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**MICROENTERPRISE ACCESS TO BANKING  
SERVICES - MINDANAO (MABS - M)**

**DEVELOPMENT ACTIVITY APPROVAL DOCUMENT  
(DAAD)**

Office of Economic Development  
USAID/Manila  
February 1997

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# U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

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February 12, 1997

## ACTION MEMORANDUM FOR THE DIRECTOR

FROM: Bob Barnes, Chief, OED

SUBJECT: Approval of the Microenterprise Access to Banking Services - Mindanao (MABS-M) Program

**Summary:** Your approval is required to allow implementation of the Microenterprise Access to Banking Services - Mindanao (MABS-M) Program. The DAAD describing the Program is attached. The MABS-M Program calls for the expenditure of up to \$8.2 million over a four-year period. The MABS-M Program is related to and supportive of the objectives of the GEM Program. Funds for the Program will be provided through the Mindanao Development Project (492-0456). Documentation is being prepared to effect amendments to the MDP Authorization and the MDP Project Agreement needed to facilitate implementation of the MABS-M Program. This documentation will be submitted to you shortly.

**Discussion:** The great majority of microenterprises in Mindanao (and the great majority of people at lower socio-economic levels in general) have no access to financial services from the formal banking system. Most surveys indicate that less than 10% of the population have ever done business with a bank - either depositing savings in a bank, or borrowing money from a bank. These surveys also indicate that, for the most part, the 10% of the population that had done business with a bank were from the better off socio-economic levels. In the case of the less well off portions of the population, in order to meet credit needs, they usually turned to pawnshops, lending investors, or to the informal credit markets. Microentrepreneurs, as they are usually not among the better off households, were generally excluded from access to bank services.

The lack of access of the great majority of Mindanao's people to formal sector financial services poses a significant constraint to accelerating Mindanao's economic growth, and puts microenterprises at a disadvantage when compared to larger businesses. Successful and growing businesses, whether large, small, or micro, require efficient and reasonably priced financial services. They require the prompt availability of

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credit for normal operations and to be able to take advantage of opportunities when they occur. They require deposit services that are a secure and convenient alternative to simply keeping cash at home. In the general absence of formal sector financial services, microenterprises must rely on their own resources or on informal credit sources for funds needed for operations and expansion. The higher cost of informal credit frequently means that microenterprises cannot afford to borrow to purchase materials for processing or resale when the goods are available at attractive prices.

Under the MABS-M Program, we will be attempting to bring about a sizable expansion of banking services, both loan and deposit services, to microenterprises and other groups at lower socio-economic levels in Mindanao. (While this program will focus on Mindanao, we believe that the experience gained through the MABS-M Program will be relevant to the banking system throughout the country). Through the MABS-M Program, we will be attempting to encourage and assist some 15-20 banks to significantly increase the amount of services they are providing to the microenterprise sector. We hope to demonstrate to the banks participating in the program that it can be sensible and profitable to offer services to the microenterprise sector, and we are prepared to assist them as they attempt to do so. We hope and expect that, as a result of experience gained through participation in the MABS-M Program, participating banks will make service to the microenterprise market a regular part of their portfolios. We hope and expect that the successful example of the banks participating in the MABS-M Program will encourage all banks to look seriously at the microenterprise market and attempt to service the market.

The MABS-M Program will be a four-year program, with a start-up in the fourth quarter of FY 1997. If necessary and appropriate, the program may be extended for one or two additional years. (Note that, in order to accommodate the expected duration of the MABS-M Program, it will be necessary to extend the period of the Mission's present "management contract" with USAID/W, and to extend the PACD of the MDP. USAID/W concurrence with an extension of the "management contract" period is being requested in the current "R-4").

The MABS-M Program will be implemented with the assistance of a technical assistance firm, whose services will be procured through a USAID direct contract. The TA firm will be working closely with the Rural Bankers Research and Development Foundation, Inc (RBRDFI). The RBRDFI is the action arm of the Rural Bankers Association of the Philippines (RBAP). The RBRDFI will be our principal partner in the implementation of the Program.

The proposed MABS-M Program was discussed and reviewed by the Economic Growth Team, and mission management, at a meeting

held on November 14, 1996. The meeting concluded with a general endorsement of the proposed program, with the caveat that several outstanding issues (e.g., possible seed capital scheme; procurement mechanism) be further discussed and clarified. This has been done. In the case of the "seed capital scheme," the document has been rewritten to make clear: 1) that what is intended is a scheme under which participating banks may receive incentive awards upon attainment of specified targets for delivery of services to microenterprises; and 2) that the decision to implement any incentive scheme will await the analysis and recommendation of the technical assistance contractor. In the case of the "procurement mechanism" to be used for the implementation of the Program, it has been clarified that, while the Program is to be implemented by the Rural Bankers' Research and Development Foundation Inc. (RBRDFI) with assistance from a technical assistance firm directly contracted by USAID, almost all funds required for the implementation of the Program will be included in the TA contract.

The attached DAAD has been reviewed by the RBRDFI/RBAP, by the Office of the Presidential Assistant for Mindanao, and by the Undersecretary of the Department of Finance responsible for credit policy. All have confirmed their agreement with the proposed program. (Formal confirmation of the concurrence of the RBRDFI/RBAP with the MABS-M Program, and of their role in the Program will be provided in a Memorandum of Agreement between USAID and the RBRDFI/RBAP. Formal confirmation of OPAMIN's concurrence with and role in the Program will be obtained through a JPIL issued under the MDP).

**Recommendation:** That you approve the MABS-M Program, and the expenditure of up to \$8.2 million (subject to the availability of funds) to implement the Program.

APPROVED: Kenneth J. Sclopell

DISAPPROVED: \_\_\_\_\_

DATE: 2/26/97

Attachment: MABS-M DAAD

Clearances:

OLA:PSullivan	(PWS)
PRM:GDy-Liacco	(draft)
OFM:FAlmeida/LBrady	(draft)
ORP:TPura/MReynolds	(draft)
OED:MBarash	(draft)
OED:JMudge	(draft)

OED:RFBarnes  
h\ed\mabsacti.2 (2.25.97)

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**MICROENTERPRISE ACCESS TO  
BANKING SERVICES/MINDANAO**

**(MABS-M)**

**DEVELOPMENT ACTIVITY APPROVAL  
DOCUMENT**

February 1997

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MICROENTERPRISE ACCESS TO BANKING SERVICES-MINDANAO (MABS-M)

DEVELOPMENT ACTIVITY APPROVAL DOCUMENT (DAAD)

I. BACKGROUND AND SETTING

A. Overview

Five of the 15 administrative regions of the Philippines are in Mindanao. Approximately 16.3 million people live in Mindanao. This constitutes about 25% of the nation's population.

Despite many natural advantages, Mindanao's economic growth has generally lagged far behind that of the rest of the country. During the period 1986-1994, its GDP grew on average by only 2.4 percent per annum in real terms compared to the Philippines' average annual GDP growth rate of 3.3 percent. The average annual growth rates of Mindanao's agriculture, industry and service sectors were below the national averages in these sectors. In 1994, Mindanao's per capita GDP was estimated at P18,979, which was 23 percent lower than the per capita GDP of the entire country.

Poverty in Mindanao is more widespread than it is in the rest of the country. In 1994, the percentage of families in Mindanao below the poverty line was estimated to be 50.5%, compared to 35.7 % for the entire country. In absolute numbers, there were 1.4 million poor families in Mindanao. This would comprise nearly one-third of the total number of poor families in the entire country. Mindanao's underemployment rate in 1994 was estimated at 28.6%, compared to the country's overall underemployment rate of 20.9%.

Recently, encouraging signs have appeared suggesting that Mindanao may be positioned for more rapid economic growth. Its GDP grew faster than that of the country as a whole in 1993-4. Mindanao's three major sectors, i.e., agriculture, industry, and services, achieved similar growth. The positive changes in the overall socio-economic policy environment, the return to political stability, the resurgence of confidence in the Philippine economy by both domestic and foreign investors, and the increased governmental budget allocations for infrastructure in Mindanao are all contributing to actual and potential greater economic progress in Mindanao.

Although recent growth of the economy of Mindanao has been impressive in many respects, USAID and the GOP are concerned that not all elements of the population of Mindanao have been sharing in the growth. This activity will attempt to address that concern by helping to bring about a sizable expansion of the availability of banking services, both loan and deposit services, to microenterprises and other groups at the lower socio-economic levels. We will be addressing this issue - the availability of banking services to microenterprises - because we believe it is clear that there is a strong positive relationship between the availability of banking services to people, and the growth of prosperity of those people.

A large majority of the people in Mindanao do not have access to banking services. Recent surveys found that 26% (approximately 755,000 households) of the total number of households in Mindanao have borrowed P1,000 or more in the past three years. Of these households, only 36% (approximately 274,000 households) had been able to borrow from formal credit institutions (i.e., banks, pawnshops, credit unions, etc.). The rest had turned to informal credit markets. Not surprisingly, the households with access to formal credit institutions almost exclusively were the better off households. Microentrepreneurs, as they are usually not among the better off households, were generally excluded from formal financial institutions.

The lack of access of the great majority of Mindanao's people to formal sector financial services poses a constraint to accelerating Mindanao's economic growth, and puts microenterprises at a disadvantage when compared to larger businesses. Successful and growing businesses, whether large, small, or micro, require efficient and reasonably priced financial services. They require the prompt availability of credit for normal operations, and to be able to take advantage of opportunities when they occur. They require deposit services that are a secure and remunerative alternative to simply keeping cash at home. In the general absence of formal sector financial services, microenterprises must rely on their own resources or on informal credit sources for funds needed for operations and expansion. The higher cost of informal credit frequently means microenterprises cannot afford to borrow to purchase materials for processing or resale when the goods become available at a price that would enhance their margins. If Mindanao is to accelerate its economic growth and share the benefits of such growth more equitably, its financial system must be able to extend financial services to significantly greater numbers of on-farm and non-farm microenterprises.

There is a large body of information available regarding the importance of providing financial services to the microenterprise sector. A good summation is contained in "The New World of

Microenterprise Finance: Building Healthy Institutions for the Poor". The introduction section of that document makes the statement as follows: "In order for their businesses to prosper, all microenterprises must have a sufficient supply of working capital for the purchase of supplies and inventories. As they expand, microenterprises also need to invest in assets such as tools, equipment, or improved premises. Lacking the access to formal financial services, many microentrepreneurs must provide this financing themselves through their own savings, the help of relatives, or business profits; others turn to informal moneylenders, whose loans can be costly. Microenterprises often fail to secure the capital they need and miss opportunities for business growth".

#### **B. Rural Banks/Cooperative Rural Banks**

A variety of financial institutions operate in Mindanao. As of 1994, about 13% of the total number of banking institutions in the Philippines were operating in Mindanao. Their combined assets amounted to P74 billion, which was roughly 6% of the total assets of the entire banking system. Given that Mindanao has roughly a 25% share of the national population, the region is relatively under-served by the banking system.

The Philippines has an unusual feature in its banking system which may facilitate its ability to address microfinance needs. This is its system of privately-owned and locally managed Rural Banks and Cooperative Rural Banks. There are over 800 RBs/CRBs countrywide and these institutions have had substantial experience in providing financial services to small enterprises, both farm and non-farm enterprises. They are situated in or near rural areas (although some have branches in a city). Many have been lending to small farmers for years, although usually for agricultural production purposes. Their location reduces the transaction costs on the part of borrowers. These institutions accept small deposits, frequently requiring a minimum balance of as low as 100 pesos to earn interest. Most of the loans they make are in amounts between P10,000 (approximately US\$400.00) and P200,000 (approximately US\$8000.0). Most of their borrowers have assets of not more than P100,000. These institutions charge market rates of interest on their loans. Currently, rates being charged range from 22 to 24% per annum (including service charges). (This means their rates are a small fraction of the rates charged by lending investors, pawnshops, or informal moneylenders). They offer competitive rates on deposits, usually 1-2 percentage points higher than rates offered by commercial banks. The number of borrowers and depositors has been growing,

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<sup>1</sup> The New World of Microenterprise Finance: Building Healthy Institutions for the Poor, Editors, Maria Otero, Elisabeth Rhyne, Kumarian Press, 1994.

respectively, over the past three years by an average of 5-6% and 7-8%.

There are 137 Rural Banks and 15 Cooperative Rural Banks in Mindanao. Some of the RBs/CRBs have only their principal branch, while others have 2-6 branch offices. (Counting branch offices, there are about 200 RBs/CRBs in Mindanao). Rural banks (either headquarters or branches) are present in almost all municipalities. There is at least one cooperative rural bank in each of the provinces of Mindanao.

Rural banks and cooperative rural banks formerly had a major role as conduits of government funds that were earmarked for on-lending to government-designated priority sectors. They made very limited efforts at deposit mobilization because of the relative abundance of government-initiated special credit funds being coursed through them. The repayment rates on these loans were consistently poor, due, most analysts believe, to the quite widespread belief that one isn't really required to repay government-sponsored loans. The poor repayment rates impaired the financial health of many rural banks and cooperative rural banks, including almost all of those operating in Mindanao. About 20% of RBs/CRBs in Mindanao failed and disappeared as a result of the situation. However, most of the remaining RBs/CRBs have gradually recovered and are now striving to wean themselves away from government support by mobilizing more deposits.

Interest rates can be freely set by the RB/CRBs. Thus they can easily set interest rate splits (the difference between the cost of funds and end-user loan rates) that will more likely generate a profit. The ratio of deposits to total assets rose during the period of 1986-1994 from 28% to 48% for rural banks and from 20% to 43% for cooperative rural banks in Mindanao. During this same period, assets of rural banks including cooperative rural banks in Mindanao doubled from P1.5 billion to P3.1 billion.

However, Rural Banks and Cooperative Rural Banks in Mindanao still have a lot of catching up to do with the rural banking system in the rest of the country. While the ratio of deposits to assets for Rural Banks in Mindanao has risen to 48%, the ratio of deposits to assets for all Rural Banks in the Philippines stood at 63% in 1994. Commercial Banks have the much higher ratio at 78%. Needless to say, Rural Banks and Cooperative Rural Banks in Mindanao need to mobilize substantially greater deposits.

Rural Banks and Cooperative Rural Banks, because they have greater experience in dealing with smaller enterprises, and because they tend to be located where the microenterprises are, are much better positioned to expand services to microenterprises than are any other elements of the formal banking system. This activity will focus on these institutions and provide assistance

and support they need to bring about a dramatic expansion of the services they provide to microenterprises.

This activity will focus heavily, but not exclusively, on the provision of financial services to microenterprises that are not directly involved in agricultural production. While much of the RB/CRB experience has been in providing financial services to the agricultural production sector, because these banks are located in the rural areas of Mindanao, they have significant familiarity with non-agricultural businesses as well. They are locally-based and owned, and are committed to providing services to their local communities.

It should be noted that some RB/CRBs have already started to enter the microenterprise market. Of the 24 different banks that were surveyed and analyzed in connection with the development of this DAAD, almost half had some type of program underway which targeted the microenterprise market - programs targeting stallholders in public markets, small agro-industries, garment makers, tricycle owners/operators, and others requiring short-term working capital. The portion of their loan portfolios going to the microenterprise market was always very limited, but some of the programs appeared to be having substantial success. (Many of the particularly successful programs had developed or adopted special technologies for servicing the microenterprise market - i.e. group lending, regular group meetings, sending out collectors to collect loan repayments, etc.).

### C. Credit Unions

Credit unions are significant providers of financial services in the Philippines. A recent survey indicates that credit unions provided loans to 8.2% of all borrowing households nationwide in the 12 months preceding the survey. Of the 3.8 million households who borrowed, 288 thousand or 7.6% borrowed from credit unions. In Mindanao, for the same period, 81,000 (or 11%) of the 755,000 borrowing households obtained loans from credit unions. Of all borrowing urban households (423,000 in Mindanao), 45,000 (10%) borrowed from credit unions; of all borrowing rural households (332,000), 37,000 (11%) borrowed from credit unions.

Credit unions, along with rural banks and cooperative rural banks, play a significant and effective role as financial intermediaries for small savers and borrowers including microentrepreneurs in Mindanao. Credit union members in Mindanao tend to be market vendors, tricycle drivers, small traders, furniture makers, owners of sari-sari stores, seamstresses, teachers, and some salaried workers. Several of Mindanao's credit unions have reported assets of between P80 and P100 million, which are much larger than many rural banks in Mindanao, and are disbursing regular loans averaging P3,000-P7,000.

There is a basic difference between credit unions and banks. Where credit unions members essentially decide which of their members will have access to accrued savings, banks function in an environment where they can intermeditate financial resources with other formal institutions. While this activity design fully agrees that there is a need for sharing savings, leveraging of outside resources clearly has opportunities for more rapid build-up of funds for the microenterprise sector, along with providing guarantees for savings accounts.

Credit unions have a major role to play in the expansion of financial services to microenterprises, and USAID support to credit unions to facilitate their expansion of these services is clearly appropriate. Substantial USAID assistance is going to be provided by the World Council of Credit Unions (WOCCU) with resources provided by a grant that organization will be receiving from the USAID/W PRIME Fund. In that support for expansion of credit union services to microenterprises will be provided from the PRIME Fund, we do not anticipate use of funds under the MABS Program for support of credit unions. The MABS Program will coordinate very closely with the WOCCU effort.

## II. PROBLEM STATEMENT

Recent financial reforms are bringing about a major restructuring of the financial system in Mindanao. Many banks have opened new branches in many parts of Mindanao, offering both traditional and new financial services to their clients. ("Traditional" services would include savings and time fixed deposits, and individual, fully-secured short-term loans. "New" services might include: checking account deposits, individual or group non-collateralized short-medium-long term loans; letters of credit; international fund transfers; ATMs, syndicated loans, leasing, etc.). Notwithstanding the increase in the number of banks in Mindanao, microenterprise access to microfinance services has not improved significantly. Most of the banks, especially the thrifts and the commercial banks, cater only to larger clients. Recent estimates, based on interviews with formal financial institutions, is that well less than 10% of microenterprises have access to formal financial services.

Some Rural Banks and Cooperative Rural Banks in Mindanao have been cautiously exploring the microenterprise market. Most RBs/CRBs, however, have not been able to provide services to a significant number of microenterprises. Principal reasons for this appear to be the following:

First, Rural Banks and Cooperative Rural Banks have been going through a period of control, rather than growth over the past several years. Because of negative experience with government-directed lending programs related to food self-sufficiency, which had the effect of greatly weakening the

financial viability of many of the banks, the RBs/CRBs have not generally been exploring new markets;

Second, most Rural Banks and Cooperative Rural Banks employ traditional, and unnecessarily conservative banking business practices which discourage innovation and new market development.

Third, the majority of Rural Banks and Cooperative Rural Banks have not been exposed to cost-effective microfinance technologies that would enable them to mobilize deposits and profitably provide microfinance services.

In the case of those banks that have essentially recovered from the problems associated with government-directed lending programs, and have regained financial viability, the MABS-M Program will provide assistance needed to overcome the second and third (and other) constraints so that they can substantially expand the services they are providing to microenterprises.

### III. ACTIVITY RATIONALE

#### A. Relationship to Mission Strategy

The proposed MABS-M activity will be one of the principal elements of the Mission's effort to attain its Strategic Objective #1 - Broadbased Economic Growth in Mindanao. While it will have impact on both of the Results Packages contributing toward the attainment of this Strategic Objective, its principal contribution will fall under RP #1 - Participation in Economic Enterprise Broadened. MABS-M will substantially increase microfinance services in Mindanao. More microenterprises will have access to deposit services. More funds for working capital and investment will be made available to microenterprises. Towards this end, MABS-M will assist selected RBs/CRBs to develop and enhance their ability to include microenterprises as a direct part of their clientele through both investment and technical assistance. We anticipate that, over the four year life of this effort, the activity will work with 15-20 RBs/CRBs.

As a consequence of assistance provided, we anticipate that these institutions will increase the level of services they are providing to microenterprises by at least 500%. That is, the number and amount of loans made to microentrepreneurs will increase five-fold from an estimated baseline of 2,000 to 3,000. The amount of microentrepreneur depositors, and deposits, will also increase five-fold. Significantly as a result of this activity, loan services will be made available to 8,000 - 12,000 microentrepreneurs who would not otherwise have received loans from these institutions. More importantly, as a consequence of the experience they obtain in making the loans, the participating

banks will have learned how to profitably make loans to the microenterprise sector and will make microenterprise lending a regular and continuing part of their business. It is also anticipated that many non-participating banks, having observed the experience of the participating banks, will also make microenterprise lending a regular part of their business.

#### **B. Relationship to Other USAID Activities**

This activity will be an important element of our overall strategic objective of bringing about "Broad-based Economic Growth in Mindanao." The principal vehicle through which we are attempting to attain our Strategic Objective is the Mindanao Development Project, particularly, the Growth with Equity in Mindanao (GEM) Program component of that project. The MABS-M Program will supplement and support the activities being carried out under our GEM Program, particularly those GEM activities that aim at assuring that as many of Mindanao's people as possible participate in and benefit from the economic growth that is beginning to occur in Mindanao. MABS-M personnel will work closely with GEM personnel in identifying suitable banks for participation in the program; in identifying organizations of microentrepreneurs and making them aware of services potentially available from participating banks; in assisting individual microentrepreneurs to open deposit accounts in participating banks and to apply for credit from those banks, etc.

MABS-M personnel will also work closely with the related microfinance promotion activity being undertaken by the World Council of Credit Unions (WOCCU) in Mindanao with support from USAID/W's PRIME Fund. That program has objectives and approaches similar to and related to the objectives and approaches of the MABS-M Program, except that the WOCCU program will focus on credit unions.

The MABS-M Program will also attempt to coordinate its activities with those of USAID/W's Loan Guarantee Program. In this context, the Mission has advised LGP management personnel that all future LGP activities in the Philippines should focus on banking institutions in Mindanao, and that we will be working with them to help assure that their activities in Mindanao support the objectives of the MABS-M Program.

#### **C. Client/End User Profile**

It is difficult to get an accurate estimate of the number of microenterprises in Mindanao. Different organizations define microenterprises differently. Microenterprises frequently are unregistered and unlicensed. They are frequently also part-time or intermittent activities of their owners. As such, it is not surprising that different surveys produce different results.

Data available from the National Statistics Office indicates that there are somewhat more than 42,000 "microenterprises" in Mindanao. Other studies indicate the sector is larger than 130,000.

With respect to the MABS-M Program, "microenterprises" are defined as non-agricultural production, owner-managed enterprises with net assets of less than \$10,000. With a population of over 16 million, and an average family size of six members, and using a conservative estimate of 10% of total families being involved in microenterprise, the number of microenterprises in Mindanao would be in excess of 250,000.

These microentrepreneurs include businesses like small traders, stallholders in public markets, tricycle drivers, small dressmakers/small garments manufacturers, and home-based businesses that are generally managed by spouses of farmers and fishermen.

In the Philippines, women make up a significant portion of the microenterprise sector. Recent surveys indicate up to 60% of microenterprises are owned and operated by women. It is expected that women will make up at least half of the new clients attracted to this program. The actual results will be carefully followed. (To address gender concerns, the program will make sure that women are not in any way precluded from participating in the activity, but they will not be specifically targeted. Data will be gender dis-aggregated and the program will ensure that appropriate remedies are put in place if an inappropriate female participation rate is occurring).

Although the intended end-use clients of the MABS-M assistance are the microentrepreneur clients of the 15-20 RB/CRBs that will participate in the activity, and the 8,000 - 10,000 microenterprises that will receive financial services from these institutions during the life of the program, the ultimate target would include the up to 1.4 million families in the lower economic strata in Mindanao who would benefit from having access to services from the formal financial system. Almost all lower income families in Mindanao derive some income and/or employment from microenterprises, but availability of formal sector credit and savings services to these people has been almost non-existent to this point.

#### **IV. ACTIVITY NARRATIVE**

##### **A. Activity Statement**

Under the MABS-M Program, we will be attempting to demonstrate to the formal financial sector that it can be sensible and profitable to service the microenterprise sector. Based upon

experience they gain through the program, we expect all banks participating in the program to make service to the microenterprise sector a regular part of their business. We also expect that, based upon the example of the participating banks, many other banks will also elect to service the microenterprise market.

Because these elements of the formal financial sector appear most likely to be interested in and capable of profitably servicing the microenterprise sector, the MABS-M Program will focus on Rural Banks and Cooperative Rural Banks. (Credit unions also appear well positioned to profitably service the microenterprise sector. A companion program, implemented by the World Council of Credit Unions, with grant support from USAID/W's PRIME Fund, will focus on expanding the capability of credit unions to service the microenterprise sector).

Most attention will be focused upon approximately 15-20 RBs/CRBs which will be selected for participation in the program based on: their interest in participating and their willingness and ability to make necessary investments of financial, staff and other resources; their soundness as financial institutions; their location. The MABS-M Program will provide technical assistance and training needed by these institutions to learn how to profitably and effectively service the microenterprise market. In some cases, the Program may also provide limited financial incentives to encourage and assist some institutions to enter the microenterprise market. This financial support will be provided on a limited basis and will be related to the amounts of funds the different institutions have committed and are disbursing for microfinance lending, and to the attainment by the banks of other microfinance related targets.

While most attention and resources will be focused on an estimated 15-20 RBs/CRBs selected to participate in the program, all banks in Mindanao interested in servicing the microenterprise market will be welcome to participate in training programs and seminars organized by the MABS-M Program. Limited in-bank technical assistance will also be provided to other requesting banks insofar as it can be provided.

#### **B. Activity Description**

The MABS-M Program will be a four-year effort during which time we will be attempting to enhance capabilities of some 15-20 RBs/CRBs to mount effective and sizable programs servicing the microenterprise sector. The program will focus on assisting the participating banks to learn and adopt a series of practices that have been developed and are being utilized by those banks around the world that are successfully servicing the microenterprise market (i.e., "Microenterprise best practices").

Through the MABS-M Program, it will be demonstrated to the formal financial sector that it can be sensible and profitable to provide financial services to the microenterprise sector. The implementor, a technical assistance contractor working in collaboration with the Rural Bankers Research and Development Foundation, Inc. (the action arm of the Rural Bankers' Association of the Philippines) will work with participating RBs/CRBs in introducing and implementing profitable microenterprise lending and deposit mobilization technologies.

**B.1. Microenterprise Best Practices.** Providing financial services to microenterprises and lower socio-economic groups in general can be profitable, but it can only be profitable if it is recognized that servicing microenterprises is a different kind of business than more traditional banking is, and that different techniques and practices must be used to service this market. Basically, given that servicing microenterprises implies the banks' dealing with smaller amounts of money (i.e., smaller loans, smaller deposits) than is the case when dealing with their more traditional markets, profitably servicing the microenterprise market means that the banks must deal with large numbers of clients, and must do so in a manner that minimizes their transaction costs of dealing with clients.

A number of sound microfinance lending technologies and practices have been developed and are being used by different banks and organizations around the world that are successfully and profitably servicing the microenterprise sector. (Notably, the Bank Rakyat Indonesia [BRI], Bancosol in Bolivia, the Workers' Bank in Jamaica, the National Commercial Bank of Tanzania, etc.). The most important of these technologies/practices appear to be:

- pricing loans and savings services in a manner that will engender sustainability and long term growth. (Because of the small amounts generally involved, and because microfinance tends to be "labor intensive," servicing a microfinance client can be more expensive than servicing a more traditional client. Interest rates charged on loans, and fees for other services provided must reflect these higher costs).
- rapid decision making with respect to loan applications, and prompt disbursement of loan funds.
- decentralization of loan decision-making authority to the lowest feasible level;
- development of intimate knowledge of the principal microenterprise sectors/industries making up the potential market;

- utilization of appropriate incentive/reward systems for both bank staff involved in servicing the microenterprise sector, and for borrowers/depositors;
- quick and easy access to savings deposits by depositors;
- close supervision of loans and use of innovative methods to encourage timely loan repayment;
- use of aggressive and imaginative techniques to encourage continuing and substantial expansion of deposits;
- use of computerized information systems that provide timely data on portfolio performance.

Through the MABS-M Program, technical assistance and training will be provided to all participating banks, as needed, in each of the above listed areas. In some cases, training will be in seminar form and will involve participants from several or all participating banks; in other cases, training will be bank specific. Some of the training may involve bringing in representatives of banks in the region that are operating successful microfinance programs, or may involve sending staff members of participating banks to those countries to observe their operations. In some cases, MABS-M Program personnel will design and implement training programs; in other cases, pre-packaged training programs available from USAID or other organizations may be used.

Technical assistance will generally be "in-bank." The amount of technical assistance provided to different participating banks will vary. Some banks may require only brief consultations while others may require weeks or months of assistance on different matters.

If necessary and appropriate, some limited commodity assistance may also be provided to the participating banks. Principally, this would consist of computer hardware or software that participating banks would find necessary and/or desirable for servicing a sizable microenterprise sector clientele. (For example, the software program "Microbanker," which was developed with support from the United Nations Food and Agriculture Organization, appears to offer a sensible and reasonably priced solution to the banks' management information needs. Other software similar to "Microbanker" is also on the market). As and if commodity assistance is provided to participating banks, appropriate cost-sharing arrangements will be worked out.

## **B.2 Implementation Scenario**

The following briefly describes how implementation of this activity is anticipated to occur.

- a. MABS-M staff organize and implement a series of workshops/seminars intended to make RBs/CRBs in Mindanao aware of the MABS-M Program, its objectives and operating procedures, and of eligibility requirements for participating in the Program. Summary information on potential benefits of servicing the microenterprise sector, and of procedures and capabilities needed to service the sector is also provided.
- b. A potential participating bank is identified by the RBAP/RBRDFI based on its knowledge of the area and of the banks.
- c. MABS-M Program staff visit the potential participating bank and carry out an initial assessment of the bank's operations and potential client base of microenterprises.
- d. With a positive finding, MABS-M staff assist the bank in developing a plan for expanding financial services to microenterprises. This plan includes an estimate of the potential number of microenterprise clients to be reached (both borrowers and depositors).
- e. When the plan developed in d. above is accepted by the RBAP/RBRDFI, a formal agreement is signed by the RBAP/RBRDFI and the individual bank, which gives formal recognition to targets established, along with a description of any and all services and/or incentives which will be provided to the bank by the MABS-M Program. Capability deficiencies and requirements for improvement in the bank's operations are identified and spelled out in the agreement.
- f. training or technical assistance needed by the bank to develop required capabilities are provided in those areas.
- g. information systems are put in place or modified that will report on both portfolio and financial performance of the activity.
- h. The bank begins or expands its services to microenterprises. The growth in loan and deposit services is monitored in the same reports. As it reaches its targets, any agreed upon incentive payments are provided.
- i. In specific cases, further training (inside or outside the country) is provided to management and staff of the bank.
- j. Regular reporting and provision of agreed upon incentive payments continues throughout the duration of the activity.

**C. Counterparts/Partners**

The MABS-M Program will work in close association with the individual RBs/CRBs that participate in the program, with the seven local federations of Rural Bankers which operate in Mindanao, and with the Mindanao Federation of Cooperative Banks. The main operational counterpart, however, will be the Rural Bankers Research and Development Foundation, Inc. (RBRDFI). **Essentially, the MABS-M Program will be implemented by the RBRDFI with assistance from a technical assistance team contracted by USAID. The chief of party of the technical assistance team will have responsibility for overall direction of the MABS-M Program.**

The RBRDFI is the operational arm of the Rural Bankers' Association of the Philippines (RBAP). Virtually all RBs/CRBs in the Philippines are members of the RBAP and thus, by extension, are members of the RBRDFI. The Executive Director of the RBRDFI resides in Davao, Mindanao, and the RBRDFI has an office in Davao.

The RBRDFI Office in Davao will be the headquarters of the MABS-M Program. RBRDFI leadership are strong advocates of providing banking services to the microenterprise sector, and to lower socio-economic groups in general, and are eager to participate in the MABS-M Program. In addition to office space for the MABS-M Program, the RBRDFI has also committed itself to providing at least three professional-level staff members for the MABS-M Program. Particular areas of responsibility of the RBRDFI under the MABS-M Program will include: assisting in the initial identification of banks suited to participate in the program; assisting in the implementation of the assistance programs for the participating banks; disseminating to other (non-participating) RBs/CRBs information on the technologies developed under the Program.

It is also anticipated that the MABS-M Program will work with the Department of Rural Banks and Savings and Loan Associations (DRBSLA) of the Bangko Sentral ng Pilipinas (BSP) - particularly in connection with efforts to obtain rediscounting facilities for RBs/CRBs for microenterprise sector lending, with the National Credit Council of the Department of Finance, and with the Office of the Presidential Assistant for Mindanao.

Given the limited resources available to the RBRDFI, and given the wide range of expertise in varied fields that will be required for the attainment of the objectives of the MABS-M Program, there will be extensive need for technical assistance to make this program successful. The great bulk of technical assistance will be provided by a technical assistance firm with extensive experience in both banking in general, and with microfinance programs. Services of this firm will be directly contracted by USAID.

#### D. Financial Plan

It is estimated that a four-year MABS-M Program, focussing on approximately 15-20 RBs/CRBs will cost approximately \$8.13 million in USAID funds.

These funds would be used to support:

1. a technical assistance team providing advice and assistance in all of the activities discussed above;
2. operational and institutional development support for the RBRDFI needed to allow that organization to play the lead role in implementation of the MABS-M Program;
3. program costs;
4. USAID Management Support Costs

#### D.1. Technical Assistance Team

We estimate that approximately 310 person-months of USAID-financed technical assistance will be required. This includes both long and short-term technical assistance. The team will be led by two expatriate experts with demonstrated successful experience in the field of microfinance banking. Their efforts will be supported by locally hired experts in banking/microfinance and by short-term consultants with expertise in a range of fields. The following chart depicts the anticipated make-up of the TA team. Note that the listing of individuals/expertise is illustrative. Firms submitting proposals for implementation of the MABS-M will be free to propose alternative arrangements.

- |  |        |
|--|--------|
| 1. Chief of Party/Microfinance Banking Advisor (E)   | 48 PM  |
| 2. Banking Operations Advisor (E)  | 48 PM  |
| 3. Banking Operations Specialist (L)   | 40 PM  |
| 4. Banking Management Info. Systems Specialist (L)   | 36 PM  |
| 5. Microenterprise Outreach Specialist (L)   | 36 PM  |
| 6. Short term expertise (in banking technologies, interbank lending, employee incentive schemes, collections, deposit mobilization, loan application and review systems, training, etc.) | 100 PM |
| 7. Support staff (secretaries, drivers, bookkeepers)   | 250 PM |

The technical assistance team will be directly contracted by USAID. A performance-based "results" type of contract is anticipated. Note that the RBRDFI will also be assigning three professional-level individuals, and one support-level individual to work with the TA team (under the direction of the Chief of Party of the TA Team. The services of personnel provided by the RBRDFI are not included in the listing shown above.

**D.2. Operational and Institutional Development Support for the RBRDFI**

As indicated above, the RBRDFI will be the principal operational counterpart for the MABS-M Program, and will have substantial responsibility for the implementation of the program. Mindanao-based capabilities and resources of the RBRDFI are, however, quite limited. For the organization to be able to fully carry out its responsibilities under the program, it will be necessary for the MABS-M Program to provide some limited support for the organization. This will primarily be in terms of providing funding for part of the salary costs of additional personnel hired for the MABS-M effort; equipment needed for the implementation of the program; vehicular support; additional office facilities and equipment; and travel costs.

**D.3. Program Costs**

These will include: cost of planning and implementing various training programs; costs of procuring and installing computer hardware/software for various participating banks; costs of possible incentive payments to encourage/assist banks to expand services to microenterprises; costs of various special studies or analyses needed for the program; costs of conferences/seminars/workshops needed to gather and/or disseminate information relevant to the program; cost of promotional efforts and promotional materials; costs of study tours and training programs; promotional expenses; costs associated with identification/development/procurement of technological improvements needed by the RB/CRB system to profitably service the microenterprise market.

**D.4. USAID Management Support Costs**

This will include costs incurred by USAID in providing effective oversight of the program, and costs of audits and evaluations of the program.

The chart below indicates estimated costs related to the categories described above. The descriptive paragraph above is referred to in parentheses.

**Illustrative Budget (in \$millions)**

Budget Item	USAID Cost	Counterpart
<b>A. Technical Assistance Team</b>	<b>\$5.482</b>	<b>\$0.172</b>
<b>1. Personnel</b>		
a. Long Term/Expat (96 PM @ \$25K per PM)	\$2.400	
b. Short term/Expat (50 PM)	\$1.250	

	@ \$25K per PM)		
c.	Long term/Local (112 PM @ \$5K per PM)	\$0.560	
d.	Short term/Local (60 PM @ \$5K per PM)	\$0.300	
e.	Home office/prof. (24 PM @ \$15K per PM)	\$0.360	
f.	Home office/support (24 PM @ \$8K per PM)	\$0.192	
<b>2.</b>	<b>TA Team Support</b>		
a.	Office furniture	\$0.020	\$0.020
b.	Office equipment	\$0.080	\$0.010
c.	Office renovation/repair	\$0.020	
d.	Vehicles (2)	\$0.050	
e.	Vehicle operation/maint	\$0.030	
f.	Office equip. maint	\$0.010	
g.	Office supplies	\$0.010	\$0.002
h.	Telecommunications	\$0.050	\$0.020
i.	In-country travel	\$0.120	
j.	Int'l Travel	\$0.030	
k.	Office space	\$0.000	\$0.120
<b>B.</b>	<b>RBRDFI Operations</b>	<b>\$0.050</b>	<b>\$0.370</b>
<b>1.</b>	<b>Personnel</b>		
a.	Prof-level	\$0.020	\$0.240
b.	Support-level	\$0.010	\$0.080
<b>2.</b>	<b>Personnel Support</b>		
a.	Office Furniture	\$0.005	\$0.005
b.	Office equipment	\$0.005	\$0.005
c.	In-country travel	\$0.010	\$0.040
<b>C.</b>	<b>Program Costs</b>	<b>\$2.000</b>	<b>\$4.520</b>
<b>1.</b>	<b>Conferences/seminars</b>	<b>\$0.050</b>	<b>\$0.060</b>
<b>2.</b>	<b>Training Activities</b>	<b>\$0.300</b>	<b>\$0.060</b>
<b>3.</b>	<b>Special Studies</b>	<b>\$0.200</b>	<b>\$0.020</b>
<b>4.</b>	<b>Study Tours</b>	<b>\$0.150</b>	<b>\$0.060</b>
<b>5.</b>	<b>Computer hardware/software</b>	<b>\$0.100</b>	<b>\$0.100</b>
<b>6.</b>	<b>Promotional Activities</b>	<b>\$0.100</b>	<b>\$0.020</b>
<b>7.</b>	<b>Incentive programs</b>	<b>\$0.800</b>	
<b>8.</b>	<b>Technological Imp.</b>	<b>\$0.300</b>	<b>\$0.200</b>
<b>9.</b>	<b>Additional Microlending</b>	<b>\$0.000</b>	<b>\$4.000</b>
<b>D.</b>	<b>USAID Management Support Costs</b>	<b>\$0.600</b>	
<b>1.</b>	<b>Monitoring</b>	<b>\$0.350</b>	
<b>2.</b>	<b>Audit/Evaluation</b>	<b>\$0.250</b>	
	<b>TOTALS</b>	<b>\$8.132</b>	<b>\$5.062</b>

Note: Estimated counterpart contributions are only those that would be directly associated with MABS-M efforts. Amounts indicated on the Microenterprise Lending line are those funds participating banks will be lending to microenterprises and other targeted groups. These funds will be over and above any amounts the banks normally put into microenterprise lending.

All funds indicated above as the USAID contribution, with the exception of "Audit/Evaluation" and "USAID Management Support" funds will be included in the technical assistance contract awarded by USAID to a U.S. firm. Funds listed under the Categories entitled "RBRDFI Support," and "Program Costs" will be placed in a "Special Activities Fund" to be administered by the contractor. All expenditures against this Special Activities Fund will have to be approved by the USAID Project Officer (or the appropriate SO/RP Team Leader), and all relevant USAID accounting and procurement regulations will have to be followed. Reports on fund usage may be required following activity completion, with USAID retaining the right of audit.

The MABS-M Program is an activity being undertaken under the Mindanao Development Project (492-0456). As such, all USAID funds expended for the Program will be MDP funds.

#### **E. Implementation Plan**

It is anticipated that almost all of the resources required for implementation of the MABS-M Program will be provided by a private firm under direct contract with USAID. A 48-month contract, expandable to 60 months if the situation warrants, will be offered. The firm would establish its principal base in the offices of the RBAP/RBRDF in Davao City. Basic office facilities and the services of support personnel (i.e., secretaries, drivers, etc.) will be provided by the RBRDF to the extent possible. RBAP/RBRDF will also provide three full-time and occasional part-time professional level personnel to work on the MABS-M Program

The technical assistance contract team leader will work closely with the Executive Director of the RBRDF and they will jointly plan key implementation activities. Day to day direction of MABS-M Program activities will be the responsibility of the contract team leader.

#### **V. DESIGN/IMPLEMENTATION CONSIDERATIONS**

##### **A. FEASIBILITY/RISK ASSESSMENT**

###### **A1. Issues**

In the view of the Economic Growth Team, the principal issues or concerns associated with the GEM effort are as follows:

**A1a. Directed Credit**

Issue: A number of specialists in credit matters have long taken the position that it is better to allow lending institutions to make their own decisions as to the types of lending they wish to make (based, essentially, on the lending institutions' market judgements) rather than requiring the institution to make particular kinds of loans for particular purposes. (USAID, as an agency, it should be noted, has never taken a position on this matter). In that this program is specifically targeting a particular sector - the microenterprise sector - and is supporting a number of activities intended to encourage participating banks to increase their lending to the microenterprise sector, the program could be seen as being directed credit.

Response: It is true that an objective of this activity is to have banks allocate a greater portion of their lending resources to a particular sector - the microenterprise sector. No governmental directive is associated with the effort however, nor are any market-distorting incentives being offered to encourage this. Rather, the MABS-M Program is postulating that what is preventing banks from naturally moving faster on their own to service the microenterprise sector is their lack of knowledge of the sector, and how profitable it can be to service the sector. The MABS-M Program further postulates that, if banks were more aware of how to profitably service the microenterprise market, they would move much more quickly to service the market on their own. The real objective of the MABS-M Program is to correct the information deficit that is tending to discourage banks from expanding their services to the microenterprise sector.

It should further be noted that the MABS-M Program will not be directing credit in the sense that it will be dictating particular enterprise sectors which will receive financial services, nor will it be dictating particular items for which credit might be used. Rather it will be working in partnership with local, privately-owned financial institutions to reach an under-served market.

**A1b. Subsidies**

Issue: In order to encourage and assist participating RBs/CRBs to initiate or sizably expand their service to microenterprises and other lower socio-economic sectors, the MABS-M Program will be offering a range of technical assistance, training, and other inducements to the RBs/CRBs. **In some cases, if the MABS-M team**

and the RBRDFI believe this is warranted (and the USAID SO/RP Team leader concurs with this assessment), a limited financial inducement may be offered which will be provided as and when the participating banks reach certain agreed-upon targets in terms of volume of new deposits from the microenterprise sector, number of new microenterprise borrowers, etc. Quite possibly, the value of the financial and other inducements potentially available to participating banks may constitute a significant share of the costs the banks may be incurring in extending services to the microenterprise sector, and/or of the total volume of funds being loaned to the microenterprise sector. As such, it could be argued that the MABS-M Program is subsidizing the banks' initiation/expansion of services to the microenterprise sector. Some individuals argue that such subsidies are inappropriate as they induce individuals or firms to undertake business activities that they would not otherwise undertake if responding strictly to market forces.

Response: Insofar as the MABS-M Program will be underwriting some of the costs the institutions' might otherwise have to bear on their own in order both to develop the capability to initiate/expand services to the microenterprise sector and to actually initiate/expand services, it is acknowledged that a subsidy element might be present. It should be noted, however, that the subsidy will be very small and will be of very limited duration. The purpose of providing the inducements to the participating banks is not to have them undertake the provision of services they would not undertake because it makes no economic sense for them to do so, but, rather, to encourage them to take the steps necessary to learn that providing services to the microenterprise sector is, economically, a sensible thing to do.

#### **A1c. Banks' Willingness to Service Microenterprises**

Issue: The banking sector in the Philippines, like most banks worldwide, has not been providing significant attention to the financial needs of the microenterprise sector. Why should it be expected that significant numbers of banks within the Mindanao region should now decide to provide services to the microenterprise sector?

Response: Essentially, we believe that a sizable number of RBs/CRBs are interested in expanding their services to the microenterprise sector because they have told us they are interested. This really is not surprising - given the increasingly intense competition that is starting to characterize the banking sector. Bankers with an understanding of what is happening to the banking sector in the Philippines are very much aware that they are going to have to expand their markets if they are to survive.

Extensive field visitations with all levels of RBs/CRBs with both staff and management indicate that a few RBs/CRBs have already had initial and promising contact with the microenterprise sector, but that they require greater exposure to successful techniques of providing microenterprise financial services if they are to expand their services. The extensive discussions carried out during the development of the activity strongly indicate that the banks would be willing to increase the level of assets allocated to the microenterprise sector if they better understood how to profitably service the sector.

**B. Key Assumptions.** There are two different sets of assumptions that will impact on prospects for success of the MABS-M Program. The first set of assumptions has to do with the overall macroeconomic climate in the Philippines. The second has to do specifically with the institutions with which we will be working.

In order for this program to be successful, it is important that the generalized economic progress that the country has been making for the past several years continues, and also that the trend toward liberalization of banking regulations continues. The increasing competition within the banking sector, which is a result both of the liberalization of banking regulations that has occurred over the past several years, and of the solid economic growth which the country has been experiencing, is an important factor impelling banks to look to expand their markets.

The second set of assumptions are also critical. The program will involve working with a large number of banks and bankers, many of whom indicate they are very interested in and willing to explore a substantial expansion of services to microenterprises, but whose actual willingness and ability to make the investments required to do so remains to be seen. The program also calls for a good deal of experimentation with different techniques and practices.

## VI. ENABLING AGREEMENTS AND TEAM WORKPLAN

The "enabling agreement" for the MABS-M Program is expected to be a Project Implementation Letter (PIL) issued under the Mindanao Development Project (492-0456). The PIL will describe the program and will indicate that the program will be implemented by the Rural Bankers' Association Research and Development Foundation with support from a technical assistance firm directly contracted by USAID. The PIL will be signed by NEDA and the Office of the Presidential Assistant for Mindanao (OPAMIN) on behalf of the GOP.

An additional "enabling agreement" will be a Memorandum of Understanding executed between USAID and the RBRDFI which will lay out understandings and expectations of both parties with respect to the MABS-M Program. Among other matters, this MOU

will make clear: that the MABS-M Program is being undertaken by the RBAP/RBRDFI with assistance from USAID; and that the Program will be directed/led by the chief of party of the contracted TA team. During actual implementation of the activity, sub-agreements between the RBAP/RBRDFI and the respective banks will be developed and signed.

To assist in management and oversight, within 60 days of mobilization, the contract firm will prepare a proposed workplan which will clearly articulate the general approach the contractor will follow in implementing the MABS-M Program over the life of the contract, and provide specific and detailed plans for activities to be undertaken during the life of the contract. The proposed workplans will be subject to RBRDFI and USAID review and approval. This activity is in compliance with the FAA 611 and ADS guidance, which is reflected in a separate document.

OED will have lead responsibility in USAID for management of the program. OED, from existing staff, will assign one USDH and one FSN to the program. These individuals will share responsibility for the management and success of the program with a Results Package Team which will include representatives from ORP, OFM, RLA and PRM.

## VII. MONITORING AND EVALUATION ARRANGEMENTS

The performance of the MABS-M Program will be evaluated chiefly by the extent to which participating banks increase the level of services they are providing to the microenterprise sector. To lesser extent, the success of the program will be evaluated by indications that participating banks have committed themselves to providing services to microenterprises on a long-term basis; and by indications that non-participating banks are also entering the microenterprise market. The following "end-of-activity" indicators of success will be used:

- each (approximately 15-20) participating bank will be managing a portfolio of at least 500 loans to the microenterprise sector, with a total of at least 8,000 borrowers among all the activity participants.
- average number of new microenterprise depositors in each participating bank will reach about 1,000, with at least 12,000 depositors among all the activity participants. Most participating banks will be carrying out aggressive and continuing efforts to attract microenterprise sector depositors.
- most participating banks will have decided to make microenterprise services a continuing and substantial part of their portfolios, and will have taken the steps required to properly and profitably service the market (i.e., will

have hired staff to service the market; will have staff specially trained in best methodologies of microenterprise finance; will have instituted special procedures and methodologies required to service the market).

- at least 5-10 non-participating banks in Mindanao will have initiated efforts to service the microenterprise market (based upon their observing/learning about the successful efforts of participating banks).
- all participating banks will have management information systems in place that allow them to quickly produce daily, weekly, and monthly information on loan and deposit performance of their microentrepreneur clients, along with clear accounting of profit and losses from their microenterprise market. Data will be available on a gender-disaggregated basis.
- descriptive/instructional material which discusses the experiences of RBs/CRBs participating in the Program, and technologies and practices banks need to adopt in order to service the microenterprise sector will have been developed, and will be regularly being disseminated by the RBRDFI to other RBs/CRBs around the country.

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