Amando M Tetangco, Jr: Overcoming obstacles to agricultural microfinance

Remarks by Mr Amando M Tetangco, Jr, Governor of the Central Bank of the Philippines (Bangko Sentral ng Pilipinas), at the Regional Experts' Consultation Meeting "Overcoming Obstacles to Agricultural Microfinance in Southeast Asia", Manila, 1 March 2007.

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President Corazon Aquino, Dr. Balisacan, distinguished resource persons, special guests, and participants to the Regional Experts' Consultation Meeting on "Overcoming Obstacles to Agricultural Microfinance in Southeast Asia." Good morning.

It is a distinct honor to be part of this Consultation Meeting to discuss and identify strategies to accelerate the development of agricultural microfinance in our part of the world. In a region like ours where the agriculture sector continues to have a significant impact on our economy and the lives of our people, this Consultation Meeting is indeed most welcome, and necessary. In the Philippines, the agriculture sector accounts for 20% of our Gross Domestic Product, employs around 40 percent of our country's labor force, and provides most of the food requirements of our total population of 86 million. Given its importance, policies and programs continue to be crafted and implemented to support and transform our agriculture sector into a modern, productive, efficient, and competitive sector.

In 1975 for instance, Presidential Decree 717 was issued to ensure the flow of credit to the agriculture sector. In particular, it mandated banks to set aside 25% of their loanable funds for agricultural agrarian reform credit. For a number of years, bank compliance to this law exceeded 25% of their loan portfolio.

This changed with the implementation of the Agrarian Reform Program, as the profile of farm land ownership shifted from vast tracts of land held by a few owners, to many small landholdings owned by numerous farmers. Thus, while the number of credit transactions increased with more farm owners, the size of the loans was significantly smaller. For small farm owners, as well as landless agricultural workers, microfinance is the key to acquiring much-needed working capital. In the Philippines, microfinance services are provided mainly by banks, NGOs and cooperatives.

The national framework for regulation, which encompasses all types of microfinance institutions, focuses on portfolio quality, outreach, efficient and sustainable operations, and transparent information. The basic premise of the framework is that all deposit-taking institutions, particularly banks and cooperatives, are subject to prudential regulation, while microfinance NGOs which collect savings greater than the compensating balance should be subject to regulation and supervision.

Circular 272 issued January 2001 by the Bangko Sentral ng Pilipinas provided the enabling policy and regulatory framework for microfinance in the banking sector. Parallel to this, Bangko Sentral mounted capacity building programs and sustained information campaigns.

Microfinance has flourished since then. Today, 223 banks are involved in microfinance with a combined loan portfolio of about P4 billion lent out to over 660,000 borrowers. Nevertheless, there is still much more that we can do. It is fitting therefore that we are addressing the obstacles to gaining access to agricultural credit through microfinance, a methodology and technology that has been proven successful. It is important to remember that the success of microfinance is anchored on the following fundamental principles: First, microfinance is typically linked to households and their microenterprises. The household is seen as one with diverse activities and multiple streams of income and expenditures. Microfinance therefore looks at the regular cash flow of the household and the microenterprise – not the loan use, in determining the size, term and repayment structure of the loan. As a result, microfinance loans are primarily short term loans with frequent repayments.

Second, microfinance loans are characteristically used for additional capital to grow an existing business. The loan amounts are not very large. Some microfinance institutions even use a growth-loan process where the clients start off with a very small loan and can only access larger loans incrementally after showing a good repayment record. This has been proven successful in mitigating risks and in establishing credit discipline among the borrowers.

There are several other basic principles of microfinance, but I have focused on these 2 characteristics as they are the features that seem fundamentally incongruent to the financing needs of the agriculture sector. In particular, cash flow lending and frequent repayments do not fit the seasonal nature of agricultural incomes. In addition, short term financing, as well as the relatively small loan amounts, result in a lack of term financing which is important to particular types of agricultural activities. The risks for both types of financing are also very diverse. Agriculture finance bears unique risks such as price and yield risks.

Having said this, it does not mean we are dismissing the possibility of combining some of the best practices of microfinance with salient features of agriculture finance to create a product that addresses the needs of the agriculture sector, specifically the poor farming households. Definitely, there is room for complementation.

First, many clients of microfinance are also engaged in agriculture activities. In the Philippines, it has been proven that those who are involved in small agricultural activities also manage other forms of enterprises. These agricultural workers usually maintain microenterprises to meet consumption needs and other short term expenses of the household. In this regard, microfinance may be extended to this worker, with some modifications on the proven methodology and technology of microenterprise lending. For instance, traditional client selection using character and cash flow analysis… may be supplemented by technical criteria relating to the particular agricultural activity. This way, the selection process is more attuned to the intricacies of the household, its microenterprise, as well as its agricultural activity.

Second, the basic feature of flexibility in microfinance can be similarly applied to agriculture finance. Flexibility in terms of repayment schedules, delivery channels and even collateral requirements is very important. Some microfinance institutions that have successfully catered to the agriculture market have created flexible repayment schedules and payment options that attract a wide range of agricultural activities. Clients are still expected to have frequent repayments with the option of having a certain percentage of the loan as bulk payment. While these schedules take the crop cycle and produce sales into consideration, they still emphasize that repayment is expected regardless of the results at the end of the crop cycle. Flexibility in delivery channels can also be very beneficial for agriculture finance. Microfinance institutions, both in the bank and non-bank sector, continue to expand their branching networks, thereby enhancing access to finance. Innovations in technology are also increasing delivery channels for microfinance. In the Philippines, for instance, the development of mobile phone banking and electronic cash platforms have provided the opportunity for both enhanced access and lower costs.

Finally, flexibility insofar as collateral requirements is also an option for agriculture finance. Microfinance institutions have proven that collateral substitutes such as group guarantees, peer pressure or even the use of personal property have been effective in reducing reliance on traditional capital and in ensuring repayment. This may be studied further to see what arrangements could be flexible, yet prudent enough for agriculture loans. Risk mitigating factors that are applied by microfinance institutions such as portfolio diversification, inclusion of savings and insurance products may also be effective for agriculture finance.

It is important that we remain innovative and open to new ideas to see where we can introduce further refinements that we could apply for the agriculture sector. Nevertheless, it is equally important that we continue to be prudent in the use of microfinance in the agriculture sector which has its own intricacies, uniqueness and particular risk profile.

The Bangko Sentral approved the Micro-Agri Product last year is a case in point. With this, we have allowed banks with microfinance operations to extend credit to those with small agricultural activities using microfinance methodologies. In doing so, these micro-agri loans are given the same regulatory treatment as microfinance loans, even as we set parameters to ensure that risks associated with agriculture finance are properly managed. With this initiative, we expect to see more banks serve the unmet needs of small farmers.

Indeed, we at the Bangko Sentral ng Pilipinas continue to find more and better ways of providing access to credit to our agricultural farmers and workers. We are therefore looking forward to the success of this Consultation Meeting so that our respective countries will be able to facilitate the growth and development our agriculture sector. In this manner, we shall meet the food requirements of our people and uplift the quality of life of our agricultural workers.

Thank you and good morning to all of you.