

RBAP/RBRDFI



MICRO - ENTERPRISE ACCESS TO BANKING SERVICES IN MINDANAO

**Cash Flow Lending and Loan Pricing
Seminar Report**

Seminar provided by

Andres "Boypee" Panganiban

Final Draft

Submitted by:

Chemonics International, Inc.
Davao City, Mindanao, Philippines

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I. INTRODUCTION

The MABS-M Program hosted a series of “Cash Flow Lending and Loan Pricing” seminars in five Mindanao cities: Davao, General Santos, Butuan, Cagayan de Oro, and Dapitan. The individual seminars were hosted by the Davao, SOCSKSARGEN, CARAGA, and Zamboanga del Norte Federations of Rural Bankers, respectively. Participants were asked to pay a nominal registration fee of P200 each. This fee was divided evenly between the Rural Bank Research and Development Foundation, Inc. (RBRDFI) and the sponsoring regional Federation of Rural Banks. The seminars, led by Mr. Andres Panganiban, President of the New Rural Bank of San Leonardo (RBSL), targeted a wide range of rural bank staff throughout Mindanao. Mr. Panganiban presented his bank’s success in the areas of cash flow lending and loan pricing to over 340 representatives of 98 rural banks in Mindanao, over 78% of the total number of rural banks on the island.

II. BACKGROUND

Alex Buenaventura, director of the Rural Bank Research and Development Foundation, Inc. (RBRDFI), and President of Network Bank, suggested we consider RBSL as a model bank for workshops and seminars. RBSL has offered successful rural banking services to the microenterprise sector for over four years. Eighty percent of RBSL’s loan portfolio in 1998 was made up of micro-loans. The bank reached a net worth of P21 million in 1998; a growth margin of 950% over four years. RBSL’s services cover mostly fourth and fifth class municipalities in Nueva Ecija in Northern Luzon. Hence, the majority of the bank’s saving and loan portfolios is from the poor, microentrepreneur sector.¹

III. SEMINAR OBJECTIVES

Through existing methods used by RBSL, the seminars intended to prove that servicing the microenterprise sector through loans and saving programs is profitable. This was demonstrated through two main lecture topics: cash flow lending and loan pricing. In addition to these main topics, Mr. Panganiban addressed the “vicious cycle of poverty” that many microentrepreneurs find themselves stuck in: living day-to-day and not earning any profits for savings. Therefore, without deviating from the intended objective of lending principles, Mr. Panganiban also made time to stress the importance of savings mobilization.

¹ For more detail on RBSL portfolios and successes, please refer to pages 2-3 of annex A, by Ms. M. P. Macaraeg, of MEDCO.

In addition to these primary objectives, the MABS-M Program team intended to introduce themselves and the program to potential participating banks from all of the regions in Mindanao. During breaks and after the seminars, the MABS-M team was able to introduce themselves, network, and market the program to potential participating bank presidents and staff.

IV. HIGHLIGHTS OF COURSE IMPLEMENTATION

Mr. Panganiban stressed the important role that rural banks play alleviating poverty in the Philippines, since many poor people are not able to access loans from large commercial banks. It is a viable, stable means of earning profits for banks as well as helping the poorest sectors of the economy. Throughout the seminars, Mr. Panganiban emphasized the fact that Filipino rural banks have always serviced the microenterprise sector. Much of their success in this sector is due to the small size of the bank and their strategic local in the rural, lower municipalities of the Philippines. His lecture intended to improve the efficiency of loan processing and approval and credit evaluation.

The seminar was divided into two main lecture topics: cash flow lending and loan pricing. An outline of the seminar is in annex B, and a general design of the workshop is shown in the following table:

Main Topics	Learning Points	Duration	Methodology
Presentation of RBSL	Actual practice and operation of a successful microfinance institution	2 hours	Slide presentation and lecture
Presentation of the MABS-M Program	What MABS-M is and what it has to offer rural banks in Mindanao	1 hour	Short presentation and questions and answers
Cash flow Lending	The Asset Conversion Cycle Analysis	3 hours	Lecture, group exercises, and questions and answers ²
Loan Pricing	Break-even approach in loan pricing	2 hours	Lecture, group workshop with exercises and computations ²

In terms of cash flow lending, Mr. Panganiban explained the "Asset Conversion Cycle

²See annex C for lecture slides and exercises.

Analysis,” in which the banker and borrower decide on a schedule of payment, based on when the borrower has available funds. On this principle, a loan (and subsequent payment schedule) is granted based on the borrower’s ability to pay, or on the cash-flow of the business. Therefore, the viability and success of a business, not collateral, is the basis for loan amount and approval. Mr. Panganiban went through the credit evaluation process, step-by-step, as well.

For the Microfinance Loan Pricing part of the workshop, Mr. Panganiban introduced the “Break-Even Approach.” This suggests that the bank establish a point equivalent to the total cost of deposits and bills payable, at which it will neither gain nor lose money. By defining this break-even point, the bank is able to determine its room for product marketing, and enables the bank to find its niche in the market. First, the bank must study the industry average and pinpoint the market range of loan prices, a process which will also help identify the bank’s strengths and weaknesses. With this break-even point identified, the bank can strategically price its loans. For the bank to profit on a loan, it must price its loans either equal to or below the market average to allow for competitive pricing.³

V. SCHEDULE OF SEMINARS AND NUMBERS OF PARTICIPANTS

As mentioned previously, the actual turn-out in terms of banks represented in the region and numbers of participants was much higher than was originally expected. This is represented in the following table:

Date	Venue	Total RBs in region	Total RBs represented	Total number of participants
9/18/98	Tower Inn, Davao City	31	27	65
9/19/98	Anchor Hotel, General Santos City	20	15	85
10/9/98	Garden Ville, Butuan City	22	16	64
10/10/98	Lauremar Hotel, Opol, Misamis Oriental	26	21	61
11/8/98	Dapitan Beach Resort, Dapitan City	26	19	68
TOTAL		125	98	343

The seminars attracted a very large number of participants, which represented over 78% of the rural banks in Mindanao. Since this was the first workshop to cover the entire island, we

³For more detailed notes on these lectures, see annex A, pages 4-5, 7.

consider this to be a very high turn-out overall. We were very pleased with the numbers of participants and the feedback during and after the seminars, in terms of both the primary goal of sharing the successes of the RBSL's loan strategies, as well as the marketing opportunities for MABS-M. During the breaks, and throughout the day, the MABS-M team introduced themselves to the rural bankers and explained the roll-out phase of the program. They invited banks to submit letters of interest and financial statements to the team for consideration. Based on the positive feedback we received from the participants in the first four workshops towards the MABS-M program, the team decided to invite banks participating in the Dapitan City workshop to bring their LOIs and financial statements. Surprisingly, 7 of the 19 participating banks did so. We are currently receiving LOIs and financial statements from other banks that participated in one of the workshops.

The seminars attracted a wide range of employees from junior loan officers to bank presidents. It was our intention that the seminar information would be attractive to bank officers and presidents. The majority of participants at the workshop in Cagayan de Oro, actually, were presidents of rural banks.

VI. SEMINAR EVALUATIONS

Participants were invited to evaluate the program in Cagayan de Oro and Dapitan City. This was an excellent way of receiving immediate feedback on the seminar for possible improvements at the subsequent venue and/or future seminars. A summary of the evaluations can be found in annex D. The results, over all, were excellent. The most common complaint, however, was the short time frame. Mr. Panganiban also suggested that a two-day workshop be considered in the future, as he was often rushed at the end of the day and had to cut the question and answer session short. This would increase the cost of the seminar, as it would add-on hotel accommodations for many participants. However, it would be possible to split the seminars of this nature into two topics and present them on two consecutive days. This way, participants can choose to attend either one or two seminar days. Another suggestion made by several participants is that Mr. Panganiban reduce the amount of time spent introducing the participants to RBSL during the slide presentation. This could easily be altered to allow for more time for the other lectures.

VII. CONCLUSIONS AND RECOMMENDATIONS

The seminar was overall very successful, as demonstrated by the participants during the workshops, in the evaluations, and by the interest in the MABS-M program that we have received. Ninety-eight percent of the participants who evaluated the program said that they would recommend it to other colleagues. The banker-to-banker approach was very effective in communicating bank operations and proven successes with rural banks in the Philippines. The seminars also proved to be an excellent way to market the MABS-M program to a large group of

potential participant banks.

The participants offered suggestions on other seminars they would like to see MABS-M sponsor. These include savings mobilization strategies, effective collection management, and more cash flow analysis, among others. These suggestions are listed in the evaluations in annex D.

The MABS-M team will propose other seminars and workshops in the future, led by either Mr. Panganiban or by another successful bank's representative. The nominal registration fee will be increased to help cover a greater part of the seminar costs, and eventually RBRDFI will be able to profit from these workshops without the assistance of MABS-M. We conclude that these seminars are an excellent way to educate and inform rural bankers on proven successful microfinance operations.

ANNEX A



Republic of the Philippines
Mindanao Economic Development Council
Regions IX, X, XI, XII, XIII and ARMM



MINDANAO ANG PAO-ASA

MEMORANDUM

TO : MR. SEBASTIAN L. ANGLIONGTO
MEDCo Chairman

THRU : ED EUFEMIA O. CALDERON
DED MA. CLAUDINA C. RODRIGUEZ
MA. FELITA L. SUBANG
MA. THERESA D. VEDUA

FROM : MARGARETH P. MACARAEG

SUBJECT : HIGHLIGHTS OF THE "CASH FLOW LENDING AND LOAN PRICING" WORKSHOPS, 9-10 OCTOBER 1998, BUTUAN AND CAGAYAN DE ORO CITIES

DATE : 13 OCTOBER 1998

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I. BACKGROUND

1. The subject workshops, organized by the *Microenterprise Access to Banking Services in Mindanao (MABS-M)*, in association with the Rural Bankers Association of the Philippines (RBAP), its implementing arm, the Rural Bank Research and Development Foundation, Inc. (RBRDFI), the United States Agency for International Development (USAID) and MEDCo/OPMin, were participated in by the following:
 - a. Presidents, Chief Executive Officers, Managers, Accounts Officers, Loans Officers, and Collections Officers of the Butuan City and Cagayan de Oro City Federations of Rural Banks (RBs);
 - b. Provincial Governor of Caraga Chamber of Commerce, Mr. Jun Galero;
 - c. Chemonics International Inc. Project Administrator, Ms. Tori Paide;
 - d. MABS-M Chief of Party, Mr. Lief Doerring;
 - e. Short-term MABS-M Consultant, Dr. Joseph Lim; and,
 - f. The MABS-M Team composed of Mr. Ed de Castro, Banking Operations and Training Specialist; Mr. Raiké Quiñones, Microenterprise Specialist; and, Mr. Anthony Petalcorin, Management Information System (MIS) Specialist.
2. The activities, which were facilitated by Mr. Andres Panganiban, President and Chief Executive Officer of the New Rural Bank of San Leonardo in Nueva Ecija and Corporate Secretary of RBAP, presented the same topics and materials though conducted in separate outings for the different federations of Mindanao RBs.
3. The subject workshops aimed to inform the attending rural bankers of effective and successful rural banking practices, particularly in microfinance, for eventual consolidation of such practices and experiences on which a system of transferrable information and theories to be established shall be based.

4/F SSS Building, J.P. Laurel Avenue, 8000 Davao City
Telephone Nos. 221-1345, 221-7195, 221-2185, 221-6929, 221-8109, 224-2278
(Fax Nos.) 221-8108, 221-7060, 221-4834
e-mail address: medco@dv. webinq.com

4. Compared to the workshop conducted in Davao City last 18 September 1998, some presentation materials have been added such as those used for the presentation in Cash Flow Lending, Loan Pricing and case studies. A Lunch Meeting between the MABS-M Team and the banks' presidents and managers was also added to discuss issues and concerns regarding the MABS-M Program.

II. HIGHLIGHTS OF DISCUSSIONS

A. ON THE MABS-M PROGRAM

1. Currently working with four (4) PBs, MABS-M, which aims to increase profitability of Mindanao's RBs and cooperative RBs, extends intensive technical training and assistance to the selected PBs in the first six (6) months and monitoring and evaluation 12-18 months thereafter or further as needed. The participating RBs shall likewise receive forms of commodity support like computers, file servers, motorcycles for better out-reach to the barangays, and hand-held radio systems. In return, the PBs shall commit loanable funds, time, and effort to microfinance.
2. The three (3) major strategies of the MABS-M Program are the following:
 - a. Commercial Profitability by assisting RBs identify new markets and extend services to new microenterprise borrowers;
 - b. Flexibility by enabling RBs to make microfinance services a regular part of their portfolios; and,
 - c. Sustainability by introducing effective microfinance lending and deposit models.
3. Since MABS-M intends to work with 5-10 more PBs by November or December this year, the attending RB representatives were urged to join the program and submit the following requirements, due on or before **10 November 1998**, which shall be kept confidential and used for the initial screening:
 - a. *Letter of Interest*;
 - b. *Financial Statements (Balance Sheets and Income Statements)* for the past three (3) years; and,
 - c. *Latest Interim Financial Statements*.
4. If on the initial screening an interested bank could pass, an institutional assessment, which includes interviews with bank personnel and clients, shall be conducted to determine its banking operations, MIS and Microfinance programs. Further, a microenterprise survey shall also be performed to appraise its market. The results and recommendations of these assessments shall be presented to the MABS-M Management Committee for approval.

B. ON NUEVA ECIJA'S NEW RURAL BANK OF SAN LEONARDO (RB SAN LEONARDO)

1. RB San Leonardo, which covers mostly agricultural areas in Nueva Ecija, caters to 4th and 5th class municipalities whose common forms of livelihood include *palay* production, vegetable-growing, and duck-raising. Hence, majority of the bank's portfolio is allocated to microfinance. Further, its strategy is to enter markets of undeveloped areas for less competition. Presently, its direct competition includes informal lending investors and other users and not other RBs.

2. The bank's Nueva Ecija-based staff, totaling to around 35, are good, honest and mostly products of well-known colleges in Manila. By projecting this image of honesty, which is an important quality of a bank staff, the bank management believes that customers will not corrupt the bank and will dutifully pay their loans. Thus, the bank's high level of repayment may be attributed to this factor.
3. The bank's loan portfolio is very diversified in terms of geography (location of borrowers), loan amounts, products (e.g. salary loans, tricycle, poultry, piggery, wedding accessories, etc.), and type of borrowers (e.g. former *Japayukis*, *Iglesia ni Cristo* borrowers, market vendors, home-based women microentrepreneurs, etc.).
4. About 64 percent of the bank's savings deposits, equivalent to only 3 percent of the bank's savings portfolio, are small amounts (not exceeding P1,000) contributed mostly by the poor/small depositors. This indicates that the poor people in the area want to save but they have very limited capacity. Further, in cases of emergencies, they automatically withdraw their savings, constantly leading their accounts to zero balances. Thus, reliable depositors are those from the middle class who are the target clients for microenterprise loans.
5. Reaching a net worth of P21 million in 1998, RB San Leonardo's net worth grew by 950% in four (4) years' time. This increase was drawn from profits and not from additional infused capital. The bank's total outstanding loan also grew dramatically from P750,000 in 1994 to P57 million as of 1998. **FIGURE A** below displays the growth of the bank's net worth and total outstanding loan from 1994 to 1998 while **FIGURE B** shows the distribution of loans, by type, as of 1998.

FIGURE A. Net Worth and Total Outstanding Loan

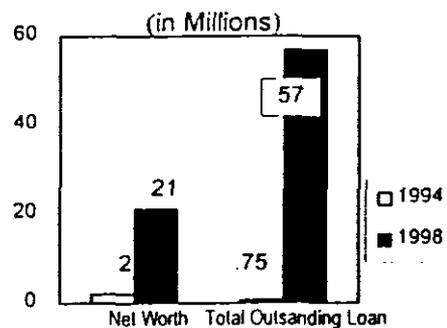
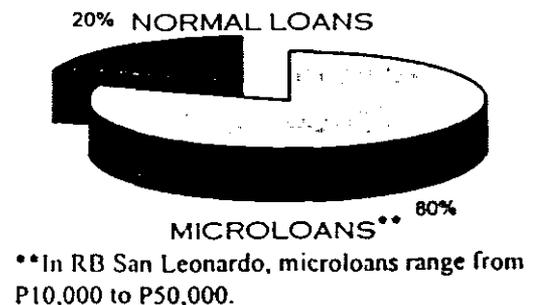


FIGURE B. Distribution of loan, by type, FY 1998



6. The common policies, practices and programs of the bank were similar to those presented in the previous workshops as shown in *Attachment A*.

C. ON MICROFINANCE AND MICROENTERPRISES

1. The RBs' microfinance program is an indirect way of alleviating poverty. Though engaged in some form of business, the enterprising poor, who usually cannot gain financing access from large commercial banks, are kept trapped in the vicious cycle of poverty because of their heavy reliance on earnings for survival. Through the availment of microloans, the enterprising poor are opened to opportunities of working capital expansion which would eventually lead to improved profitability.
2. According to Mr. Panganiban, Philippine RBs, with their small and uncollateralized loans ranging from P2,500 to P50,000, have always been servicing the microenterprise sector.

Mr. Panganiban remarked that based on his experiences, microfinance is not common in commercial banks and involves mostly very personal transactions with customers. To attain success in microfinance, the bank must not depend entirely on theoretical or quantitative analyses of financial management but must become the financial friend of the borrowers.

3. The microenterprise sector is not easily affected by swings in the economy, not even by the Asian economic crisis. When the financial crunch hit the economy last July 1997, most commercial banks were not performing very well as many of their transactions depend on the foreign currency exchange rates. Many RBs, on the other hand, were booming because of the increase in microloans particularly for tricycles and other products. This shows that RBs have a stable market in the microenterprise sector. Further, the Philippine economy may relatively be strong if importance is given to this sector.

D. ON LOAN APPLICATION, PROCESSING AND APPROVAL

1. In processing and approving a loan application, the most important information are those that pertain to the borrower, which can be sourced from interviews and credit investigations conducted in his neighborhood, and those that concern his business that can be generated through financial statements. However, most microenterprise borrowers cannot formulate these statements themselves. Further, many microentrepreneurs are involved in various income-generating activities. For example, a farmer who is engaged in palay production may also have a piggery, a sari-sari store and a daughter abroad who frequently sends remittances. Thus, in processing a loan application, it is best to draw a complete picture of the borrower's economic activities.
2. Documentations must be properly and perfectly done as these are the only protection the bank has in cases of defaults in payments and litigations. As practiced in RB San Leonardo, banks may require non-refundable fees for loan applications to ensure authenticity and avoid pseudo applicants who do not actually intend to borrow but just seek to know their property's appraised value. This fee also evades unnecessary large loans that are not well accounted for or have no real or clear purpose.
3. When disapproving a loan application, it may be better to inform the applicant of the reasons for disapproval. This openness will enable the applicant to provide correction if there is an error or defend himself if there are untrue findings in the credit investigation.
4. Farmers who present Emancipation Patents (EPs) as their collateral are usually not attended to by banks because it is not certain as to whether EPs are mortgageable or not. However, in RB San Leonardo, EPs, if already fully paid with Land Bank, are considered mortgageable properties. For loans to be secured only by partially-paid EPs, the RB becomes the secondary mortgagee only, Land Bank being the primary. RB San Leonardo ventures into such loans by paying off the farmer's remaining balance to Land Bank through a loan and then acquiring the property as the collateral.

E. ON CASH FLOW LENDING

The discussion was the same as that of the Davao City workshop, highlights of which appear in *Attachment B*.

F. ON LOAN PRICING

1. The *Break-Even Loan Price* equivalent to the total cost of deposits (i.e. savings, current, and time) and bills payable, is established at a point where the bank will neither

gain nor lose money. By defining it, the bank is able to determine its elbow room for marketing and locate itself in the competitive market. Thus, the bank must study the industry average (provincial level) and pinpoint the market range. For the bank to profit, the loan must be priced at a range that is either less than or equal to the market range. The bank will definitely lose if its Break Even Loan Price is greater than the market range. With the Break-Even Loan Price, the bank is also encouraged to identify and analyze its strengths and weakness.

2. Other factors which may also be considered in pricing the loan are the loan loss, customer relationship and the industry. In pricing the loan, the bank must develop a mutually beneficial relationship with the customer. The price must be competitive, covering all costs, funding the bank's growth, and earning money for the stockholders.
3. Since Mindanao has a dearth of funds, average interest rates in the island are relatively higher, ranging from 30 to 36 percent. Worse, effective rates are even higher. It was recommended that, coupled with a good deposit mobilization scheme, the bank's break even loan price must be lowered so that a wider spread can be maintained to allow competitive pricing. As the bank gets closer to the market range, the customer is given less choices. Further, with a lower lending rate, the bank may demand a reciprocal business from the borrower like letting him place a savings deposit.

**COMMON POLICIES, PRACTICES AND PROGRAMS
OF NEW RURAL BANK OF SAN LEONARDO**

[NOTE: The information outlined below have been obtained from inputs provided by Mr. Andres Panganiban, President and Chief Executive Officer of New Rural Bank of San Leonardo, during the "Cash Flow Lending and Loan Pricing" Workshop.]

POLICIES	SPECIFIC ACTIVITIES AND PRACTICES
Pro-poor strategies	<ul style="list-style-type: none"> • No minimum initial deposit required • Loans with minimum amount of P10,000
Maintaining high repayment rate	<ul style="list-style-type: none"> • Borrowers are required to personally pay their loans • High penalty fees charged in cases of defaults • Implementation of a "Babad Approach" system wherein collectors actually sit in the borrowers' stores or shops to directly collect from the borrowers' buyers and ensure repayment
Maintaining high quality of bank's management	<ul style="list-style-type: none"> • Hiring of graduates from good universities in Manila • Pirating of high-ranking officials from commercial banks • Ensuring that Credit Investigators and Loan Officers are not pressured by clients to be lenient and forbearing in conducting credit evaluation and collection • Provision of quarterly and performance-based bonuses which may include travels abroad
Implementing promotional campaigns	<ul style="list-style-type: none"> • Conduct of periodic shows wherein depositors and borrowers showcase not only their talents but also their success testimonies attributed to RB San Leonardo's assistance • Encouraging clients to invite potential borrower/depositors
Providing loans to borrowers whose products are firmly imbibed in the culture	<ul style="list-style-type: none"> • Lending to <i>balut</i> vendors, and makers of <i>burong mustasa</i>, smoked fish, mosquito nets, <i>walis tambo</i>, peanut butter, etc.
Deposit mobilization for varied type of depositors	<ul style="list-style-type: none"> • Development of a savings scheme for children known as the "Happy Future Savers Club" • Implementation of a program for Overseas Contract Workers (OCWs) by coordinating with Far East Bank and Solid Bank for their remittances
Delivery of high quality service to bank clients	<ul style="list-style-type: none"> • Provision of sound and effective financial advice to clients • Assignment of a weekly Guest Relations Officer from among its staff to attend to clients' needs

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BASICS OF CASH FLOW LENDING

1. In *Cash Flow Lending*, the mode of repayment is determined by the *Asset-Conversion Cycle* through which the banker draws the schedule of the borrower's cash flow and pinpoints the right moment when he has available funds. This way, the bank is able to ascertain the borrower's cash surplus from which repayments for the loan may be obtained. Thus, repayment is made convenient for him.
2. Every loan applicant who enters the bank is seen equally. What is given focus is the viability and performance of his business. Unlike in Asset-Protection Lending which bases the approval of a loan on the collateral provided by the applicant, the borrower is entertained only when he has high-valued properties.
3. *Tables A and B* defines the major guiding principles of lending and the standard steps involved in credit evaluation.

TABLE A. MAJOR GUIDING PRINCIPLES OF LENDING

PRINCIPLES	DEFINITION
ASSET-PROTECTION LENDING RATIONALE	<ul style="list-style-type: none"> • A loan is seen in its ability to protect itself through a collateral. • The business for which the loan is to be allocated is not emphasized.
ASSET-CONVERSION CYCLE LENDING RATIONALE	<ul style="list-style-type: none"> • A loan is given on the basis of the borrower's capability to pay. • The important element involved here is the cash flow of the business.

TABLE B. CREDIT EVALUATION PROCESS

STEPS	SPECIFIC ACTIVITIES
A. Threshold Test	<ol style="list-style-type: none"> 1. Applicant Orientation and Interview 2. Credit Investigation 3. Banks and other Financial Institutions Checking 4. Court and Police Checking
B. Credit Analysis	<ol style="list-style-type: none"> 1. Assessment of applicant's current position 2. Evaluation of proposed project 3. Asset Conversion Cycle Analysis
C. Collateral Appraisal	<ol style="list-style-type: none"> 1. Asset Protection 2. Property Valuation
D. Risks and Mitigants Study	Analysis to determine if lending risks are fully mitigated
E. Conclusion	Decision-making on the applicant's creditworthiness
F. Relationship Packaging	Documentation
G. Monitoring	Assessment of Borrower's Financial Status
H. Collection Management	Accounting of Loan Repayments

ANNEX B

Outline of Training on Loan Pricing and Cash Flow Lending

I. Loan Pricing

Duration: 2 hours

Methodology: Lecture and mini-workshop session by group

Materials:

- Handouts from the lecturer
- Participants to bring their bank's FS for 1996 & 1997 and/or financial projections for 1998 or 1999 (for the workshop practice session)

A. Lecture (1 hour)

- Break-even approach: rationale and significance
- Determinants in loan pricing
 - Break-even lending rate
 - Industry factor
 - ROI
 - Customer-relationship factor
- Steps in a break-even lending rate analysis
 - Projecting expenses and loan portfolio
- The Case of NRBSL

B. Workshop session (1 hour)

- Projecting the bank's expenses and loan portfolio
- Determining the break-even lending rate
- Pricing the loan
- Sensitivity analysis: Exercises

II. Cash Flow Lending

Duration: 2 hours

Methodology: Lecture; case analysis; role play

Materials: Lecturer's handouts; mini cases

A. Lecture (1 hour)

- Rationale
 - Schools of thought in bank lending
 - Cash flow lending
 - Collateral lending
 - Others
 - Repayment is the heart of credit
 - Money is fungible

- The credit evaluation process using cash flow lending rationale
 - Threshold test
 - Character test: Pass or Fail rating system
 - Assessment of the current financial position(s) of the borrower
 - Drawing up of the asset-conversion-cycles
 - Identifying cash flows (sources and uses of funds)
 - Evaluation of the proposed project using the asset-conversion-cycle approach
 - Integration of all cycles, when applicable
 - Identifying projected cash flows (sources and uses of funds)
 - Risks and mitigants analysis
 - Collateral appraisal, when applicable
 - Conclusion
 - Relationship packaging
 - Amount of loan
 - Interest rate
 - Repayment scheme
 - Collateral, if any
 - Other terms and conditions of the loan
 - Reciprocal business (deposits, etc.)
 - Monitoring program (or repayment management program)

B. Workshop and exercises

fn:S\technical\BoyPee Seminar Outline\22 July 98

ANNEX C

Credit Evaluation Process

CREDIT EVALUATION PROCESS

THRESHOLD TEST

- Orientation & Interview
- Credit Investigation
 - Character checking
 - Banks & financial institutions checking
 - Court & Police cheking

CREDIT ANALYSIS

- Assesment of applicant's current position
- Evaluation of proposed project/s
- Asset Conversion Cycle Analysis

COLLATERAL APPRAISAL (Asset Protection)

- Property Valuation

RISKS AND MITIGANTS-STUDY

Are the risks fully mitigated?

CONCLUSION

- Is the applicant creditworthy?

RELATIONSHIP PACKAGING

MONITORING

COLLECTION MANAGEMENT

I. Initial Interview

A.) Orientation

B.) Interview

(could lead to
formal application)

II. Threshold Test

A.) *Personal Identity*

- 1.) name
- 2.) address
- 3.) date of birth
- 4.) status
- 5.) spouse
- 6.) number of children
- 7.) educational attainment
- 8.) occupation
- 9.) I.D.
- 10.) signature

B.) Character Check

- 1.) barangay officials
- 2.) neighbors
- 3.) superiors and
co-employees
- 4.) personnel officer
- 5.) business partners

C.) Banks and other financial institutions checking

1.) Deposit accounts

a.) Account Type

(S/A,TD, C/A others)

b.) ADB

c.) length of relationship

d.) account management
particularly C/A

2.) Loan accounts

a.) Loan Amount

b.) Term

c.) Date Granted

d.) Date to mature

e.) Purpose

f.) Interest rate

g.) Security

h.) Repayment schedule

i.) Outstanding balance

j.) Length of relationship

k.) Credit Experience

l.) other remarks

D.) Court & Police Checking

a.) Municipal Trial Court

b.) Regional Trial Court

c.) Municipal Police
Station

Rating: Pass or Fail

LOAN PRICING

- * develop mutually beneficial relationship with customer
- * remain competitive
- * cover costs
- * fund the bank's growth
- * earn money for the stockholders

Costs of Funds

Deposits

- savings
- C/A
- time

Bills payable

- loans
 - rediscounting
 - O/N or call loan
-
- bank must have a clear strategy on fund sourcing
 - cheap
 - broad
 - long

Administrative Expenses

- o all expenses except loan loss provisions and cost of funds
- o study industry average (provincial level)
- o pinpoint market range
- o establish trend of the bank's AE/Ave. LP over a period of 3-5 years
- o project A/E visavis projected average LP

B/E loan Price = Sum of cost of
funds; administrative
expenses

loan loss rate ?
capitalization rate ?

The diagram consists of a large circle at the top containing the equation $\text{Loan Price} = \text{Break-even} + \text{K rate}$. Below the circle are three upward-pointing arrows. The leftmost arrow is labeled "Loan Loss", the middle arrow is labeled "Customer Relationship Factor", and the rightmost arrow is labeled "Industry". A dashed line extends from the bottom of the "Loan Loss" arrow towards the bottom left of the page.

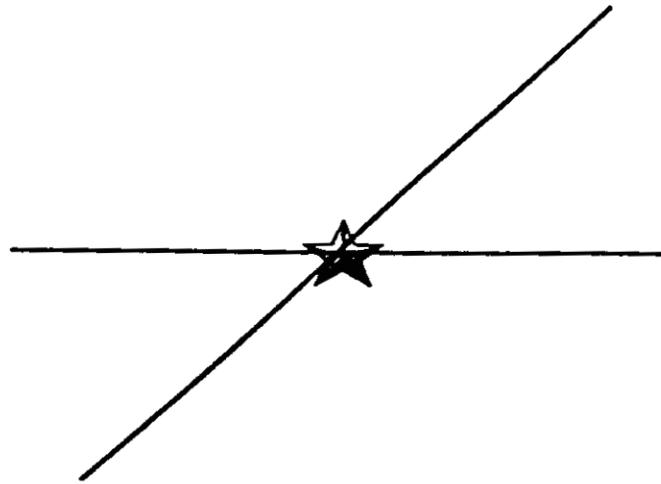
$$\text{Loan Price} = \text{Break-even} + \text{K rate}$$

Loan
Loss

Customer
Relationship
Factor

Industry

Break-Even Loan Price



- o determine the price level by which the bank will neither lose or earn money
- o demonstrates the bank's elbow room for marketing
- o enables the bank to locate itself in the competitive market
- o encourages the bank to identify/analyze strengths and weaknesses

Loan Pricing

Exercises

- A.) Average loan portfolio of Moderate Rural Bank is P42,625,307 and has an average total expenses of P10,312,863. Given a margin of 2%, compute the bank's lending rate. Is Moderate Rural Bank's lending rate within the market range? Plot your answer on the given bar.
- B.) Due to the slow down loan in loan applications and non-renewal of existing loans, the bank's average loans outstanding dropped by 20%. The bank's expenses, however, remained at the same level due to lack of austerity measures. With the margin still at 2%, compute and plot the bank's lending rate.
- C.) Moderate Rural Bank launched a spirited promotional campaign raising their existing deposit by P10,000,000.00. Required reserve is 5%. The new funds created by the rise in the deposits was fully utilized through new loan releases. The campaign despite new personnel and other costs involved pushed the expenses of the bank by only P750,000.00. If the bank's previous lending rate is 26%, by how many percentage points can it decrease its rate and still maintain the same margin. Plot your answer.
- D.) Due to poor repayment performance, Moderate Rural Bank was forced to write-off 3% of its average loan portfolio. Due to lack of provisions, the write-off directly increased the bank's expenses. Pressured by the Bank's board to maintain the same interest margin, the bank's management plans to increase its lending rate. What would be the bank's new interest rate? Is it still within the market range. Plot your answer.
- E.) The Board of the Moderate Rural Bank promised its manager a special bonus if the interest margin increases from 2% to 4%. The bank's lending rate is at 26%. Through new deposits, the manager increased the average loan portfolio by P7,000,000.00. Inspired to meet his target, the manager was able to keep the corresponding increase in the expenses by only 5% compared to its previous level (P10,312,863). Given the changes, did the manager meet his target? What would be the bank's new break-even rate. Plot your answer.

Loan Pricing

Exercise

0000 400 0000

0000 0000 0000

0000 0000 0000

	Market Range	
	12%	13%
	14%	15%
	16%	17%
	18%	19%
	20%	21%
	22%	23%
	24%	25%
	26%	27%
	28%	29%
	30%	31%
	32%	33%
	34%	35%
	36%	37%
	38%	39%
	40%	

A.) _____

B.) _____

C.) _____

D.) _____

E.) _____

III. Credit Analysis

A.) Assessment of borrower's current position

1.) Description of present economic activity/ies

Business

a.) business type

b.) site

c.) volume of production

d.) sales

e.) raw material source

f.) market

g.) industry situation

h.) ownership and management

i.) ownership type

- single

- partnership

- corporation

ii.) management structure

iii) labor

Employed

- a.) employer
 - i.) government
 - ii.) private
- b.) job description
- c.) employment status
 - i.) regular/permanent
 - ii.) casual
 - iii.) contractual
- d.) remuneration
 - i.) gross pay
 - ii.) net pay
- e.) mode of salary disbursement
 - i.) paycheck
 - ii.) cash
 - iii.) others
- f.) employment history

2.) Income and Expense

a.) Income

i) Regular income

- salary
- remittance
- income from regular business

ii.) Seasonal income

- livestock
- crop

b.) Expenses

i.) Regular expenses

- food and groceries
- utilities
- education
- personal effects
- others

ii.) Occasional expenses

c.) Savings/surplus

3.) Assets and Liabilities

a.) Assets

i.) Current

ii.) Fixed Assets

b.) Liabilities

c.) Equity/capital

B.) Evaluation of proposed project/s

1.) Project description

a.) personal or consumer use

i.) personal effects

ii.) education

**iii.) household asset acquisition
or improvement**

b.) business

a.) business type

b.) site

c.) volume of production

d.) sales

e.) raw material source

f.) market

g.) industry situation

h.) ownership and management

i.) Ownership type

- single

- partnership

- corporation

ii.) Management structure

iii.) Labor

MODERATE RURAL BANK
Statement of Condition
As of December 31, 1997

RESOURCES

Cash on Hand and Due from Banks	P23,506,061.00
Loans & Discount (net)	42,625,307.00
Investments	5,000,000.00
Bank Premises, Furnitures, Fixtures and Equipment (Net)	4,617,799.00
Other Assets	766,024.00
TOTAL RESOURCES	<u>P76,515,191.00</u>

LIABILITIES

Deposit Liabilities	P49,023,141.00
Bills Payable	8,000,000.00
Unearned Income & Other Deferred Credits	1,488,579.00
Other Liabilities	1,953,964.00
TOTAL LIABILITIES	P60,465,624.00

CAPITAL ACCOUNTS

Capital Stock - Common	P 5,000,000.00
Surplus	764,534.00
Undivided Profits	10,285,033.00
TOTAL CAPITAL FUNDS	P16,049,567.00
TOTAL LIABILITIES and CAPITAL	<u>P76,515,191.00</u>

MODERATE RURAL BANK
Statement of Conditions
As of December 31, 1997

INCOME

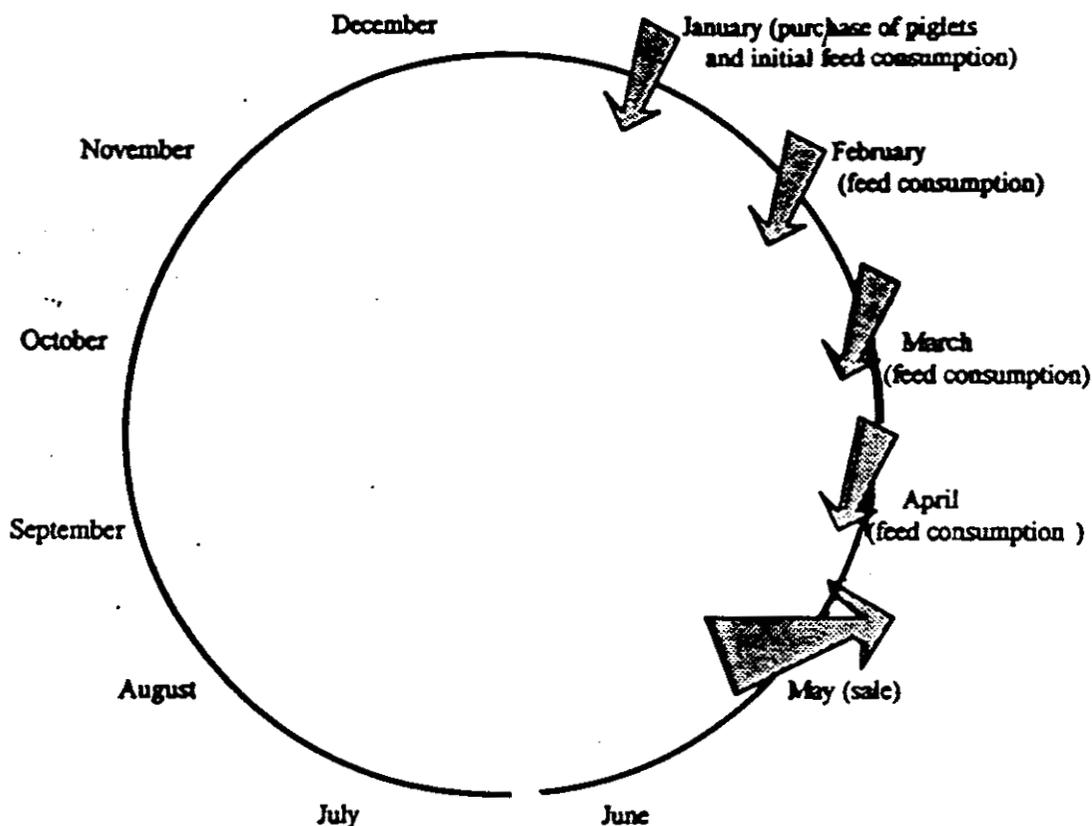
Interest/Discount Earned -	
Loans and Discounts	P11,367,854.00
Interest - Deposit with Banks	917,876.00
Interest - Investments	120,000.00
Service Charge and Fees	734,434.00
Other Income	1,313,108.00
	<hr/>
TOTAL INCOME	P14,453,272.00

EXPENSES

Interest Expense	P 4,565,543.00
Compensation and Fringe Benefits	2,820,794.00
Advertising and Promotions	776,214.00
Representations	516,000.00
Depreciation	687,546.00
Mgt. & Other Professional Fees	256,232.00
Insurance	78,427.00
Other Expenses	612,107.00
	<hr/>
TOTAL EXPENSES	P10,312,863.00
	<hr/>
NET INCOME	P 4,140,409.00

ASSET CONVERSION CYCLE

Activity: Hog-raising (10 heads)



<u>Month</u>	<u>Activity</u>	<u>Financing</u>	<u>Cost Conversion</u>	<u>Net Income</u>
January	purchase of piglets	P12,000.00		
	feed consumption	2,500.00		
February	feed consumption & supplements	4,000.00		
March	feed consumption & supplements	6,000.00		
April	feed consumption & supplements	7,500.00		
		P32,000.00		
May	sale		P 40,000.00	P 8,000.00
June				

*Assumptions: piglet costs P1,200/hd.; average feed consumption is P2,000/hd/cycle; ave. weight during sale is 80 kilos/hd and price per kilo is P50.00

ASSET CONVERSION CYCLE

SCENARIO:

Juan dela Cruz is an old client of Moderate Bank. In January 1999, he chanced upon a 1,000 sq. m. lot being bargained for P22,000.00. He plans to plant 20 mango trees (cost is P50.00 each) on said lot once acquired. He was told that he will spend P1,000.00 for the transfer of title. Immediately, he applied from Moderate Bank a new loan in the amount of P60,000.00. The bank's lending rate is 25% pa plus a straight service charge of 5% both collected in advance. Mr. dela Cruz wants the term to be 1 year.

Mr. Manager instructed his CI to conduct an investigation on the loan application of Mr. dela Cruz. The following are the CI findings:

- 1.) Mr. dela Cruz cultivates a 1-ha. irrigated palay farm (twice a year cropping) with an average yield of 80 cavans per harvest. Average price per cavan is P300. Production period is for 3 months (excluding harvest month) with an average monthly expenditure of P3,000.00. Harvests are scheduled in April 1999 and October 1999.
- 2.) Mrs. dela Cruz maintains a sari-sari store with a daily net income of P120. The store is open daily (30 days in a month).
- 3.) A daughter of the applicant sends a regular remittance of P5,000.00 monthly. However, the daughter wrote in January 1999 that she will not be able to remit during the months of April to July 1999 due to job transfer and will resume the remittance in September 1999.
- 4.) Mr. dela Cruz raises 2 hog fatteners (acquired December 1998) and projected to be disposed in April 1999 for P8,000.00 (2 hogs). Production expense for both hogs is P1,000.00 monthly (month of April excluded).
- 5.) Household expenses (food, utilities, education, etc.) is P3,000.00 monthly except during the months of April, June, October and December when it reach P8,000.00
- 6.) Mr. dela Cruz pays a monthly amortization of P1,000.00 for a tricycle unit he acquired 3 years ago. The amortization shall end in May 1999.

EXERCISES:

- 1.) Draw and make a calendar of Mr. dela Cruz' asset conversion cycle from January 1999 - January 2000
- 2.) If you were Mr. Manager, how much loan will you grant? Why?
- 3.) Draft an appropriate repayment schedule for Mr. dela Cruz based on his asset conversion cycle

ASSET CONVERSION CYCLE

	January 1999	February 1999	March 1999	April 1999	May 1999	June 1999	July 1999	August 1999	September 1999	October 1999	November 1999	December 1999	January 2000
Cash-in: Loan Proceeds	24,500.00												
palay prod.				24,000.00						24,000.00			
store income	3,600.00	3,600.00	3,600.00	3,600.00	3,600.00	3,600.00	3,600.00	3,800.00	3,800.00	3,600.00	3,600.00	3,800.00	3,800.00
remittance	5,000.00	5,000.00	5,000.00					5,000.00	5,000.00	5,000.00	5,000.00	5,000.00	5,000.00
hog-raising				8,000.00									
<hr/>													
	33,100.00	8,600.00	8,600.00	35,800.00	3,600.00	3,600.00	3,600.00	8,600.00	8,600.00	32,600.00	8,600.00	8,600.00	8,600.00
Cash-out:													
land acq.	22,000.00												
titling	1,000.00												
wango trees	1,000.00												
hog-raising	1,000.00	1,000.00	1,000.00										
palay prod.	3,000.00	3,000.00	3,000.00				3,000.00	3,000.00	3,000.00				3,000.00
household exp.	3,000.00	3,000.00	3,000.00	8,000.00	3,000.00	8,000.00	3,000.00	3,000.00	3,000.00	8,000.00	3,000.00	8,000.00	3,000.00
tricycle smort.	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00								
<hr/>													
	32,000.00	8,000.00	8,000.00	9,000.00	4,000.00	8,000.00	6,000.00	6,000.00	6,000.00	8,000.00	3,000.00	8,000.00	8,000.00
Surplus:	1,100.00	800.00	600.00	26,800.00	(400.00)	(4,400.00)	(2,400.00)	2,600.00	2,600.00	24,600.00	5,600.00	600.00	2,600.00 = 60,300.00
Repayment Schedule:				15,000.00				1,000.00	1,000.00	14,000.00	3,000.00		1,000.00 = 35,000.00

Notes: Loan is secured by the approval for 235,000.00 and released in January, 2000.

ANNEX D

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

**EVALUATION
CASH FLOW LENDING & LOAN PRICING SEMINAR**

November 8, 1998

Dapitan City Resort Hotel, Dapitan City

1. Reaction to the seminar	Excellent	Very Good	Fair	None	Total
a. Seminar	4 (24%)	13 (76%)			17
b. Material	6 (35%)	11 (65%)			17
c. Instructor	9 (53%)	8 (47%)			17
d. Pace	6 (36%)	10 (59%)		1 (5%)	17
d. Practicality of information	7 (42%)	9 (53%)		1 (5%)	17
2. Would you recommend this program to others?					
a. Yes	17 (100%)				
b. No					
Total					
3. Areas particularly beneficial to the participants job performance.					
a. All areas	e. Credit Analysis				
b. Loan Pricing/Evaluation	f. Asset Conversion Cycle				
c. Cash Flow Lending	g. Micro enterprise & Micro finance				
d. Credit Collection Technique	h. beneficial to 3 rd & 4 th class municipalities				
4. Least like about the program.					
a. Very short time frame					
b. Other participants were uncooperative					
c. Overview of MABS-M Program					
d. Generate more funds from deposit of middle class clients					
5. Topics that should be added/deleted to improve the presentation.					
a. Add	a.1. Make it a two-day or stay-in seminar a.2. Should have more workshops				
b. Delete	b.1. Should not be time pressured				
6. Topics would like to see in future MABS-M training/seminars.					

- a. Cash Flow
- b. Credit Collection Scheme/ Strategies
- c. Repayment Management
- d. Microfinance/Microenterprise
- e. Fund sourcing
- f. Product Innovation

7. Overall Comments

- a. Very good/ satisfactory
- b. Informative program
- c. Lectures were good/impressive
- d. Could increase savings and deposits and
could help establish good relationship with the clients
- e. Creative and energetic speaker and best entertainer
- f. Other co-employees wanted to attend the basic rural banking seminar
- g. Applicable to bank operation

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

**EVALUATION
CASH FLOW LENDING & LOAN PRICING SEMINAR
October 10, 1998
Lauremar Beach Resort, Opol, Cagayan de Oro**

1. Reaction to the seminar	Excellent	Very Good	Fair	None	Total
a. Seminar	26 (62%)	15 (36%)	1 (2%)		42
b. Material	25 (60%)	16 (38%)	1 (2%)		42
c. Instructor	33 (79%)	9 (21%)			42
d. Pace	13 (30%)	25 (60%)	2 (5%)	2 (5%)	42
d. Practicality of information	27 (64%)	10 (24%)	1 (2%)	4 (10%)	42
2. Would you recommend this program to others?					
a. Yes	38 (97%)				
b. No	1 (3%)				
Total	39				
Note: (3) Participants have no answers					
3. Areas particularly beneficial to the participants job performance.					
a. All areas	e. Credit Analysis				
b. Loan Pricing/Evaluation	f. Asset Conversion Cycle				
c. Cash Flow Lending	g. Micro enterprise & Micro finance				
d. Determining the Break Even Rate					
4. Least like about the program.					
a. Very short time frame					
b. The program/agenda are not strictly followed					
c. Too much concentration and discussion on the products and operation of New Rural Bank of San Leonardo					
d. Relationships between banks and borrowers					
e. Breaks					
5. Topics that should be added/deleted to improve the presentation.					
a. Add	a.1. Must have practical application on micro finance a.2. Give more emphasis on the techniques on cash flow analysis, loan packaging and cost mix computation for loan pricing				
b. Delete	b.1. b.2. b.3.				

6. Topics would like to see in future MABS-M training/seminars.

- a. All topics
- b. Savings mobilization strategies
- c. Bank lending procedures
- d. Effective collection management
- e. Assessment and evaluation on microfinance
- f. Long term cash flow analysis

7. Overall Comments

- a. Very good/ satisfactory
- b. Excellently done
- c. Beneficial to rural bankers
- d. Worthwhile, informative and motivating
- e. Effective Speaker/excellent presentor
- f. Some topics are applicable and some are not
- g. Good accommodation
- h. Short time frame