization

[1] For Lenny, this paper is impossible and unimaginable without you.

Chapter 1 Introduction

The plot only thickens for microfinance.

Muhammad Yunus having been investigated for misallocation of funds after receiving the Nobel Peace Prize, Banco Compartamos earning massive profits over the first ever Initial Public Offering (IPO) of an MFI, and of most recent, the suicide committed by thirty farmers in Southern India because of microfinance debts. Still, at the end of the day, microfinance can always rely on its humble beginnings back in the 1980's when Yunus lent money from his own pocket to a group of rural poor women in a remote village in Bangladesh, and the rest as they say is microcredit history.

If you add in a little bit of Jeffrey Sachs smiling brilliantly side by side with the rockstar Bono and Oscar-winner actress Natalie Portman lending her face to the cause, microfinance is all set to save the world's poor. Press fast forward and it takes spectators into the Cinderella story of a huge and growing financial industry that targets the poor as its clientele that microfinance has become today.

The development world has never been this abuzzed with twist and turns, villains and superheroes, glitter, drama, and controversies.

This paper looks at the industry's catching-up regulation, yet another controversy in microfinance. The paradox in its integration or "inclusion" into the field of formal finance regulation is that policymakers are transforming NGOs into formal financial institutions *i.e.* turning away from the original microfinance model despite the fact that no concrete evidence has been presented of it being inefficient.

As Roy Mersland (2007) pointed out in his paper "The Cost of Ownership in Microfinance Organization", numerous national legal frameworks and policy papers are bank-friendly, yet most providers of microfinance services are NGOs and cooperatives (Berenbach and Churchill, 1997; CGAP, 2003; Chavez and Gonzalez-Vega, 1994; Christen and Rosenberg, 2000; Greuning, et al., 1998; Hardy, et al., 2002; Jansson, et al., 2004; Staschen, 1999 cited in Mersland, 2007).

He added that policy papers and national legal frameworks "seem to consider" NGOs and most cooperatives as inferior banking organizations, as a consequence, "there has been a call for NGOs to transform" (White and Campion, 2002; Fernando, 2004; Rhyne, 2001 cited in Mersland, 2007: 4). Meanwhile, researchers found little evidence of banks' efficiency more than cooperatives and NGOs "in mature bank-markets where different ownership types coexist" (Altunbas, et al., 2001; Crespi, et al., 2004; ESBG, 2004 cited in Mersland, 2007: 5).

Mersland (2007: 5) then asks: why is there a need for transformation of NGOs today when it wasn't needed before? While Mersland resolves the ownership question and have shown in his paper how an MFI's ownership structure matters least in achieving financial sustainability, this study looks at the specific case of the Philippines, whose regulatory framework for microfinance requires the same NGO transformation. The aim is to trace the policy process of this framework to determine the underlying principles of the regulation and ultimately determine the interests the regulation serves. The overarching question this study asks is: what drives the Philippine Regulatory Framework for Microfinance?

Since the required transformation is part of an entire framework, the research puzzle calls for a holistic discussion of the policy. In examining a branch, one looks at the tree and traces its roots to better understand. This is what the study sets out to do.

On the surface, the storyline of a catch-up regulation sounds complex, especially that there is no single international standard for microfinance yet. Peter Aagaard (2011) in his recent article identified three emergent microcredit policy ideas with varying organizational identities, microcredit concepts, microcredit environment concepts, strategic features, and tools and programs that are now competing for international dominance, namely the idea of Grameen Bank, of WorldBank, and of SKS India. According to Aagaard, Grameen Bank conceptualizes a microcredit that is a tool for poverty reduction while WorldBank and SKS India have a microcredit concept that is a commercial banking variation. All three organizations, however, share one clear characteristic: they are financial institutions that want to create institutional change.

From a public policy perspective, two ideas for the process of policymaking can be drawn (Lobo, 2008: 20):

1.) Linear – sees policymaking as a problem-solving process that is rational, balanced, comprehensive, analytical and linear.
2.) Policy as practice – a policymaking process that is chaotic and open-ended, and "not a matter of the rational implementation of so-called decisions through selected stages".

However, as I propose to show in this study, the real policy process was more cohesive and linear in the Philippine context than how microcredit policy regulation appears internationally, a process that is not to be confused with a complex perception a "catch-up" regulation provides. While various stakeholders, local and international interests played a role, one of the main characteristics of this specific policy process is its almost unified decision-making process suggestive of an almost unified interest.

The almost encompassing role played by USAID through its technical assistance to National Credit Council (NCC) provides policy stability coupled with a solid direction for microfinance regulation, which initially comes off as surprising considering that USAID is an external policy actor, yet a brief recollection of our country's long history of special relations with the US put everything back into its "usual" context. The curiosity then shifts to whose (local) interest the regulation is serving and focuses on what to do next given the current regulation set-up.

Indeed, the banks are the ones more and more benefitting from this microfinance regulation. With the tiered regulation developed by the Bangko Sentral ng Pilipinas (BSP), it even appears that these banks have to be enticed by the government to deliver microfinance services and be given incentives to bear the risk of lending to the poor, as if microfinance has not shown a strong and consistent record of good performance and profitability in recent years.

In turn, what is happening is that NGOs are the ones bearing the transaction cost of transforming into a bank to be able to legitimately mobilize savings deposits, while cooperatives remain at the back seat and is hardly even heard in the whole policymaking process, two main microfinance providers that, despite of a constricting regulation or even the long absence of a regulation, have continuously proven the financial sustainability of microfinance while at the same time serving their original vision of delivering poverty-alleviation programs to the poor.

Most ironically, microfinance is continuously mentioned in the government's development plans from one administration to another yet the poor and their interests are nowhere to be heard in the whole process. Not even a discussion on the interests of the poor and how it can be further through the regulation, and the only explanation the narrative could find for this is the mutual and tacit assumption among policy actors that the delivery of microfinance alone is in itself addressing poverty.

The paper traces the policymaking process looking for specific clues (interests, existing institutions, political set-up) that could have accounted for the current bias of the regulation's outcome against NGO-MFIs in particular through its required transformation into formal financial institutions. In other words, it muddles through the policymaking process of the microfinance regulation hoping for more stories and plots and endings.

The process starts off with the National Credit Council that was created in 1993 being tasked to "solve" the dilemma of catching up with the growth of microfinance. Then this credit council released a national strategy in 1997, followed by the formulation of microfinance regulatory framework in 2002, whose implementation is being facilitated by various government regulatory bodies, and this regulatory policy is currently being adhered to by various microfinance players. That is, too linear and cohesive to be true, even unperturbed by the changes in administrations that is very unlikely in the Philippine government context.

Structure of the paper: Section 2 provides an overview of the Philippine microfinance landscape putting the policy in the overall context of a catch-up regulation. Section 3 traces the history of the policymaking process from the financial reforms in the 1980s up to the present regulation approved in 2002, and provides an analysis on the decision-making process alongside the institutional setting and organizations involved. Section 4, in conclusion, provides regulatory alternatives that can be considered as regulation of microfinance in the Philippines progresses along.

1.1 Aim

Generally, this paper aims to gain a better understanding of policymaking process and decision-making in the area of microfinance policy. It is interested in determining the principles underlying the Philippine Microfinance Regulatory Framework.

The study also aims to put more emphasis on a shaping microfinance regulation that presents an opportunity for future studies and discussions centred on innovative government regulatory policies that will increasingly respond to the context and issues akin to the microfinance sector in the Philippines.

1.2 Research Problem

What drives the Philippine Regulatory Framework for Microfinance?

1.3 Methodology

This study primarily employs document analysis. Primary data sources are publications and policy documents released by the Philippine government available online through official government websites, and secondary sources include reports and studies related to microfinance and its regulation.

1.4 Scope & Limitations

Microfinance remains a highly challenged economic development approach. However, this research does not aim to disprove or support the effectiveness of microfinance in combating poverty. Since there is a continued demand for microfinance services in the Philippines, this paper remains rooted in the reality of the industry's growth, indicating instead where government policy figures in the whole microfinance equation.

Chapter 2 Literature Review

Central to understanding the way we are governed is the concept of policy, while social policy defines the government's impact on the welfare of its citizens (Colebatch, 2007). Colebatch (2002: 7) presents various meanings to the word "policy" in his article "What's the Idea?" yet clarifies one thing: that "the term implies something broader than simply what the government wants to do".

One paper published by IFAD provides a comprehensive perspective on policy process analysis. It identifies two broad policymaking views, the Linear Model, and the "Policy as practice" model (Lobo, 2008). The Linear model treats policy as "speaking truth to power" (Keeley 2001 cited in Lobo, 2008: 20) wherein "issues are seen largely as amenable to technical analysis and solution". Here, policy implementation is treated as a separate activity that starts after making a decision (Pasteur 2001b cited in ibid). In this perspective, the implementation, lack of support, political and bureaucratic establishment are seen at fault once the intended objectives are not achieved, and not the policy itself.

This contemporary policy analysis focuses on "rational methods of decision making" wherein "problems are cast as a choice between alternative means for achieving a goal, and rationality means simply choosing the best means to attain a given goal" (Stone, 2002: 232). All policy problems, in this approach "become subspecies of a single meta-problem: how to make a decision that will attain given goals" (ibid). According to Stone (ibid), these models of decision-making "are prescriptive, rather than descriptive or predictive; they define policy problems as decisions, and they purport to show the best decision to solve a problem".

In the "policy as practice" model (Keeley 2001 cited in Lobo 2008), policymaking is "chaotic and open-ended" and is "not at all a matter of the rational implementation of the so-called decisions through selected stages" (Clay and Schaffer, 1984 cited in ibid: 20). In this perspective policymaking is viewed as (Lobo, 2008: 20-24)[2]:

1.) Non-linear, complex and incremental
2.) Influenced by practice
3.) Influenced by interest groups, actor and policy network and coalitions
4.) Influenced by the governance and political context
5.) Influenced by policy/development narratives
6.) Influenced by development discourses

[2] For a detailed account of each of these points see Lobo (2008: 20-24).

7.) Influenced by international regimes

Thus, "policymaking process is anything but linear and orderly" "Policymaking in the real world is political and contested", which "also explains why there is often a big gap between policy prescriptions or statements and what is observed in the field" (Lobo, 2008: 24).

Mediating policies are institutions (markets, laws, procedures, media), organizations (courts, departments, NGOs, civil society bodies) and at times powerful leaders, the knowledge, capacity and commitment of these agents, plus the nature and extent of their interactions with the people determine the policy impact and outcomes, while forums for people's feedback are also provided by these same agents (Lobo, 2008: 24).

In another article, Colebatch (2009: 23) posits that "more than one account may be drawn upon in explaining and justifying what is happening" in policy process, and he identifies numerous ways to account for policy, putting emphasis on the policy processes at work. He mentions policy framing as choices made by governments; as a product of interactions between stakeholders; as an activity of shared understandings, values and practices (ibid). "It is useful to identify each of these accounts in turn, and to think about the ways in which they are used in analysis and in practice" (Colebatch, 2009: 23).

Colebatch adds that "governing does not just happen: it is constructed out of an array of shared ideas, categories, practices and organizational forms" and "policy is a way of labeling thoughts about the way the world is and the way it might be, and of justifying practices and organizational arrangements, and the participants in the governmental process seek to have their concern and activities expressed as policy" (Colebatch, 2002: 8).

Chapter 3 Conceptual Framework

The illustration below provides the basic structure for analysis in muddling through the policymaking process of the Philippine Microfinance Regulatory Framework.

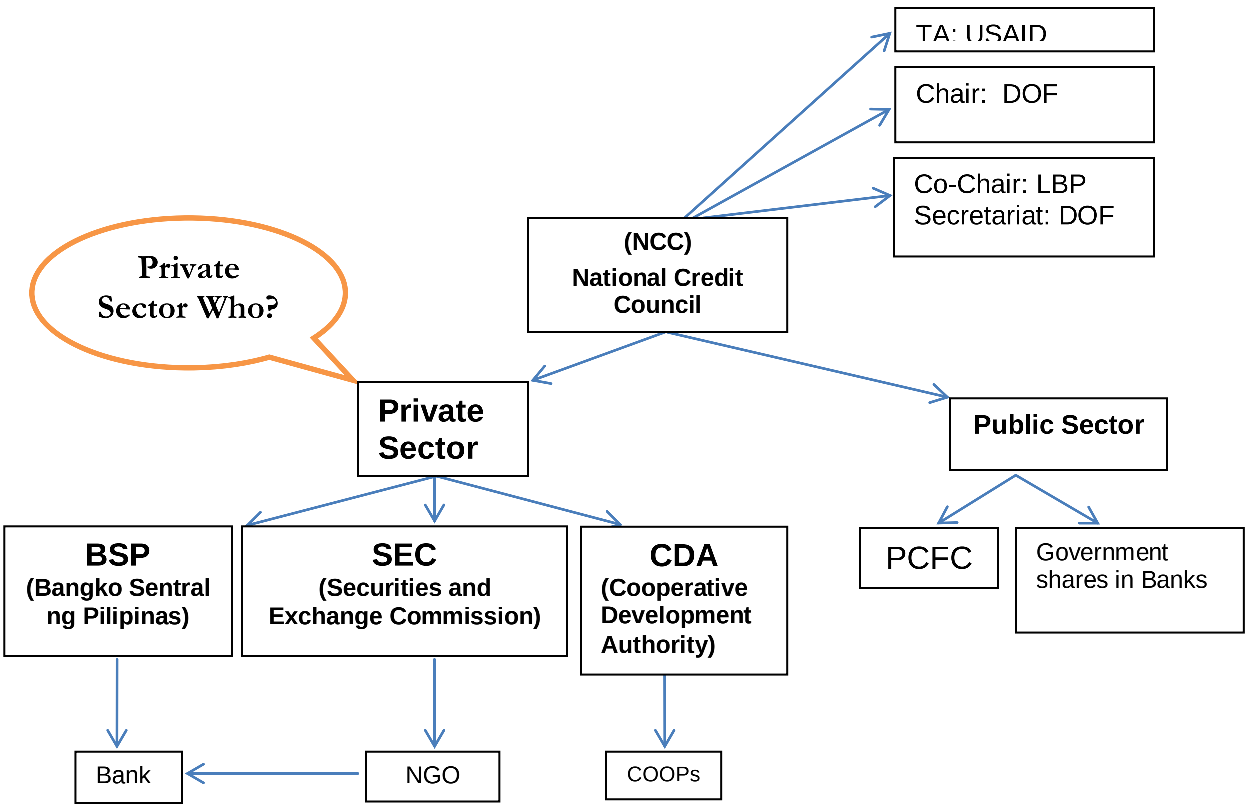

Figure 1. Private sector who?

Mainly, the framework considers institutions and organizations in policy analysis. The study considers institutions to matter because "they determine the growth path (social, economic, political, technological and cultural) of society, as well as distribution of benefits, access to resources and power (Lobo, 2008: 12). As Douglass North (cited in Lobo, 2008: 12) argues, an enabling institutional environment plays a central role in economic development by reducing transaction costs and risk, and thus promoting trade and specialization – the prerequisites of growth, "in other words, representative, robust and effective institutions play a significant role in advancing the development of society and enhancing the quality of life".

This focus provides a more concrete basis for analysis within the intended aim of the research, considering that "policymaking process is non-linear, complex and incremental; influenced by practice, interest groups, actor and policy networks and the governance and political context; and shaped by development discourses and narratives" (Lobo, 2008: 24), in short, broad, complicated, and one that involves the art of "muddling through" as put by Lindblom.

Such focus is helpful when looking at the Philippine microfinance regulation especially that it is a regulation that has "sprung-up" to "catch-up" with the reality of the industry's growth. This, together with the acknowledgment of microfinance as a viable tool for economic development, and its subsequent integration into the formal financial regulation provides an incremental policy process frame, in contrast to the linear policy process model.

Chapter 4 Microfinance Background

4.1 Origins

The Microfinance Handbook published by the World Bank in 1999 says that "microfinance arose in the 1980s as a response to doubts and research findings about state delivery of subsidized credit to poor farmers" (Ledgerwood, 1999: 2). With the success of Grameen Bank and their 2006 Nobel Peace Prize, microfinance has increasingly been associated with Grameen and Muhammad Yunus, the Bangladeshi economist who founded Grameen in 1976 and shares the Nobel recognition with the bank (EIU, 2009; Grameen, 2011).

Others say that financial services for the poor experienced growth in the late 1970s from the Rotating Savings and Credit Associations (RoSCAs) in Latin America through the affiliates of a US non-government organization with volunteers in Latin American - ACCION International (Gallardo, 2001). Some literature trail microcredit up north in the 18th century through the Irish Loan Fund System, which provided small loans to poor farmers that lacked collateral, and the subsequent financial cooperative in Germany followed by the spread of cooperatives throughout Europe and then to the rest of the world in the mid19th century (Sarkar and Singh, 2006; Esmail, 2008). In microfinance history, typical accounts would either credit microfinance to Muhammad Yunus in Bangladesh, Accion International in Brazil or Opportunity International in Colombia (Qureshi and Roodman, 2006: 2).

Still, savings and credit groups have operated for centuries such as the "susus" of Ghana, "chit funds" in India, "tandas" in Mexico, "arisan" in Indonesia, "cheetu" in Sri Lanka, "tontines" in West Africa, and "pasanaku" in Bolivia (CGAP, 2006). Numerous informal savings clubs and burial societies can be found all over the world, one example is the old practice in the Philippines called "paluwagan" wherein people in the community form a group, contribute a certain amount regularly that can be withdrawn by one person at a time for a given period. The lack of banks or formal financial institutions does not mean that poor individuals are unable to borrow, informal sources such as moneylenders, neighbors, relatives, and local traders are also common credit sources (Armendáriz and Morduch, 2005). The moneylenders being one of the inspirations for Muhammad Yunus' microcredit idea in terms of his drive to get them out of business due to their high interest rate charges (Yunus, 2010).

Microfinance began as the activity of informal savings and credit groups, moneylenders, donors, and NGOs (Meagher, 2002). It has existed in various forms for centuries but "the development of distinct MFIs came into prominence in the 1980s after the emergence of the Grameen Bank, which developed strategies and lending techniques that influenced microfinance organizations all over the world" (Bogan, 2008: 3).

4.2 Definitions

In most cases, the term microfinance is more commonly used to describe and discuss the provision of financial services to the poor or "a clientele poorer and more vulnerable than traditional bank clients" (CGAP 2003 cited in Khawari, 2004; Llanto, 2000).

In the literature, microfinance and microcredit are sometimes treated synonymously and the terms commonly interchanged. For instance, one author describes how Yunus has "devoted himself since the 1970s to demonstrating, institutionalizing and spreading *microfinance*" while saying that Grameen Bank is "the largest *microlender* in the world" (Bornstein, 2011). Another writer provided a separate definition for each and referred to microfinance as the "array of financial services that include credit, savings, and insurance" while defined microcredit as "the provision of credit which is usually used as capital for small business development" (Bogan, 2008). Microcredit is also sometimes used to refer to the microloan product of microfinance (Christen, Lyman and Rosenberg, 2003).

The term microfinance used interchangeably with microcredit already has its implications. One author who identified the microfinance movement in the 1970s and early 1980s writes how the term *microfinance* started to replace *microcredit* and *microenterprise finance* when the sector began to consider savings, not just credit as an important financial product for low-income clients (Rhyne, 2001).

Another book cites the shift from microcredit – referring specifically to small loans – to microfinance – a broader term that includes savings collection, provision of microinsurance, and distributing and marketing clients' output (Armendáriz and Morduch, 2005: 14). Microcredit has since been linked with the Microcredit Summit and the Grameen Bank philosophy – focusing on getting loans to the very poor and explicitly working towards poverty reduction and social change with NGOs as key players, while the term microfinance has been closely identified with the financial systems approach – serving the "less poor" households and moving towards the establishment of commercially oriented, fully regulated entities (Rhyne, 2001; Armendáriz and Morduch, 2005).

The terms are used alternately but microfinance and microcredit have "different resonances and are loosely attached to contrasting beliefs about the state of rural finance and the nature of poverty" (Armendáriz and Morduch, 2005). There are many materials written about the topic of financial services provision to the poor, as well as numerous ways and implications of terminologies used, and "hardly any agreement on a universally accepted definition of microfinance" (Khawari, 2004: 3).

Chapter 5 The Philippine Microfinance Landscape

The first organization to deliver microfinance services in the Philippines was an NGO that pilot tested a Grameen lending methodology in 1989 (Seibel and Torres, 1999), while the first microfinance-specific government policy has been issued by the National Credit Commission (NCC) in 1997 through the National Strategy for Microfinance.

The regulation has caught up with microfinance while it was already in operations in the country that one writer refers to it as a “necessity that sprung up” for several reasons he identified as 1) to uphold performance standards in governance and operations, 2) to respond to the increasing competition among the microfinance players, 3) and to respond to microfinance’s increasing commercialization (Jimenez, 2009).

The case for microfinance regulation globally is not any different, it is said that microfinance “grew to a point where financial regulators see the need to frame a policy and eventually integrate some portion of the microfinance spectrum into the framework of regulated financial services institutions” (Meagher, 2002: 1). Briefly put, microfinance regulation sprung up like an automatic reflex to meet the growing demands of the poor (Wijewardena, 2004).

An IDLO-published paper confirms this by saying that in reality, the regulation of microfinance is still continuously catching up with the changing structures and growing size of microfinance worldwide, however, it does not simply mean systems are designed to control an emerging industry and fill the regulatory void (Valdemar, Encinas and Imperio, 2007). Other than this, microfinance regulation is said to be needed to meet the growing demand for microfinance services, to be able to mobilize, and to protect the clients.

According to CGAP (1996), microfinance regulation is necessary because there is a huge demand for financial services that remain unmet. MFIs reach fewer than 5% of its potential clients and for them to serve a growing market, fund sources (*i.e.* commercial fund sources including deposits) other than what donors and governments can currently provide become a requirement.

According to Vogel (1999), the drive of sustainable and growing yet unregulated MFIs to mobilize deposits from the general public has led to interest in the regulation and supervision of microfinance. Reaching sustainability makes it difficult for MFIs to receive continued funding from governments and donor agencies, yet this does not stop the MFI’s need for additional funding to continuously increase outreach, adding that regulation and supervision is a central in microfinance since virtually all countries mobilize savings from the general public.

Gallardo (2001) on the other hand points out consumer protection as the primary reason for the regulation and supervision of traditional financial institutions. He said that moral hazard issues arise due to the likely incompatibility between the financial institution's interests and that of the consumers. He further mentions the issue of asymmetric information in citing the need for "an impartial third party" (*i.e.* the state or one of its agencies) that will regulate and control the soundness of a country's financial institutions, as well as suggested the protection of the whole banking and payment system as additional objective of regulation and supervision.

Another paper cites that "with new entrants in the field of microfinance and the continuous commercialization of the industry, a regulatory framework must be in place to ensure the sound, sustainable, and transparent development of the industry"(Almario, Jimenez and Roman, 2006: 5).

Recently, the Philippines was recognized as the world's best in regulatory framework among 54 countries by the Economist Intelligence Unit (EIU, 2009) as reported in their publication "Global Microscope on the Microfinance Business Environment". According to EIU, the Philippine government's regulatory and policy framework is conducive to commercialization of microfinance, and is encouraging of the establishment of microfinance banks. The regulation has promoted the upgrade of NGOs specifically, since the adoption of the National Strategy for Microfinance in 1997.

In "Commercialization of Microfinance in the Philippines", a paper published by the Asian Development Bank (ADB) further writes that the Philippines, compared to other Asian countries, has a "fairly supportive legal and regulatory environment in which MFIs can operate", and that since it "gave formal recognition to microfinance in 1997", it "has been steadily improving the environment for MFI commercialization" (Charitonenko, 2003: x).

Finally, as stated in the Regulatory Framework for Microfinance (NCC, 2002), "the specific policies and strategies to be pursued for the effective delivery of microfinance services are spelled out in the National Strategy for Microfinance".

Based on the various discussions cited above, there seems to be a common understanding about the conduciveness of the Philippine microfinance regulation to its commercialization, a regulation that is pointing to a common government policy, the National Strategy for Microfinance.

5.1 The microfinance regulation

The Philippine National Regulatory Framework for Microfinance was formulated and approved by the National Credit Council (NCC) in July 2002

(MCPI, 2006). The government's thrust and policy direction for microfinance is delineated here, as well as the roles and duties of the industry's public and private sector actors (NCC, 2002). It especially spells out the non-participation of the public sector and encouragement for the private sector in the delivery of microfinance services is the country.

As exactly stated in the policy, the regulation is built on the following principles (NCC, 2002):

1. Greater role of private microfinance institutions (MFIs) in the provision of financial services;
2. An enabling policy environment that will facilitate the increased participation of the private sector in microfinance;
3. Market-oriented financial and credit policies, *e.g.* market-oriented interest rates on loan and deposits;
4. Non-participation of government line agencies in the implementation of credit and guarantee programs.

Moreover, the framework states that the vision of microfinance in the country "will be achieved in a liberalized and market-oriented economy where the private sector plays the major role and the government provides the enabling environment for the efficient functioning of markets" (ibid: 2). A vision set to be achieved through: adoption of market-based financial and credit policies; greater private sector participation in the delivery of microfinance services to the basic sector, and establishment of an appropriate regulatory framework for microfinance" (ibid).

The thrust of the framework as clearly and repeatedly presented is adherence to market principles that provides opportunity for the private sector organizations to greatly participate in the delivery of microfinance services in the country.

The succeeding discussion of this paper focuses on this thrust. It specifically looks into the private sector actors of microfinance being recognized as the major providers of retail microfinance[3] services in the country, and more importantly, being given preference to deliver microfinance services over the public sector by the regulation itself.

[3] Retail microfinance is the direct provision of financial services such as loans, savings, microinsurance, etc. to end-clients, and wholesale microfinance provides financial services to institutions.

5.2 Private Sector Who?

As defined by the regulatory framework, microfinance is the private sector's provision of viable and sustainable financial services to poor and low-income households[4] (MCPI, 2006). What is classified by the policy as a microfinance credit is a loan amounting to or less than PhP 150,000[5] (ibid). Microfinance services are demanded by small-scale borrowers for savings, business, or personal financing, and majority of the clients are market vendors, tricycle operators, petty traders, microentrepreneurs, and other small-scale borrowers (Llanto, 2000).

In the most recent MIX Market country report for the Philippines for the year 2010, the consolidated loan portfolio of 93 retail MFIs reached USD 632.1 million from 3.0 million active borrowers, and a savings deposit of USD 454.4 million from 3.7 million depositors. Unsurprisingly, microfinance is said to be gaining momentum in the Philippines "driven by the numerous empirical evidence and many success stories that demonstrate microfinance as an effective tool for economic development and poverty alleviation (Roman, 2004: Intro).

As summarized in the succeeding table, microfinance services in the country are delivered by public and private sector organizations. Under the public sector are government financial institutions like People's Credit Fund Corporation (PCFC) and government shares in commercial banks, the private sector is composed of various financial organizations that are not government-owned (Gallardo, 2001).

Within this private sector are three generally recognized retail microfinance providers, namely, the rural/thrift banks, credit cooperatives and the microfinance NGOs (NCC, 2002; Charitonenko, 2003; MCPI, 2006?; Llanto, 2000).

Table 1. Type of Microfinance Institutions in the Philippines[6]

Sector	Type of MFI
Private	Commercial Banks, Thrift Banks, Non-Stock Savings and

[4] The 1997 NEDA poverty estimates show that the established annual per capita poverty threshold for the Philippines is P 11,319. The annual per capita poverty threshold in the urban areas and rural areas is P 12,577 and P 10,178 respectively. Below this threshold or minimum income, that individual will be considered "poor." (NCC, 2002)

[5] This definition is consistent with the provisions of RA 8425 (Social Reform Agenda) (NCC, 2002)

[6] Table is based on data by Gallardo (2001).

	Loan Associations, Rural Banks, Finance Companies, Private Lending Investors and Pawnshops
	NGO-MFIs, NGOs
	Cooperative Banks, Federation of Credit Unions & Savings & Credit Associations, Credit Unions & Credit Cooperative Associations, Non Stock Savings and Loan Associations.
Public	Government Financial Institutions (*e.g.* PCFC); government shares in commercial banks

It is estimated that 500 NGOs, 4,579 savings and credit cooperatives, and 195 banks are engaged in microfinance as of December 2005 (MCPI, 2006?). Although it was only in the late 1990s that significant numbers of rural banks and cooperatives started considering microfinance as a market niche with potential profitability, retail MFIs have expanded the provision of microfinance that is attributed to the government and donor-supported programs' continuous and current efforts to expand the commercial outreach of microfinance (Charitonenko, 2003; Llanto, 2000).

No data on the total number of organizations and volume of microfinance services delivered by formal and semiformal MFIs in the country can be found in the database of MIX Market, as well as in government websites such as that of the Department of Finance (DOF), National Statistics Office (NSO), and the BSP, NCC on the other hand has no official website.[7]

Furthermore, Mersland (2007) identified three types of MFIs with three different ownership structures: the Shareholder Firms (SHF), the Not-for-Profit Organizations (NPOs), and the cooperatives (COOP). SHFs are firms that have limited shares like banks and non-bank financial institutions (NBFIs) owned by investors whether profit seeking or social investors, individuals or organizations; COOPs are customer-owned organizations like credit unions, building societies, savings and credit cooperatives, etc.; and NPOs are organizations that have no legal owners (Mersland, 2007).

Applied in the Philippine context, the private sector retail microfinance providers can then be grouped according to Mersland's ownership structure as shown in the following table.

[7] Unavailability of a comprehensive microfinance data was also mentioned in Llanto (2000), Gallardo (2001) and Charitonenko (2003). I contacted NCC via email and was referred to the Director but haven't received any reply for my inquiry about the council.

Table 2. Ownership structure of Private Sector MFIs[8]

Type of Ownership	Type of MFI
SHF (Private Investors; banks and non-bank financial institutions)	Commercial Banks, Thrift Banks, Non-Stock Savings and Loan Associations, Rural Banks, Finance Companies, Private Lending Investors and Pawnshops
NPOs (Private Trustee/ Parties/ Charitable Institutions or NGOs)	NGO-MFIs, NGOs
COOPs (Individual Members / Cooperative Societies)	Cooperative Banks, Federation of Credit Unions & Savings & Credit Associations, Credit Unions & Credit Cooperative Associations, Non Stock Savings and Loan Associations.

For consistency, the paper shall follow the Philippine context, thus, Share-Holder Firms will be referred to as financial institutions under BSP or simply "banks" hereafter[9], while NPOs shall be referred to as microfinance NGOs and cooperatives as COOPs.

The ownership structure identified by Mersland (2007) that coincides with the classification of the three main microfinance providers under the private sector are also regulated differently by the microfinance regulatory framework in the Philippines. As shown in Table 3, banks are regulated by the BSP, cooperatives are regulated by the Cooperative Development Authority (CDA), while microfinance NGOs are unregulated but are given legal entity by the Securities and Exchange Commission (SEC) as a non-stock, non-profit organization (NCC, 2002).

The basic premise of the Philippine microfinance regulatory framework is that only deposit taking institutions will be subjected to regulation, as such banks and COOPs are considered deposit-taking institutions while microfinance NGOs are not (ibid).

Table 3. Types of MFIs in the private sector and their regulation in the Philippines[10]

[8] Table is based on data by Gallardo (2001) and Mersland (2007).
[9] Since NBFIs have not been identified as main retail microfinance providers
[10] Table is based on data by Gallardo (2001).

Type of Ownership	Financial Institutions	Regulation
SHF (Private Investors; banks and non-bank financial institutions)	Commercial Banks, Non-Stock Savings and Loans Associations, Rural Banks, Cooperative Banks, Finance companies	BSP under the provisions of the General Banking Law or other institution-specific laws
	Thrift Banks (including Savings and Mortgage Banks, Private Development Banks, Stock Savings and Loan Associations)	
COOPs (Individual Members / Cooperative Societies)	Credit Cooperatives (registered under the Cooperative Code; including Savings and credit units of multipurpose cooperatives)	Cooperative Development Authority (CDA); outside the regulatory and supervisory jurisdiction of the BSP, as well as of the deposit insurance system.
	Credit Unions	
NPOs (Private Trustee/ Parties/ Charitable Institutions or NGOs)	NGOs (provide both microloans and nonfinancial services)	Law on Trusts and Charitable Institutions under Securities and Exchange commission (SEC)
		Credit activities are not regulated or supervised by external government agencies.

Another irony this brings is that savings deposit is considered a main microfinance financial product (Owens and Wisniwski, 1999 cited in Reinke, 1999), yet technically, microfinance NGOs, recognized to be one of the major microfinance providers, are not allowed by the regulation to legally collect savings deposit beyond the compensating balance[11] from clients (NCC, 2002). And if microfinance NGOs collect savings more than the compensating balance, they "*will be required to transform* into a formal financial institution

[11] Compensating savings balance refers to the savings amount that is equal to the total amount of loan borrowed by the client.

(either a credit cooperative or a bank) to be able to continue collecting savings from their borrower-clients" (NCC, 2002: 8 emphasis added).

Although the regulation specifies that a microfinance NGO can transform into a cooperative or a bank, it is noticeable how the regulation for transformation into a bank is more developed than the transformation into a cooperative. In fact, only transformation into bank has been made possible by a few NGOs and none has transformed into a cooperative yet. BSP has even developed a "tiered regulation" for NGOs to easily transform into banks and for regular commercial banks to offer microfinance services.

In a paper written by an officer of BSP's Microfinance Unit, Roman (2004) cited nine circulars that were issued by BSP to encourage banks to engage in microfinance and enumerated the following modalities:

1. Banks can now engage in microfinance through the creation of a new microfinance-oriented bank.
2. Banks can now establish microfinance branches.
3. Banks now have an option to create a unit or department within their existing offices that will provide microfinancial services.

These modalities refer to the reduced capital requirement for the establishment of microfinance banks, as well the lifting of the moratorium to open bank branches solely for the opening microfinance banks.

On top of this, four major trends in microfinance have been identified by Charitonenko (2003: 11):

1. The increasing downscaling of rural banks to serve the microenterprise market.
2. Initiatives of donors to commercialize cooperatives that are spurring their transformation into banks.
3. Transformation of several microfinance NGOs into microfinance-oriented rural banks or thrift banks.
4. New players such as the new established microenterprise-oriented thrift bank in mid-2001 by a partnership between domestic and international institutional investors headed by the German consulting firm, Internationale Project Consult (IPC).

In short, in encouraging the private sector, the regulation to encourage banks to participate in microfinance seems to be developing most.

The next part of the paper will now be concerned with the root of the tree that is the microfinance regulatory framework that grew a branch requiring NGO transformation *i.e.* leaning towards banks. For the purpose of this study, institutional analysis at this stage will focus on the underlying rule systems and the organizations as agents of institutional change, following the limitations set by Bandaragoda (2000: 5), "a thorough analysis to cover various credit agencies is beyond the scope of this framework, and such a task would involve an analysis of leadership, motivation among organizational members, their knowledge, skills and capacities and their value systems and preferences," he added that “most of these aspects are directly related to management functions, which can be addressed when action plans are considered by various stakeholder groups”.

Chapter 6 Understanding and mapping the institutional and organizational milieu

The chapter starts off with a general discussion on the policy in focus, the Philippine Regulatory Framework for Microfinance, and then proceeds with a backtracking of its history. Sections on institutions and organizations are mainly guided by North's (1990: 4) definition of institutions as being the "rules of the game", organizations as "the players" and entrepreneurs are "agents of change" or the decision maker/s in an organization.

Before proceeding, it is worth note taking that in a football game, there are 17 official laws written in the "Laws of the Game" adhered to by all teams that play football. These are only the formal rules and informal rules actually apply once the actual game is played. Note also that only the breaking of formal rules entails punishment. The teams are the "players"; and these teams are composed of individuals like David Beckham who are identified as the "entrepreneurs".

6.1 Institutions defined

Institutions can be formal or informal, and are a combination of the following: 1) policies and objectives, 2) laws, rules and regulations, 3) organizations, their bylaws and core values, 4) operational plans and procedures, 5) incentive mechanisms, 6) accountability mechanisms, and 7) norms, traditions, practices and customs (Bandaragoda, 2000: 5). Informal practices can also become rules after years of as they become socially accepted. "The key characteristics of institutions are that they are patterns of norms and behaviours which persist because they are valued and useful" (Merrey 1993 cited in Bandaragoda, 2000: 4).

An institution as the rule of the game provides "a structure to the game" and is the "basis as to how the game should be played" (Bandaragoda, 2000: 4). At the same time, an institution is also defined as an "organized, established, procedure" (Jepperson, 1991 cited in Bandaragoda, 2000: 4), and "these procedures are represented as constituent rules of society". From these two definitions alone, confusion may arise in a sense that the latter definition of institution projects stability, while the former provides a dynamic image, hence, the seemingly contradicting tree and game analogies for policy analysis.

However, "the notion that an institution is a social order or pattern that has attained a certain state or property" (Bandaragoda, 2000: 4) makes institution both dynamic and stable, a tree and a sports game in one. Institutions shape and stabilize the actions of human beings yet human actions shape and stabilize institutions themselves. In other words, institutions are neither permanent nor a given, and institutions that shape human behaviour have been shaped by humans (or organizations considered here as "players of the game" to be discussed in a separate section) as well. Such "cyclic phenomenon related to institutions… is an important consideration in analysing institutions for possible change" (ibid: 7).

This chapter attempts to describe the pattern that has attained a certain state or property (stability), while looking at the organizations involved in developing the pattern (dynamism) to look at change and its future possibilities applied to the context of the microfinance regulation in the Philippines.

Financial Sector Reforms

Typical of the Southeast Asian countries in the 1960s and 1970s, wherein the financial sector was deemed excessively regulated and macroeconomic instability was rampant, the Philippines is described to have had an economy under "financial repression" (Kohsaka, 1991). Following the recommendation of the IMF/WorldBank joint mission in the beginning of the 1980s, the government introduced financial reforms that were aimed at strengthening the savings mobilization to financial intermediaries; devise provision of medium- and long-term industrial funds; and enhance the productivity of the financial sector by expanding its scale (ibid).

During the mid-1980s, the robust economic performance of ASEAN-4 countries, composed of Malaysia, Thailand, Indonesia, and the Philippines highlighted the role played by open economies, and supported the link between financial liberalization and economic performance (Huntington 1992, Diamond 1999 cited in Raquiza, 2010).

From the authoritarian rule of the Marcos regime that started in 1965 and ended in 1986 after the EDSA people power revolution, the 1980s and its peaceful people's revolution legacy is also considered to be the start of earnest financial sector reforms in the country (Morales, 2004). It was during this decade and especially during Corazon Aquino's presidential term (1986-1992) that several initiatives were implemented to liberalize the financial sector and promote rural growth (ibid). Specifically, the Philippine banking system was restructured to allow greater competition among different types of banks, interest rate ceilings on both deposits and loans were lifted, and the termination of subsidized agricultural credit programs began (Lamberte, 2006).

Being a significantly agricultural country, the Philippine government has, from the 1970s up to mid-1990s, implemented various subsidized direct credit programs (DCPs) especially focused on agriculture, which were delivered by government non-financial agencies (GNFAs) and government financial agencies (GFIs) (Geron, 2002; Jimenez, 2009). Towards the end of the 1980s, these DCPs that were primarily funded by the national government through budgetary allocation, and/or donor loans and grants, were eventually evaluated as inefficient and ineffective (ibid). Studies and evaluations pointed out the

DCPs' low outreach and costly subsidies, plus their "unsustained replicability" and low or unmet desired impact to the intended users of funds – the poor (Jimenez, 2009). Low outreach and poor financial sustainability of the programs were considered a waste of government resources.

At the same time, a wide range of safety net programs aimed at reducing poverty, including employment creation, food subsidies, livelihood programs, and credit assistance proliferated in the 1970s and 1980s, which the World Bank evaluated to be mostly ineffective and in most cases poorly targeted (Morales, 2004). The implementation of these various poverty programs was also cited to have been hindered by economic, political, and social disturbances; natural disasters; fund release failure or delays; changes in the government's spending priorities; and misappropriation or wasteful use of funds (Mandap 2002; Reyes 2002 cited in Morales, 2004).

When Corazon Aquino came into power in 1986, she issued Executive Order 113 that created the Agricultural Credit Policy Council (ACPC), a milestone in her administration that has been referred to as an enduring legacy of the reform process spurred by the 1986 revolution (Corpuz, Kraft, Guinto and Crisostomo, 2011). The following year, ACPC was attached to the Department of Agriculture (DA) and was mandated to administer the Comprehensive Agricultural Loan Fund (CALF) (ibid). This mandate consequently cancelled the government's commodity-specific lending programs. Instead, the funds were intended to be used as a "loan guarantee fund to encourage private banks to lend to agriculture by offering to cover as much as 85% of their credit risks in providing loans to small agricultural borrowers and enterprises" (ibid). ACPC's overall role in the agricultural reform process focused on rural financing system restructuring by infusing a market-oriented approach in the country's agri-finance system and increased private sector participation.

In other words, towards the end of the 1980s, the Philippine government moved away from delivering DCPs and started implementing market-oriented approach in the country's rural finance system. The government also started guaranteeing loans to encourage private banks to deliver commodity-specific lending, while guaranteeing the loans so that private banks will be encouraged to lend to a particular sector (*e.g.* farmers). Consequently, private banks were intended to replace the role of the government in commodity-specific lending.

In the 1990s, an informal group identified as the Social Pact on Credit (SPC) reportedly had a growing concern over the inefficiencies and inadequacies of DCPs and came up with a resolution suggesting the rationalization of all DCPs in particular, and credit rationalization in general (Morales, 2004). SPC submitted a resolution to President Fidel Ramos who, in turn, responded with the creation of the National Credit Council (NCC) in October 8, 1993 (Geron, 2002). Through Administrative Order No. 86, NCC was since then tasked to coordinate the various credit programs of the government (Morales, 2004).

In 1993, the Medium-Term Philippine Development Plan (MTPDP) was formalized, which became the banner program of the Ramos administration tagged as the "Philippines 2000" (Raquiza, 1997). In 1994, another major agenda was passed as an accompanying program to the MTDP, the Social Reform Agenda (SRA) (ibid). Both programs were aimed at addressing poverty: MTPDP aimed for rapid economic growth that was expected to have a "trickle down benefit" effect, while SRA was deemed to "level up the playing field in favour of the poor majority" (ibid).

Three years after the creation of NCC, during the latter part of 1996, the Philippine government requested for a technical assistance from the United States Agency for International Development (USAID) "to ensure the effective functioning of the NCC" (Lamberte, 2006; Geron, 2002). USAID funded and delivered the technical assistance program called Credit Policy Improvement Program (CPIP) through NCC's secretariat to assist NCC in the rationalization of government-sponsored credit and loan guarantee programs (Geron, 2002).

A few months before the USAID's assistance, in February 6 of 1996, NCC's secretariat was transferred from the LandBank of the Philippines (LBP), a government financial institution, to the Department of Finance (DOF). The move was said to have been a response to a study conducted by the Philippine Institute of Development Studies (PIDS) recommending the transfer of the secretariat functions in view of DOF's mandate to manage government financial resources to support development objectives, and in avoidance of any conflict of interest that may arise from LBP's active involvement in credit delivery (Lamberte, 2006; Geron, 2002).

In 1997, roughly a year after USAID started CPIP in NCC the council released "several critical credit policy reforms" (Quinones, 2007) "that benefited from CPIP's technical assistance to the NCC" (Lamberte, 2006). One of them is the issuance of the National Strategy for Microfinance. This strategy called for (i) an enabling policy environment to facilitate the increased participation of the private sector in microfinance; (ii) a greater role of private MFIs in the provision of financial services; (iii) adoption of market-oriented interest rates on loan and deposits; and (iv) non-participation of government line agencies in the implementation of credit and guarantee programs (Quinones, 2007).

Another major policy measure that was approved that same year of 1997 is the Social Reform and Poverty Alleviation Act or RA 8425, which mandates the expansion of microfinance services and capability building. This Republic Act established the National Anti-Poverty Commission (NAPC) that in turn mandated the commission to monitor the People's Development Trust Fund (PDTF), a fund allocated to microfinance, livelihood and micro-enterprises development programs. This act places microfinance as the central strategy for the government's poverty reduction programs (Gallardo, 2001; Morales 2004:

4). In fact, the overall policy framework for microfinance is said to be "informed by the overall framework strategy for poverty alleviation, safety nets and rural development" (Gallardo, 2001: 15).

These liberalization policies in the country's overall financial reforms have been recognized and continuously pursued by the administrations of Estrada and Macapagal-Arroyo following Aquino and Ramos's lead. On January 20, 2001, the Arroyo administration specifically placed microfinance "at the forefront of the nation's battle against poverty, and a more focused microfinance program was implemented as a tool in alleviating the plight of poor Filipinos".[12] In July 2002, the Microfinance regulatory Framework was issued by NCC, whose pursued policies and strategies are laid out in the National Strategy for Microfinance (NCC: 2002).

Lastly, "when President Benigno S. Aquino III took his oath of office last June 30, 2010, his administration has strengthened the role of microfinance as one of the key elements of the government's framework for poverty reduction and inclusive economic development"[13].

Thus, the financial systems reform and development has been dominated by the development of banks, and the adaptation of microfinance into this financial system, if only taken as a "newbie", inevitably provides NGOs (and cooperatives as well) an unequal playing field.

Direct Credit Programs

During the 1970s and mid-1980s, the Philippine government's approach to credit financing was supply-led "whose hallmarks were mandatory credit allocation, loan targeting, below-market interest rates and credit subsidies to target sectors" (Llanto, 2003: 1). The government provided funding for subsidized credit programs to "small farmers, small fisherfolks and generally small-scale borrowers because of their inability to borrow from banks", these programs were otherwise known as Direct Credit Programs (DCP) (ibid: 1; Llanto, Geron and Tang, n.d.).

It has been argued that DCPs did not address the core issues in areas lacking formal financial services, *i.e.* high risks and transaction costs (Vogel and Llanto, 2005). Thirty-eight agricultural credit programs implemented in the 1970s and early 1980s "did not work because they could not substitute for the failures in agricultural development" (Lamberte and Lim, 1987 cited in Llanto, Geron and Tang, n.d.: 9). The staffs of Government Non-Financial Agencies (GNFAs), who administered DCPs, were lacking in expertise and that their

[12] http://www.pcfc.ph/ [Accessed 14 November 2011]
[13] http://www.pcfc.ph/ [Accessed 14 November 2011]

credit judgments were susceptible to "political interference" (OECF, 1995 cited in ibid: 11).

The participation of GNFAs was considered to create credit market distortions led to the discouragement of banks to expand in rural areas (Llanto, 1993 cited in Llanto, Geron and Tang, n.d.). Instead, it is argued that GNFA managed DCPs are transferred to Government Financial Institutions (GFIs) due to their higher repayment rates; higher repayment rates of GFIs are attributed to the GFIs' criteria for credit approval which is set higher than the individual programs (Lamberte, 1992 cited in Llanto, Geron and Tang, n.d.: 13).

NGOs and COOPs are acknowledged as "alternative channels" for credit programs, in particular, to the "nonbankable" sectors because of their closer relationships to the beneficiaries, facilitating cheaper credit approval screenings (ibid). Although, these alternatives are only promoted with caution as NGOs are argued to have "very high spreads from administering the credit programs," and, "sustainability and governance problems" that would hamper efficiency as micro credit institutions (Llanto et al., 1995 cited in Llanto, Geron and Tang, n.d.: 12).

Quinones (2007) aptly summarizes the common theme of the literature on credit and the directed credit programs of the Philippine government:

> The government's policy of providing subsidized credit to enhance the productivity of certain sectors, such as the small agricultural producers, severely hampered the growth of a microfinance industry in the Philippines. Private financial intermediaries (*e.g.* rural banks, cooperative banks, cooperatives) were used to channel subsidized credit from government programs. According to the National Credit Council (NCC), 111 government directed credit programs, 13 of which were targeted at the poor, existed in 1995. An assessment by Callanta, et al. (1996) showed that these programs were symbolic in nature and had limited outreach. The study found government credit programs to be "costly and unsustainable, leading to gross inefficiencies, financial market distortions and a weakening of private sector incentives to innovate." (ibid)

The lesson learned from the DCPs' inefficiencies thus provides an explanation as to why the regulatory framework encourages the private sector over the public sector to deliver financial services.

Functions of Institutions

The whole narrative of financial reform brings forth adherence to market principles in the delivery of financial services in the Philippines including microfinance. Although the text is mostly dominated by the role of formal institutions, the financial reforms since the 1980s nonetheless presents a milieu of the dominance of market principle adherence that has been extended into the regulatory framework for microfinance. It provides a picture on how microfinance actually caught up with the (pre)existing institutional setting of credit rationalization and financial liberalization reforms at large.

The definitions of institutions provided above emphasizes "humanly devised constraints to shape human action" (Bandaragoda, 2000: 7), while at the same time providing opportunities and guidance to individual and group actions (Bromley, 1987 cited in Bandaragoda, 2000). This duality is important in the delivery of microfinance services. Most microfinance-related rules are meant to constrain the socially undesirable behaviour by individuals and groups in delivering microfinance services. In this case, the undesirable behaviours are subsidized credit and the provision of credit by the government, which experience failure in the past.

Having been placed within this institutional setting implicates the regulation of microfinance in many ways. One implication is shown in the following section, wherein the private sector's interest is placed above the public sector in the delivery of credit programs in the country as constrained by the regulation itself.

6.2 Organizations defined

Douglass North (1999: 3) writes that "if institutions are the rules of the game, organizations are the players". He adds that organizations are "purposive entities designed by their creators to maximize wealth, income, or other objectives defined by the opportunities afforded by the institutional structure of the society" (North, 1990: 73 cited in Bandaragoda, 2000: 5).

In the following section, the organizations involved in the financial reforms that led to the formulation of the National Strategy for Microfinance will be discussed.

Note that in a football game, there are strong teams who dominate leagues, and individuals who become superstars and could actually take control of how the game is played. Still, David Beckham may be a superstar and as captain of the team, he may influence how the game is played (and how he gets massive support from his followers surely matter), but football is still a team sports and as such, the performance of the team would still be reliant on how the whole team plays *i.e.* teamwork. Besides, none of these factors actually change the rules, they just influence how the game is played and won.

The National Credit Council

NCC is an inter-agency policy council composed of government regulators, government financial institutions and other government line agencies as well as representatives from the private sector whose membership includes representatives from concerned government agencies and the private sector (Morales, 2004; Jimenez 2009).

The council is chaired by the Secretary of the Department of Finance with the Land Bank of the Philippines as Co-Chair (Jimenez, 2009). "Under the leadership of the NCC, several policy dialogues and consultations were made that resulted in the crafting of the National Strategy for Microfinance. The NCC was also instrumental, together with Agricultural Credit Policy Council (ACP) in crafting and supporting changes in laws, regulations and policy framework that supported growth of credit in the rural areas. (Jimenez, 2009)

The functions of NCC as enumerated in Lamberte, (2006: 3) are as follows:

1. Rationalize and optimize the use and delivery of the various credit programs of all government institutions.
2. Develop a national credit delivery system.
3. Encourage a higher level of private sector participation, with its extensive network of commercial banks.
4. Define and rationalize the role of guarantee programs and guarantee agencies.

Agricultural Credit and Policy Council

The ACPC is an attached agency with the Department of Agriculture (DA). It is the agency tasked to oversee the country's rural financial system, by adopting a holistic approach towards an efficient, effective and sustainable delivery of rural financial services in the countryside. Executive Order No. 113 signed by President Aquino in 1986 mandates ACPC to provide policy directions on agricultural credit towards a healthy and sustainable rural financial system. (Jimenez, 2009)

The ACPC in support of its mandate assist in credit facilitation so that credit can flow to the countryside. The ACPC is also the lead agency that developed a system whereby government credit resources were used when all directed credit programs were terminated and subsequently replaced by the virtue of Agro-Industry Modernization Credit and Financing Program under the AFMA Law of 1997. (Jimenez, 2009)

ACPC is still an existing government agency composed of the DA Secretary as Chair, BSP Governor as Vice-Chair, DoF Secretary, Department of Budget and Management (DBM) Secretary, National Economic Development Authority (NEDA) Director-General. Its current programs are Cooperative Banks Agri-Lending Program (CBAP), Agri-Microfinance Program for Small Farmers and Fisherfolk and their Households (AFMP-PCFC), Agri-Fishery Microfinance Program (AFMP-Fishery).[14]

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[14] www.acpc.gov.ph

United States Agency for International Development

The Credit Policy Improvement Program or CPIP is the technical assistance program to the NCC funded by the USAID with the following objectives: (a) effective functioning of the NCC; (b) rationalization of the government's policies on credit, savings and loan guarantees; and (c) the creation of an enabling policy environment that will facilitate the increased participation of the private sector, including microfinance institutions (MFIs), in the provision of financial services to all sectors of the economy, including the basic (poor) sectors (Lamberte, 2006).

In summary, USAID, through the Department of Finance – the secretariat, provided technical assistance to the NCC in the rationalization of all government-sponsored credit and loan guarantee programs, at the same time aimed for an increased private sector participation in the provision of financial services in the country.

Interestingly, CPIP's first objective – help in the effective functioning of NCC – whose mandate is to (1) rationalize government credit programs, (2) develop credit systems and strengthen involved institutions, (3) encourage greater private sector participation, and define and rationalize the role of guarantee programs and guarantee agencies – is what could be classified a redundancy of the goals and functions of CPIP in its technical assistance scope to the NCC.

Further, in two USAID-supported reports, the start and end date of CPIP varies, as well as the budget allocated for the program. According to Lamberte (2006), CPIP was initiated in November 1996 and ended in February 2006, with a total expended assistance amounting to more than USD 4 million. In Geron's (2002) paper, however, CPIP started in November 1996 until October 1998 with the initial cost of USD 1.788 million, and extended until April 31, 2003 with the amount of assistance adding up to more than USD 3 million, supposedly due to the "evident importance and effectiveness of the policy reforms being pursued by NCC" plus a number of additional work identified.

Meanwhile, USAID Philippines posted a notice in 5 February 2002[15]: "USAID/Philippines will modify contract no. 492-C-00-97-00004-00 with International Management Consulting Corp. (IMCC) with business address at 2201 Wilson Blvd., Suite 900, Arlington, VA 22201 to extend the work in providing assistance and support required by the National Credit Council (NCC) to carry out its mandates in order to bring about a much greater flow of microfinance services to the poorer people in the Philippines."

15
https://www.fbo.gov/index?s=opportunity&mode=form&id=c628619d7a8bd10825 10df8124f2c4a6&tab=core&_cview=0 [Accessed 16 November 2011]

Besides the inconsistencies in CPIP's project dates and budget, it appears that the USAID-CPIP contract has been turned over to a private consulting firm based in the United States in 2002, and continued to operate under this firm's assistance until its conclusion in 2006 without being mentioned in both papers.

Further, Geron's (2002) CPIP's information coincides with the information written in a report called "Credit Policy Improvement Program (Completion Report November 1996 to February 28, 2006)" submitted by Development Alternatives, Inc. (DAI, 2006) listed as contractor and IMCC as subcontractor. The report states the same results as in Geron (ibid):

Initial total cost of the project was estimated at US$ 1.788 million for the period November, 1996 to October, 1998. As the importance and effectiveness of the policy reforms being pursued by the NCC became more evident and with a number of additional work identified, CPIP has been successively extended to April 31, 2003 with the total amount of assistance increased to a little more than $3 million, adding that CPIP has been successively extended to February 2006, with the total amount of assistance increased to more than $4 million – this time coinciding with the information available in the other paper written by Lamberte (2006).

This completion paper contains a comprehensive regulatory policy assessment, recommendations, standards, and memorandum of agreements initiated and achieved through CPIP's technical assistance, which has been approved by then President Gloria Macapagal-Arroyo, the Philippine Senate, and the House of the Representatives in November 13, 2002.

The CPIP project cost is detailed in Annex B based on this completion report. A rather mild inconsistency is that the report initially stated that the project started in November 6, 1996 with the initial budget of $1.78 million, and proceeded to state in the summary that the project duration was from December 1996 to February 2006. The actual computed project cost based on the chronology of events and the changes made to the contract is $4,327,530.00[16].

However, during the 7th phase of the project which ran from June 20, 2003 to October 19, 2004 with an additional budget of $987,530.00, CPIP was then mentioned to have been implemented under a new contract arrangement under Accelerated Microfinance Advancement Project (AMAP), of which IMCC is a sub-contractor to Development Alternatives Inc. (DAI). Whereas, the change of contract awarding the continuation of the technical assistance to

[16] See Appendix B for computation.

CPIP by IMCC as posted on the USAID Philippines website was dated February 5, 2002.

Meanwhile, in "September 2003, USAID awarded one of the Financial Services Knowledge Generation (FSKG) task order contracts under the Accelerated Microfinance Advancement Project (AMAP) Microfinance IQC (Indefinite Quantity Contract) to Development Alternatives, Inc. (DAI)" (DAI, 2006). With this 5-year task order, USAID and DAI "generated knowledge products designed to help move the microfinance field forward in its efforts to extend efficient, sustainable and quality financial services to the poor, this "new knowledge" is "expected to increase the capacity of EGAT/MD (Economic Growth, Agriculture and Trade/Microenterprise Development) and its partner USAID missions to design and strengthen the implementation, monitoring, and evaluation of USAID-supported microfinance projects". (ibid)

The key project results of CPIP as identified in its evaluation are as follows: publication of policy studies, government adoption of key credit policy reforms, rationalization of government DCPs, establishment of support information structure, establishment of an appropriate regulatory environment for microfinance, which includes establishment of the performance standards for all MFIs, and establishment of the appropriate legal environment for the effective functioning of a credit information system in the Philippines, and establishment of an appropriate and effective regulatory environment for cooperatives with Savings and credit services (ibid).

The Philippine government through NCC adopted the following critical credit policy reforms, with the technical assistance from CPIP: (Quinones, 2007)

1. **National Strategy for Microfinance, 1997, which provided for:**
   - (i) Enabling policy environment to facilitate the increased participation of the private sector in microfinance;
   - (ii) Greater role of private MFIs in the provision of financial services;
   - (iii) Adoption of market-oriented interest rates on loan and deposits; and
   - (iv) Non-participation of government line agencies in the implementation of credit and guarantee programs;
2. **The Social Reform and Poverty Alleviation (SRPA) Act, 1997**
   - Rationalized government directed credit and guarantee programs, gave emphasis to savings mobilization, and provided capacity-building assistance to MFIs;
3. **The Agricultural Fisheries Modernization Act (AFMA), 1997**
   - Consolidated government directed programs in the agriculture sector and specified the role of GFIs as wholesaler of funds;
4. **The Barangay Microenterprise Business (BMB) Act, 1997**
   - Directed GFIs to set up a special wholesale credit window for

accredited MFIs;

5. **Executive Order (EO) 138, 1999,**
   - Transferred the credit programs of government line agencies to GFIs; and required GFIs to provide wholesale credit funds to avoid competition with MFIs; and
6. **The General Banking (GB) Act with specific provisions on microfinance, 2000,**
   - Recognized the peculiar characteristics of microfinance (*e.g.* non-collateralized lending) and the use of the household's cash flow as basis in the design of microfinance products.
   - 40% foreign ownership allowed in banks

The CPIP is said to have "substantially achieved its objectives in providing technical assistance to the NCC," and "more specifically, the credit policy environment has changed significantly, with the institution of a general credit policy framework that serves as an anchor for reforming various segments of the financial sector; the withdrawal of DCPs albeit still incomplete; the discernible shift toward greater reliance on market-based principles and toward a supervisory and regulatory regime that can promote the development of viable and sustainable financial institutions; and the increased private sector participation either directly, as in the case of microfinance-oriented banks, or indirectly, as in the case of large banks engaged in microfinance wholesaling, in the provision of financial services especially to the basic sector" (Lamberte, 2006).

Further, "great change in the mindset and attitude of the public, in general, and concerned stakeholders both in government and private sectors, in particular, toward the government's role in ensuring access to financial services for the basic sector" of CPIP" has been underscored (ibid). "All these changes have been influenced to a significant degree by the NCC, which has become an effective policy-making agency on credit" (ibid).

The reports on CPIP, with special mention to those supported by the USAID, seems content and pleased about the scope of CPIP influence, and the extent of success the program's initiative have accomplished. Considering the holistic credit policy measures adopted by the Philippine government, CPIP's scope of assistance apparently encompasses numerous government agencies and not just limited to NCC and the Department of Finance, its secretariat. Appendix A provides a comprehensive summary and description of these policies.

In summary, the CPIP was able to create a microfinance regulatory framework that adheres to market-based principles in regulating, evaluating and operating microfinance in the Philippines. It has ordered the rationalization of DCPs, and transfer of GNFA-facilitated DCPs to GFIs, and specifically tasked GFIs to provide wholesale funds to MFIs.

In fact, what has been pointed out as a major accomplishment of CPIP by the consultants that helped NCC formulate and implement the credit plan is the market-oriented policy reform measures adopted by the government in the financial services delivery in the country (DAI 2006: 22).

The Social Pact on Credit

The formation of the National Credit Council that has since then became responsible for the rationalization of DCPs in the country is traced to a group identified as the Social Pact on Credit (SPC). The story behind the formation and existence of the group has been very limited to the resolution it submitted to President Ramos that led to the formation of the NCC in 1993.

However, varying and sometimes contradicting descriptions of the group and a general ambiguity on how it was formed are apparent in some of the available literature, especially exemplified by three papers supported by the USAID. First, in a paper written by Geron (2002) entitled *Market-Based Credit Policies for Increased Access to Rural Finance*, the Social Pact on Credit is described as "an informal group that initiated discussions on the inefficiency and ineffectiveness of government DCPs".

The group is said to have been composed of representatives from NGOs and POs, the academe, concerned government agencies and government financial institutions. (ibid) In another paper authored by Morales (2004) entitled *Microfinance and Financial Institutions in Bukidnon*, the Social Pact on Credit is said to have drawn together a multisector group of banks, government institutions, cooperatives, and farmer groups that has "not only acknowledged the weakness of the existing financial system in meeting the credit needs of poverty groups but also promoted interest for banks to explore alternative means of delivering credit to the poor".

Meanwhile, in a paper written by Lamberte (2006) released by CPIP-NCC itself entitled "An Evaluation of the Credit Policy Improvement Program (CPIP)", the Social Pact on Credit is said to have been formed in October 8, 1993 by the Philippine government together with NGOs and POs, as a response to the inability of low-income people to access formal credit. Then the Pact became a part of the Social Reform Agenda, said to be a move towards a "broad attempt to address the problem of poverty in the country" (ibid). Moreover, this CPIP-NCC report stating that the Social Pact on Credit was created in October 8, 1993 would be inconsistent with the chronology of events that led to the creation of NCC, contradicting its own statement that NCC was an outcome of SPC's initiative.

Nonetheless, what is common among the descriptions is that the formation of the group identified as Social Pact on Credit led to the creation of NCC, after it submitted a resolution to President Ramos pushing for the rationalization DCPs. The Pact's concern over DCPs' low outreach was also commonly cited as the driving force behind the group's campaign, and how the president readily responded to its recommendation by creating the National Credit Council in October 8, 1993.

Role of Organization in Effecting Change

According to North (1999: 2), "the degree to which there is an identity between the objectives of the institutional constraints and the choices individuals make in the institutional setting depends on the effectiveness of enforcement". "Enforcement is carried out by the first party (self-imposed codes of conduct), by the second party (retaliation), and/or by a third party (societal sanctions or coercive enforcement by the state) (North, 1999: 2).

In the case of the Philippine Regulatory Framework for Microfinance, there is a general "smoothness" of enforcement which makes the identity between the institutional constraints and the choices made almost unified. There has not been a major conflict identified and striking differentiation in the texts among enforcing parties. Instead, there is an apparent common interest of adherence to market principles in the overall financial reform landscape.

"While the coexistence of formal and informal institutions is inevitable, situations where some informal rules tend to contradict formal rules are obviously dysfunctional," (Bandaragoda, 2000: 4) however, in the case of the microfinance regulation, and financial reforms in the Philippines at large, there is a seemingly dysfunctional harmony in the coexistence of formal and informal institutions as at least told in the documents. Moreover, there is not much discussion on the informal institutions, considering that microfinance has been classified as an informal form of financial services delivery prior to its integration into the formal financial system.

For instance, the informal group Social Pact of Credit pushed for what ACPC, a government agency, was already pushing for, which is credit rationalization. How SPC had such influence and power was not discussed in the texts, yet the group was powerful enough to be able to primarily influence the formulation of a council that was made responsible for the entire credit rationalization program in the country.

Did SPC lobby the policy? Was it as simple as submitting the resolution to the President of the Philippines as presented in the texts? Crucially, did the members of SPC become members of the National Credit Council itself? First, considering the date that the SPC had been formed, and the date where the resolution was passed, it seems like there was a simple, linear process involved. Second, the literature does not present any opposition party, no conflict, and no issues against the group itself and/or the policy they forwarded. Third, the literature does not specifically identify the individual members of neither SPC nor NCC, yet the similarity in the composition of SPC and NCC is palpable.

Aside from the current similarity (to the point of redundancy) of the functions and programs of ACPC and NCC, interestingly, ACPC has been supposedly implementing credit rationalization in the 1980s, yet SPC was still able to put forward a very similar agenda that has resulted into a new yet very similar government credit council (in the form of NCC) in the 1990s. Note that ACPC was formed during Aquino's administration, while was formulated during Ramos' term, and again, the similarity in the composition of SPC and NCC.

Although institutions have been previously described to have a stabilizing effect, it does not mean that they themselves are not subject to change. "As society and its priorities change, institutions (conventions, codes of conduct, norms of behaviour, laws, and contracts) seem to evolve and continually alter the choices available to the individual" (Bandaragoda, 2000: 7).

Such is the case in microfinance. It is a separate institution that is changing the formal financial institutions as it is integrated into it, and vice-versa. Yet organizations that dominate the change process matter and in the case of credit rationalization and development of the regulation for microfinance, the process is not apparently dominated by microfinance NGOs or cooperatives.

The link of this past to the present is discussed in the following chapter.

Chapter 7 Analysis of the Microfinance Nexus: The Driving Principles behind the Philippine Microfinance Regulatory Framework

Commercialization of microfinance is defined as the adoption of market-based principles in MFIs' microfinance activities, regardless of whether they are under prudential or non-prudential regulation (Charitonenko, 2003; Poyo and Young, 1999; Christen, 2000 cited in Charitonenko, Campion, and Fernando, 2003). This commercialization involves several factors, such as the: (1) Degree to which policy environment and the legal and regulatory framework are conducive to the development and growth of commercialized MFIs; (2) Availability and access of commercialized MFIs to commercial sources of funds, and; (3) Existence of institutions that support the industry (Ibid).

Here, the regulatory framework and microfinance commercialization coincides in that both drive for a microfinance that adheres to market principles. Put differently, the regulatory framework is driven by the principles of microfinance commercialization, and microfinance commercialization is complemented by the regulatory framework that adheres to market principles.

One critic of microfinance writes that the stated aim of microfinance commercialization is "to ensure large-scale outreach without the need for subsidization" (Bateman, 2010). He added that "introducing market rates would mean cutting subsidies, and having the ability to mobilize savings through higher deposit interest rates. According to him, cutting subsidies that entail increased fixed costs ensures a "push for outreach increase to spread fixed costs across a larger number of microloans as possible" (ibid: 14). Here, he aptly summarizes how microfinance practitioners typically describe financial sustainability and the process in which it can be achieved.

In microfinance, grants and subsidies allow MFIs to cover costs that may result in relatively lower credit interest rates charged to clients. In commercializing MFI, these subsidies have to be removed and market-based interest rates are charged instead. If an MFI takes out subsidies, the operations has to be profitable enough to cover costs and be financially sustainable. Hence, financial sustainability is used interchangeably with the term profitability in microfinance. In this context of commercialization, microfinance operates just like any other private enterprise *i.e.* it needs to be sustainably profitable to ensure continuous business operations.

The idea of financial sustainability merges with the principles of commercialization and microfinance regulation in their drive for one thing: adherence to market principles *i.e.* adoption of market-based interest rates in the delivery of microfinance services that will encourage greater private sector, forming the nexus of microfinance.

Further, the regulatory framework recognizes microfinance as an important tool to alleviate poverty and states that "the continued viability and sustainability of MFIs is important for microfinance to effectively contribute to the poverty alleviation objective" (NCC, 2002: 1). The vision of the Philippine government for microfinance is "to have a viable and sustainable (micro)financial market," to make it "the cornerstone for poverty alleviation" (NCC, 2002: 2), while microfinance commercialization is a "relatively accepted prerequisite" to sustainable outreach expansion that will at the same time respond to the financial demands of the poor in the Philippines (Charitonenko, 2003).

Binding the nexus of microfinance is this conceptualized role of microfinance in poverty alleviation built on the premise that the provision of microfinance in itself is already a fulfillment of its goal to alleviate poverty. *This is the general "rule of the game".*

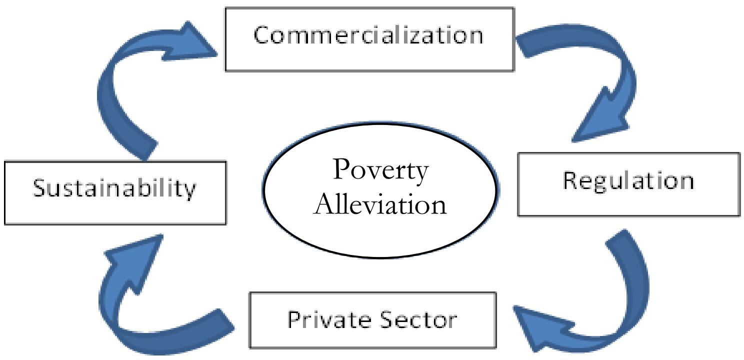

Figure 2. The Microfinance Nexus / Rule of the game

The principles of microfinance commercialization fit perfectly well into the principles of credit rationalization. In this case, a seemingly seamless "inclusion" of microfinance into the formal, regulated finance appears. In other words, credit rationalization in the 1980s have pursued market-based interest rates in the delivery of DCPs, eventually abolished government directed credit programs to encourage private banks to deliver sector-specific credit programs instead, which is the same as what is being pursued by the principles of microfinance commercialization in the current regulatory framework for microfinance today.

The Philippine National Regulatory Framework for Microfinance is the formal rule that constrains microfinance actors and their interactions. The constraint imposed is adherence to market principles, while an opportunity for the private sector to participate in microfinance is presented by the policy.

Although NCC has been the principal driver of financial reform specific to microfinance, BSP has been actively participating in drafting and recommending reforms and the central bank will "continue to promote a market-driven approach to microfinance by facilitating the engagement of banks in microfinance, supporting capacity building for MFIs, and collaborating in the establishment of performance and reporting standards" (Llanto, 2000: 247).

With the onset of commercialization, banks are becoming more and more involved in microfinance because they see the potential profitable market niche in microfinance as MFIs take a for-profit orientation (Roman, 2004).

In this context of microfinance commercialization, the heterogeneity of the microfinance actors in the private sector is being dealt with an increasingly homogenous regulation that is more and more fitted for banks to participate in microfinance.

Chapter 8 Alternatives

8.1 Policy alternatives to commercialization

It is not surprising if the Philippine microfinance regulation institutional setting is dominated by veteran players of this existing institutional setting of formal finance, *i.e.* the banks. Nonetheless, if indeed the purpose of the regulation is to serve the interest of the banks as demonstrated by the study, then it is up to the other policy actors to pursue their own interest (*i.e.* microfinance NGOs and COOPs) and push for alternative regulatory frameworks. It is a challenge for everyone to come up with a more innovative regulatory framework for microfinance.

It is noteworthy that the development of banks does not necessarily result in growth and/or development. "As the experience with the Asian financial crisis showed, the fast growth of the banking sector in recent years does not necessarily mean that the financial system is healthy and sound. Financial liberalization encouraged more banking activities and the establishment of more banks, but the quality of banking institutions and their supervision did not keep pace with the growth in number" (Llanto, 2000: 251). Even though alternatives entail a lot of cost (but so is the pursued current set-up costly to microfinance NGOs alone), the poor performance of the banking sector makes it worth considering.

Especially because serious doubts have been raised in microfinance, there are other alternative forms of regulation that can be considered by NCC and the rest of the government's policymaking bodies. Below follow three policy alternatives, or "tree branches", that could be considered, aside from the transformation of NGOs into banks, to achieve a significant scale of outreach for microfinance operations (Hishigsuren, 2006).

1. Geographical coverage expansion and diversification of services and/or products offered, which could lead to an increasing number of clients and/or members served. It will require an increase in human, physical and financial resources.
2. Advocacy and partnership with other organizations working for the same cause. "This strategy does not require an organization to increase its human, financial and physical resources, as it will be leveraging the resources already available in other organizations" (ibid).
3. "Restructuring of microfinance operations, such as through merger & acquisition, franchising, linkage with or downscaling of mainstream financial institutions or transformation from NGO to regulated financial institution" (ibid).

The transformation of microfinance NGOs into regulated financial institutions (RFI) is considered to be one of the most appealing and effective strategies for financial sustainability, but should not be viewed as the only approach there is (Hishigsuren, 2006: 4).

8.2 If not transformation, what are the available alternatives for regulating microfinance?

Although the transformation of NGOs has been prompted by Muhammad Yunus himself, the originator of the Grameen Model has this to say regarding NGO transformation (Yunus, 2003 cited in Akash, Ahmed and Bidisha, 2010: 45):

> The paradox of the situation is that many of these NGOs operate within areas where there is plenty of money all around them. They can easily get to it only if they are allowed to. Not only are they not allowed to take public deposits, in many countries they are not allowed to take savings of their own borrowers. A legal framework to create enabling environment for the NGOs to convert themselves into micro-credit banks will change the whole scenario.

According to Akash, Ahmed, and Bidisha (2010), the transformation of NGOs is plausible because "by becoming a bank the NGO will be able to not only solve their fund problem; they will also be coming under a new definite banking regulation act", and eventually serve the *missing middle* as the borrowers graduate into individual lenders with increasing loan amounts. "This process of redirecting part of the microcredit fund to the *missing middle* has already been started in an indirect manner by the relatively more successful NGO-MFIs, but the two questions that arise are: (ibid: 45-46)

1. What is the guarantee that in becoming a bank, microfinance NGOs will not behave like other commercial profit maximizing banks and give up their social goals?
2. Who will own these transformed NGOs? Do they operate under the old legal framework of an NGO "where the board of directors is the virtual owners of their organization"?

On the basis of the review of the experiences of Grameen Bank experience, the research team of the Bureau of Economic Research in Dhaka University suggests "that if the poor borrowers can become the shareholders of the newly transformed bank then the social nature of the bank could be easily maintained" (ibid: 46). "If development goals are set locally or nationally, then the issue of ownership is critical (Gaboury and Quirion, 2006: 7 cited in Mersland, 2007)

After all, "historically, pro-poor banking has been dominated by COOPs and NPOs" ever since the 17^{th} century, and "[s]till the cooperatives and the savings banks continue to flourish in several highly competitive markets"

(Mersland, 2007: 4-5). Mersland mentions as well "that many cooperatives organizations are highly effective and succeed very adroitly in linking their economic mission to a social one". Given this, it is indeed time to devote greater analysis to cooperatives and microfinance NGOS to be able to determine their success factors within a regulatory framework that suits their nature better, that is, these microfinance actors "must no longer be lumped into one basket marked low quality" (Mersland, 2007).

Chapter 9 Conclusion

This study set out to ask what drives the Philippine Regulatory Framework for Microfinance, following in the footsteps of Mersland's (2007) questioning of why the transformation of NGOs into banks is needed today when it was not needed before; this, in turn, as there has been little evidence to prove the efficiency of banks over cooperatives or NGOs.

The study took as its view of institutions and organizations the institutional change framework of North (1990), conceptualizing institutions as being the "rules of the game", organizations as "the players" and entrepreneurs as "agents of change" or the decision maker/s in an organization.

The commercialization of microfinance that drives the current Microfinance Regulatory Framework reinforces the pro-bank institutional setting of credit rationalization within the financial liberalization reforms that go as far back to the 1980's. As microfinance gets integrated with the regulatory framework, it also adapts to the pro-bank set-up, encouraging greater bank participation, instead of the generally stated greater private sector participation in the regulatory framework.

Microfinance, by informally "playing by the rules" to some degree in the delivery of credit/financial services (*i.e.* lending to the poor not previously done by banks due to collateral issues), has shown competence enough to have been invited to play in the formal, "big", league. As such, it must adapt and follow the formal rules of formal lending. In return, this puts microfinance in the realm of formal financial institutions, legitimizing microfinance operations as well as MFIs. Playing in the big league will attract more capital (which could translate into more and/or faster growth), however, this also entails transaction costs for microfinance NGOs since they would have to learn the new rules through training and adhere to capital requirements among others, in its transformation.

Although liberalization of the Philippine financial system resulted in its fast growth, the financial sector grew from 3 per cent of GDP in 1986 to 5 per cent of GDP by 1998, and overall decline in poverty through most of the 1990s, nearly half the rural population remains poor (Llanto, 2002: 250-251). The policymaking process has from beginning to end been dominated by an external organization, USAID, which suggests that the policy formulation has been closely aligned to the interests of USAID rather than following a deeper understanding of what works in the Philippines.

This study suggests, on the basis the review of the experiences of Grameen Bank discussed in the paper "The NGO-MFI in Bangladesh: The Issue of Ownership and Governance" that if the borrowers are the shareholders of the newly transformed bank "then the social nature of the bank could be easily maintained" (Akash, Ahmed, and Bidisha, 2010: 46).

As microfinance is continuously integrated into the formal financial system, the "burden of proof" lays in the NGOs and cooperatives to "prove itself worthy" of the integration when it is the banks that have shown little improvement in its performance and growth in the past years. As evident in the financial performance of the Philippines amidst financial liberalization and reforms since the 1980s, the country's economy has remained stagnant.

From the 1980's up until now, the same goal of credit rationalization is being pursued by government policies. It gives an impression that there is less to the Philippine microfinance regulation than what meets the eye. It is the same old story of financial liberalization rhetoric that is newly packaged in microfinance commercialization, a case of a prescriptive, linear policy process that misses the point of a complex, exciting catch-up regulation for microfinance. The entire narrative of the regulation is a constant justification of the reforms being undertaken, as if rationalizing a complicated process and presenting it as linear and rational.

The paper wishes to end on this simple note: there are alternatives to regulation. A long road is still ahead of microfinance, the journey is not even halfway through the end. Microfinance didn't start in the bank, why should it only have to lead to the bank?

Chapter 10 Epilogue:

10.1 Microfinance as a Development Tool

The concept of microfinance has gone through major changes through time, especially in its recent years of widespread promotion as an international economic development approach aimed at benefiting the poor. In this current positioning, microfinance is a development tool differentiated by its dual mission of profitability and social impact.

The year 2005 was declared the International Year of Microcredit by the United Nations "as part of an effort to build support for making financial services more accessible to poor and low-income people" and was designated within the context of the UN Decade for the Eradication of Poverty in 1998. (UNDCDF, n.d.) Among the development strategies, microfinance "is supposed to help attain - more or less directly - several of the MDGs adopted by UN in 2000" (Balkenhol, 2007). Other development agendas that consider microfinance as an alternative to achieve Millennium Development Goals by 2015 are the G8 Declarations of 2005; the UN 2005 World Summit, the Commission on Private Sector Development, the Brussels Programme of Action; and the Africa Commission Report (Alemu, 2008).

On the far left, there is a growing drive of aligning microfinance with the neoliberal agenda, as one author writes, "microfinance is a prime example of neoliberal poverty-alleviation strategies" and identified WorldBank and the United Nations as the link between microfinance and neoliberalism (Townsend, et al. cited in Esmail, 2008: 12). Another writer points out how "neoliberalism and globalization operate at the grassroots through the micro-credit policies of NGOs" (Karim, 2008). While some consider microfinance as a "prime example of how Washington takes small ideas from the global south and promotes them as neoliberal big ideas"[17] (Townsend, et al., 2004: 847 cited in Esmail, 2008: 12).

Microfinance's "redistributive and direct approach to poverty" is said to be appealing to the left while "independent, self-sustaining penny capitalism" that it represents appeals to the political right wing (Mosley and Hulme, 1998). As a result, microfinance has critics and allies coming from all directions of the political, economic and development arena, with an entirely different chapter on the sociological aspect (*i.e.* social capital vis-à-vis group lending methodology) of its story. At best, the approach of small-lending is hailed simple yet extraordinarily effective in poverty alleviation. At worse, it is

[17] For a more detailed discussion see Roy (2010).

considered a sector beset with moral contradictions over its pretense of helping the poor people yet making money out of them.

The role of microfinance in alleviating poverty is controversial. Its role in poverty alleviation is contrastingly perceived, either hailed or hated, and always doubted by members coming from left, right, top, and bottom groups.

Microfinance is promoted as a poverty alleviation tool within the realms of economic development while moving towards being a profitable industry, a taboo in aid-driven, charity-laden, subsidy-fed development world. On one hand, this same development world has long been thinking twice about the effectiveness of continuous foreign grants with attached (hidden) conditionality and issues of dependency, while on the other, it finds profitability as key to sustainability questionable and even to some extent unacceptable.

Nonetheless, in the Philippine Regulatory Framework for Microfinance and the related literature on Philippine microfinance regulation, issues raised against microfinance are absent. The assumption is that the role of microfinance in poverty alleviation is always linked to financial sustainability *i.e.* the dual mission of microfinance. In this duality, it is understood that the more financially sustainable an MFI, the more poor people will be able to avail of the financial services, thus, by default, the availment of microfinance financial services is already considered a poverty impact.

Thus, the goal of the regulation is to promote financial sustainability and expansion through commercialization. Microfinance has been mentioned in several poverty alleviation acts of the government, yet the regulation/policy on microfinance itself only provides for adherence to market principles and greater private sector participation as the direction of microfinance.

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Appendices

Appendix A: Summary of the major policy measures adopted by the Philippine government that is recognized to have been from CPIP's technical assistance to the NCC: (Lamberte, 2006)

Policy Measures	Key Provisions
National Strategy for Microfinance (1997)	1. Market orientation of interest rates. 2. Rationalization of subsidized directed credit programs 3. Government to only provide the enabling policy and regulatory environment for the effective delivery of microfinance services by the private sector 4. Donors primarily as providers of technical assistance, e.g., capacity building 5. Recognition of savings mobilization as an integral part of successful microfinance programs
Enactment of the Social Reform and Poverty Alleviation Act in December 11,1997	1. Defining capacity-building to exclude any and all forms of seed funding, equity infusion, and partnership funds from government to microfinance institutions 2. Deletion of equity funding from the list of specific uses of the People's Development Trust Fund (PDTF), a trust fund created under the law which is aimed at funding capability building activities for MFIs 3. Rationalization of directed credit and guarantee programs 4. Emphasis on savings mobilization
Enactment of the Agricultural Fisheries Modernization Act (AFMA) in December 22, 1997	1. Phase-out of directed credit programs in the agriculture sector over a four year period (i.e. ending February 2002) 2. Rationalization of loan guarantee programs 3. Adoption of market-based interest rates 4. Non-provision of credit subsidies 5. Review of mandates and performance of government agencies and government financial institutions in light of the rationalization of directed credit programs
Issuance of EO 138 (August 10, 1999) that directs government agencies implementing credit programs to adopt the NCC Credit Policy Guidelines.	1. Non-participation of government non-financial agencies in the implementation of credit programs 2. Government financial institutions to be the main vehicle in the implementation of government credit programs 3. Adoption of market-based financial and credit policies

	4. Increased participation of the
Approval of the design of the Agricultural Modernization Credit and Financing Program (AMCFP).	1. No further implementation of directed credit programs by government non-financial agencies by end 2002 2. Limit lending decisions only to banks, viable cooperatives and microfinance NGOs 3. Adoption of market-determined lending rates to enable conduits to cover their costs and achieve sustainability in the long run 4. Focus of the Department of Agriculture on the monitoring and evaluation of the AMCFP, provision of infrastructure, institution building, research and extension and the provision of an appropriate policy environment conducive for increased private sector participation.
Enactment of the General Banking Law (GBL) in May 23, 2000, which includes provisions mandating the Bangko Sentral ng Pilipinas (BSP) to recognize the unique nature of microfinance as it formulates banking policies and regulations	1. Lifting of the moratorium on branching, specifically by microfinance banks 2. Issuance of BSP Circular 272 in January 30, 2001 implementing the microfinance provisions of the GBA 3. Review of the supervision and examination process to consider the special nature of microfinance i.e. non-collateralized loan
Enactment of the Barangay Microenterprise Business Act.	1. Adoption of market-based credit policies in the provision of financial services to barangay or village-based microentreprises. 2. Setting up of a special credit window, within a GFI, that will provide credit to barangay microenterprise business at market based interest rates.

Appendix B: CPIP Project Cost

Project Phase	Date/Duration	Amount	Reason
1	November 6, 1996 to October 31, 1998	$1.78 million	N/A
2	Extended to August 2000;		Due to the depreciation of the peso and the need for continued technical assistance in pursuing market-based credit policy reforms.
3	Contract modification made in	$1 millions	In the course of project implementation, the project implementing agency and its partner

	September 2000 extending the project to May 31, 2001		agencies recognized the need to have a permanent body, the NCC that will monitor, coordinate and sustain the credit policy reforms initiated through the technical assistance provided by CPIP. In coordination with the private sector, this body will work on the identification and development of viable alternatives to Directed Credit Programs (DCPs) and continue advocacy work to prevent policy reversals. **The extension period was to help institutionalize the NCC into a permanent body in the Department of Finance (DOF).**
	Sub Total	$2.78 million	
4	June 1, 2001, to February 28, 2002	No-cost extension	In line with the implementation of credit policy reforms (i.e., the rationalization of DCPs in particular), NCC with assistance from CPIP identified viable alternatives to DCPs. Strengthening credit cooperatives through appropriate and effective regulation is recognized as one of the measures that should be undertaken by the government. **Extension was made to ensure that the appropriate policy and regulatory environment for credit cooperatives would be established.**
5	March 2002 to January 2003	$250,000.00	Upon request of the Philippine government:

6	February to May 15, 2003	$60,000.00	The extension focused on the provision of the necessary advocacy and technical support to the NCC as it worked towards the development of relevant policy and regulatory structures for the effective participation of the private sector in the provision of microfinance services. **Extension was to ensure continuing support for the policy reforms already instituted and to continue work on the issues arising from the implementation of the policy measures adopted, the government again requested for an extension of the technical assistance to the NCC.**
7	**June 20, 2003, to October 19, 2004.**	**$987,530.00**	This phase of CPIP focused on the provision of necessary advocacy and technical support to the NCC as it works toward the development of the relevant policy and regulatory structures for effective participation of the private sector in the provision of microfinance services. ***This phase of CPIP was implemented under a new contract arrangement wherein, under AMAP, IMCC is a sub-contractor to Development Alternatives Inc. (DAI)**
8	October 2004 to February 2006	$250,000.00	Realizing the need for continuing assistance in these areas (development of the relevant policy and regulatory structures for effective participation of the private sector in the provision of microfinance services), CPIP was again extended .
	December 1996 to February 2006	$4,327,530.00	Total project resources