

MABS-M PROGRAM
Microenterprise Access to Banking Services in Mindanao

Expanding MABS Outreach to Muslim Clients

Submitted by:

Lief Doerring

Chemonics International Inc.
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Introduction

This report is divided into four main sections: expanding financial services in Muslim Mindanao and an overview of the study, opportunities in working with current MABS-M participant banks, opportunities in working with new Muslim-owned banks or banks operating in Muslim areas, and a final section on general recommendations. Below, we begin with a short background on the history of Muslim Mindanao.

History of Muslim Mindanao. Most of the 5 million Filipino Muslims reside principally in Mindanao and neighboring islands. This figure constitutes roughly seven percent of the total population in the Philippines, and Muslims also represent the single largest minority group in country. Islam was introduced to Mindanao when Shariff Makhdum came to the Sulu archipelago sometime in 1310. Later in the same century, Shariff Kabunsuan brought the religion to greater Cotabato and Lanao. The introduction of Islam by these Arab missionaries led to the formation of Islamic communities throughout Mindanao. The majority of Mindanao's population converted to Islam.

In the 1900s, the Philippine government opened Mindanao to immigrants from the Visayas and Luzon, in order to take advantage of Mindanao's rich natural resources. Initially, the new Christian settlers co-existed peacefully with the existing Muslim communities. However, a gradual erosion in relationships eventually led to protest and revolt against the government which escalated into armed conflict between the Moro National Liberation Front (MNLF) and the Philippine armed forces. This conflict continued intermittently for more than 20 years, with a peace agreement signed between the MNLF and the Philippines government on September 2, 1996.

Previous to the end of the MNLF conflict, on November 6, 1990, the Autonomous Region for Muslim Mindanao (ARMM) was created during the presidency of Corazon Aquino. Considered the 15th region of the Philippines and covering approximately 12,000 square kilometers, ARMM is located in the southern portion of Mindanao and includes the mainland provinces of Lanao del Sur, Maguindanao, and the traditional island centers of Muslim economic, political, and social activities: Sulu and Tawi-Tawi. ARMM has a population of more than two million predominantly Muslim inhabitants.

Rural banks in ARMM have faced a difficult struggle, especially those in conflict areas. For example, in late 1998, sixteen Muslim-owned rural banks were closed in the Lanao del Sur area. These banks had not actually been in operation since their last BSP examinations in the 1982-1987 period. The 1998 closings represented final PDIC endorsement of the bank liquidations. Still, the closings and the long liquidation process have not helped the perception of risk to rural banks in the ARMM region. This is made worse by the capitalization problems at the Islamic Philippines Amanah Bank (PAB), which is effectively defunct and inactive at present as it suffers from continued high delinquency rates and liquidity problems. Created in 1973 by Presidential Decree, the PAB has seven branches located in the major cities of Muslim

Mindanao, plus one in Makati. The establishment of the PAB was a response by the Philippines government to the Muslim rebellion, and its primary task was to assist in the rehabilitation and reconstruction in Mindanao, Sulu, and Palawan. It is not strictly an Islamic Bank, since interest-based operations continue to coexist with the Islamic methods of financing.

A. Expanding Micro-Financial Services to Muslim Areas of Mindanao

A1. Methodology and Scope of the Assessment

As part of the rapid appraisal and assessment of the potential for the MABS-M program to intensify the scope and level of services participant banks offer to Muslim clients, field visits and meetings with banks were undertaken to the areas of Mindanao where the concentration of Muslims is the highest. As highlighted in the map in Annex A, these areas included Maguindanao, Lanao del Norte, Lanao del Sur, Cotabato City, South Cotabato, and Sultan Kudarat. Institutional assessments of potential rural banks were conducted on the Rural Banks of Parang, Datu Paglas (conducted in 1999), Cotabato City, and Maranao (in Marawi City), and also included broader consultation with the following rural banks:

Rural Bank	Location	Other information
1. Partner Rural Bank	Cotabato City	Christian-owned, 4 units
2. Rural Bank of Parang	Maguindanao region	Muslim-owned, single unit
3. Rural Bank of Cotabato	Cotabato City	Christian-owned, majority Muslim clients, single unit
4. Rural Bank of Lebak	Sultan Kudarat region	Current MABS-M PB, 2 units, Christian-owned, 15-20% Muslim clientele in MABS-M program
5. Rural Bank of Midsayap	North Cotabato region	Christian-owned, 2 units
6. Rural Bank of Tacurong	South Cotabato region	Current MABS-M PB, single unit, Christian-owned, 15-20% Muslim clientele in MABS-M program
7. Rural Bank of Isulan	South Cotabato region	Sister bank to RB Tacurong, 4 units, Christian-owned
8. Rural Bank of Datu Paglas	Maguindanao region	Muslim-owned, single unit, data collected in 1999
9. Kapatagan Rural Bank	Lanao del Norte	Current MABS-M PB, Christian-owned
10. Siam Rural Bank	Lanao del Norte	Current MABS-M PB, Christian-owned
11. Cooperative Bank of Lanao del Sur	Marawi City	Muslim-owned, 100% Muslim clientele
12. Rural Bank of Maranao	Marawi City	Muslim-owned, 100% Muslim clientele
13. UCPB Rural Bank	Nationwide	Christian-owned, 2 nd largest

		rural bank in country, one branch in Basilan
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A2. Major Challenges

Cultural Divide. In general, we found that Christian bankers were extremely reluctant to lend to Muslim clients, and vice versa. There are especially high levels of mutual animosity in areas where Muslim and Christian communities overlap or co-exist.

Reaching Muslims. While there are some obvious and large Muslim communities such as Marawi City, the Muslim population at large is generally rural, remote, and clustered in small towns or villages. Most of these smaller villages appear to have no formal financial institution of any kind. Because of the ongoing conflict, some Muslim communities and people have been on the move, such that the number of Muslims in any given community can change very quickly. Even in larger cities, populations fluctuate. For example, Cotabato City recently elected a Muslim mayor. The balance of Muslims to Christians has since reportedly changed from 40 percent Muslim to 60 percent, a response to the perception that a Muslim mayor will create more opportunities for Muslims in the city. Finally, banks do not – and should not – track clients by religion, so delineating exact numbers of Muslim clients in each bank was not possible.

Perception that Muslim clients are unable to meet basic bank loan prerequisites. In many cases, Christian bankers reported that they only lend to established Muslim businesses (which are few) as most other Muslim clients do not meet the loan prerequisites, which can include a business permit and some sort of permanent business location. Many Muslims doing business in Christian communities are “ambulatory vendors,” and do not have this kind of documentation. Another Christian bank required an income tax return as part of the application process, but reported that most Muslims could not produce this documentation and so were turned down for a loan. Further, in other cases, Christian banks reported that Muslims in their area lack a permanent address as they are evacuees or refugees. Without an address, banks have no way to follow up on loan collection.

Borrower maturity. In Marawi City, the Muslim-owned RB Maranao has been able to find established Muslim clients and did not complain about Muslim clients being unable to meet loan prerequisites. However, the bank requires 2 hours of client training per day for one week before extending a loan. Reasons cited for this training included client inexperience with a commercial bank, high client exposure to government handouts and grants, and the need to build trust and a business relationship. This high level of pre-loan training has obvious cost implications for a microfinance operation, and is also due to the Grameen-type group lending approach the bank follows.

Perceived inability to collect from and litigate against Muslim clients. Christian bankers expressed concern that, because some Muslims support MILF secession efforts and do not necessarily respect the current government and related legal structures, it can be extremely difficult to collect from or litigate against Muslim clients who do not repay their loans. Even land collateral was viewed by many Christian bankers as inadequate security as measured against the

risk of lending and default given the difficulty in attempting to foreclose on property. Additionally, other Christian bankers expressed fear in pressing for collection too strongly, for fear of retaliation or kidnapping. Two of the three Muslim banks visited were not actively litigating against their defaulters, citing the need to be sensitive to the hardships of their clients. However, the third Muslim bank in Marawi City is currently litigating its first case, the outcome of which will be a litmus test for future legal actions against defaulting clients. In one Christian-owned bank, RB Cotabato, the bank has hired a Muslim collection consultant. She is paid on commission, 10% of the principal for any of the past due loans she can collect. While this effort is young, it is meeting with some success and serves to buffer bank management from the perceived risk of retaliation.

A3. Major Opportunities

Even given the constraints listed above, there appear to be some major opportunities for a program like MABS-M to reach greater numbers of Muslim clients through rural banks in Mindanao:

Muslims have a history of entrepreneurship. The traditional occupation of Muslims in Mindanao is trading, both wholesale and retail. This trading is largely unregulated and small-scale. Significantly, the entrepreneurs do not currently access the formal banking system. For MABS-M and participant banks, this represents a potentially large – and untapped – market. In addition, trading-related enterprises have regular cash flow, and have proven to be among the best clients for the existing MABS-M participant banks.

Muslim entrepreneurs currently rely on moneylenders, a practice that Islam prohibits. Even in Marawi City, most Muslim entrepreneurs are forced to borrow from loan sharks or “five-sixers.” Rates of interest are reportedly charged as traditional interest rates as high as 20 percent per month, or as an up front fee of 20 percent, no matter what the length of the loan term may be. This situation offers significant potential for a rural bank willing to offer Muslim clients financial services. For example, RB Maranao packages its services as “sharia” banking, or Islamic Banking, with no interest being charged, but only a fee for “profit-sharing.” Additionally, the Muslim-owned bank markets their services as “rescuing” good Muslims from bad moneylenders. In effect, they are offering clients a way to save money *and* stay within the dictums of Islam, a combination which appears to be working very well for them.

There is a well-run Muslim-owned bank in Marawi City that has started a microfinance program using PCFC money and training obtained through MABS-M. As highlighted below in Section C, the Rural Bank of Maranao in Marawi City offers significant potential for MABS-M to reach Muslim clients. The bank is 100 percent Muslim-owned and has 100 percent Muslim clientele. In our short visit, the bank appears to be well-managed and -- while still young and small -- is also appears to be in relatively good financial shape. Using a P3 million loan from PCFC and a P1 million loan from the ERAP Trust Fund, they have already started a new microfinance program, focused on group lending to women. While off to a good start, the bank is making some errors due to inexperience. They would benefit from assistance in deposit mobilization,

loan pricing, loan repayment management, computerization, and other areas of bank strengthening and training.

B. Working Through Existing MABS-M Participant Banks

As part of this assessment, four MABS-M participating banks that operate in areas with significant Muslim populations were interviewed. “Significant” was defined as a population of at least 20 percent Muslims in the immediate service area of the bank. These four MABS-M banks included RB Tacurong in South Cotabato, RB Lebak in Sultan Kudarat, and Siam Bank and RB Kapatagan in Lanao del Norte. Findings of these interviews, as well as some data from each of these banks, is presented below.

B1. Status and Overview

All four of the PBs operating in Muslim areas have achieved profitability in their MABS-M-assisted microfinance operations. As of February 2001, the banks had achieved the following results:

Participant Bank	Date Started, Number of Current Participating Units	Number of Active Borrowers	Microenterprise Loan Volume	PAR, more than 7 days
RB Lebak	1 st rollout, 1	228	P947,730	6.83%
RB Tacurong	2 nd rollout, 1	286	P2,065,609	0.00%
Siam Bank	2 nd rollout, 6	534	P5,145,619	2.80%
RB Kapatagan	1 st rollout, 2	587	P2,731,342	3.44%

Additionally, in interviews, the participant banks reported that they are lending to a small base of Muslim clients through their MABS-M-assisted microfinance units. Reported percentage of Muslim clients ranged from 10-20% of their microenterprise portfolio. As previously noted, it is not possible to get an exact number of Muslim clients, as loans are not -- and should not be -- monitored by religion. However, most of the bankers know their communities and clients well, including religious background, and so were able to estimate the percentages of Muslim clients.

Significantly, RB Tacurong reported that the percentage of Muslim clients in their MABS-M-assisted microenterprise portfolio is 15-20 percent of their microenterprise portfolio while Muslim clients are only 5-10 percent of their larger portfolio. RB Lebak reported similar statistics. In other words, through the use of the MABS-M Approach, the banks are 2-3 times more likely to lend to Muslim clients. This could be for a variety of reasons, including no collateral requirements, the high percentage of Muslims in microenterprise-related trading businesses, or smaller loan sizes. Regardless of the reason, MABS-M appears to assist in bridging the gap between Muslim microenterprises and access to financial services, including overcoming the high degree of risk perceived by Christian-owned rural banks of lending to Muslim clients. The MABS-M efforts in these banks are still new and growing. As rural banks

gain more experience with Muslim clients, there is great potential for continued increases in outreach to Muslim clients.

B2. Conclusions: Working Through Existing MABS-M Banks

In summary, there appears to be some potential for working through existing MABS-M banks to reach Muslim clients. However, the opportunities are specific to each bank, and for the large part these Christian banks are reluctant to make concerted efforts to target Muslim clients. They were not overly interested in designing or offering a Muslim-friendly loan product (one that does not charge interest) or in hiring Muslim staff, though one or two of the banks might agree to do so with the right assistance from MABS-M. On a positive note, there are at least two current MABS-M participant banks that are interested in opening branches in areas with large Muslim populations. Specific opportunities bank are listed by bank below:

- **RB Lebak.** The Rural Bank of Lebak has no problem with lending to Muslims using their existing methodologies and the current MABS-M Approach. Significantly, the 15- 20 percent of Muslim clients in the bank’s microenterprise portfolio appear to match the percentage of Muslims in the Sultan Kudarat region (as shown in the map in Annex A). However, RB Lebak reported that the past due ratio for Muslim clients tends to be higher. Therefore, MABS-M and USAID can best assist RB Lebak by offering continued training in repayment management, and by continuing to help the bank in its general outreach and expansion efforts, since it is already reaching Muslims.
- **RB Tacurong.** The manager of RB Tacurong reported that the bank plans to expand to Buluan, a 3rd class municipality in Maguindanao with a predominantly Muslim population. To do so, they would like to have help in developing a program and system for client training, in order to overcome the perceived lack of education and inexperience with banks among Muslim clients. RB Tacurong was also interested in some type of loan guarantee arrangement with MABS-M, as they see such outreach to Muslims as extremely risky. However, such an arrangement would be against the basic precepts of the MABS-M program. As such, it is not recommended that an exception be made in assisting banks to have greater outreach to Muslim clients.
- **RB Kapatagan.** For the most part, RB Kapatagan only lends to Muslims for political reasons – for example, to Muslim politicians in the region. The owner claimed these loans are not repaid. In cases where the bank has foreclosed on land offered as collateral by Muslim clients, the bank owner related that the bank owns or has liens against about 60 hectares of land “that the bank has never seen.” This is because none of the bank staff is willing to go out to where these lands are. The defaulted loans are then only repaid when the original Muslim owner of the land wants to sell it, and must clear up all liens and loans made against the land asset. In any case, this bank is not interested in expanding its Muslim client base.

- **Siam Rural Bank.** Siam Rural Bank is currently lending to a small base of Muslim clients through its MABS-M-assisted microfinance unit. While ostensibly in a region with a significant population of Muslims, the bank's primary operations are in towns where Christians comprise the vast majority of the population. This is about to change, as the bank is in the process of opening two new branches in Linamon and Bacolod, both of which are in Lanao del Norte and have significant Muslim populations. Siam Rural Bank would tentatively be interested in extending loans to Muslim clients, but only through the traditional MABS-M Approach, with no relaxation of the current borrower screening process and loan requirements, and without hiring Muslim staff. However, the president of the bank claimed to have "many Muslim friends" and seemed genuinely interested in ways to expand outreach to Muslim clients successfully.

In summary, working through existing MABS-M participant bank offers some, but limited, potential to assist participant banks to reach greater numbers of Muslim clients than they are already reaching. The strong animosity between Christians and Muslims unfortunately works to limit the possibilities of Christian-owned and operated banks from reaching Muslim clients. The same is true in reverse, as the Muslim-owned Rural Bank of Maranao was equally resistant to lending to non-Muslims. With the challenges of cross-cultural lending in mind, where there is potential, MABS-M could assist current Christian-owned participant banks to:

- Expand to areas and communities with significant Muslim populations where participant banks are interested in doing so. Such expansion could not be done with any type of directed credit focused on Muslim clients, however. Such types of targeted lending have failed around the world, especially where donor funding has inadvertently created unsustainable business arrangements and operational systems through non-financial client conditionalities.
- Where there is interest (such as RB Tacurong), with minimal additional resources, MABS-M can put in place systems focused on improving outreach to Muslims. Such efforts may include adjustments in loan pricing and marketing, outreach, and loan collection.
- On behalf of the interested banks, MABS-M could research the reasons for higher default among Muslim borrowers and find innovative ways to address these issues, thereby lowering the perceived risk of lending to Muslims. RB Lebak stated that a promissory note in Islamic might help, such that Muslim borrowers better understand that the loan is not a grant and must be re-paid. In fact, after visiting RB Maranao, we found that such an agreement already exists. MABS-M can also help by being a conduit to share information across the cultural divide. There may also be potential for using jewelry or gold as security, as this may make more cultural sense among Muslims.
- MABS-M could develop a Sharia-based loan product, perhaps in cooperation with, and based on the products developed by, RB Maranao (see institutional assessment

overview below). Once developed, such a product might be piloted in a Christian-owned rural bank willing to hire Muslim staff to implement it, such as might be possible at one of the branches in RB Siam. This activity needs further discussions with participant banks, however, as moving from “possibility” to “reality” may result in no Christian-owned bank being truly interested in this type of Muslim outreach. Without hiring Muslim staff, marketing and managing this type of product and Muslim outreach would likely be beyond the capacity of a Christian-owned and operated bank.

C. Selecting New Participant Banks Operating in Muslim Areas

Interviews were held with a total of eight rural and cooperative rural banks that are not currently participant banks in the MABS-M program. Brief institutional assessments were conducted with three of these banks, included in section C1 below. All three operate in predominantly Muslim areas, have existing Muslim clients, and two are Muslim-owned.

C1. Status and Overview of Potential Banks

Institutional assessments (IAs) were conducted on RB Cotabato City, RB Parang, and RB Maranao. Additionally, information was gathered by MABS-M from an institutional assessment of the Muslim-owned RB Datu Paglas in 1999, as well as relevant information from discussions with UCPB Rural Bank concerning its branch on the island of Basilan. The detailed institutional assessments are attached in Annex B. Below, we present an overview of each bank, as well as the most significant findings.

C1a. Rural Bank of Cotabato City

Overview. The Rural Bank of Cotabato City is a Christian-owned bank, owned by the Tanghal family. The seven children of the late Mr. Tanghal fought over control of the bank after he died in March 1993, with the in-fighting lasting for over 2 years until 1996. Mrs. Remedios Lopez, one of the sisters, has now run the bank since 1997. She admits to being a “reluctant banker” with no real financial background or training, but there was no one else willing or able to take the job.

On a day-to-day basis, the bank is managed by Mr. Emmanuel Cardaso, the bank manager, who has worked in the bank for 38 years. He previously retired, but was convinced by the Tanghal family to continue managing the bank until his designated successor, Teodora “Teddy” Ma, presently the administrative officer, is ready to take over. Mrs. Ma joined the bank just six months ago.

Last year, the bank had 60 percent of its portfolio in secured loans, with the other 40 percent unsecured. Interest rates are 24 percent for secured loans and 26 percent for unsecured loans, with a three percent service charge and a one percent filing fee. After Mrs. Lopez attended a MABS-M training, a small microfinance effort was started. The bank currently has about 30

microenterprise borrowers, comprised of sari-sari store operators, rice retailers, fish and vegetable vendors, and a few sidewalk vendors.

The current past due rate of the bank is 47 percent, with an additional 21 percent in foreclosure litigation, resulting in 68 percent of its portfolio being past due. Five years ago, the past due ratio was 93 percent, most of which were defaults on supervised agricultural loans under the Central Bank's farm mechanization loan program.

The bank has P5.4 million in capital, but will be raising this to P6.6 million by December 2001 in order to meet BSP requirements. Currently, a majority of their clients are Muslims, a factor which is one of the reasons the bank gives for the high past due. Still, with the current demographic shift in Cotabato City – the city has reportedly increased from 40 to 60 percent Muslim – the bank envisions continuing to have a majority of Muslim clients and therefore is very interested in assistance in better systems to offer credit to Muslim clients successfully. However, the owner categorically stated that the bank was not interested in hiring any Muslim staff to work in the bank. However, the bank has hired a Muslim loan collection consultant, though this woman does not work in the bank itself.

Opportunities for MABS-M. RB Cotabato City appears to offer significant opportunity for reaching Muslim microenterprise clients. In fact, the bank's recent start of a microfinance program after attending some of MABS-M trainings is encouraging, as is the fact that the bank is already lending to a majority of Muslim clients. However, the bank is small, has extremely poor loan portfolio quality, and is not extending many new loans, though it is in fact very liquid. While nearly 70% of its capital is tied up in non-performing assets, another large portion – over P 2 million – is held in a time deposit at LandBank, along with much of its deposit base. It also has no re-discounted funds and no other borrowings. In effect, the bank is currently lending very little, but has the potential to put either cash on deposit or the new infusion of capital to work in its loan portfolio. The owner said she would be willing to expand the microfinance portfolio with MABS-M assistance, including greater outreach to Muslim clients.

C1b. Rural Bank of Parang

Overview. The Muslim-owned Rural Bank of Parang was established in 1995. Parang is a municipality about 27 kilometers away from Cotabato City, and about 70 percent of the population is Muslim. RB Parang is a small, one-unit bank with only 6 employees, all of whom are Muslim except the cashier. On the day of our visit, the accountant and loan officer were both on a one-month leave, and the teller did not report to work, probably because the bank has few clients coming in, since new loans have been on hold for a few months due to peace and order problems.

The bank is owned by a devout Muslim, Datu Rasul Mitmug, who is presently the Regional Director of the Commission on Audit (COA) for Region XII, and his wife's family, the Yap family from Wao, Lanao del Sur. Datu Mitmug is the president of the national association of Tabligns in the Philippines. (A Tablig is a Muslim missionary.) When he became a Tablig in 1997, Datu Mitmug wanted to convert the rural bank into an Islamic bank since Islam prohibits

charging interest or “reba.” However, according to the bank manager, Datu Mitmug has now dropped this idea when he was convinced by his own Muslim friends that a small Islamic Bank would have difficulty surviving in a non-Islamic banking environment such as that of the Philippines.

Mr. Espinosa, the outgoing manager, started as bank accountant in 1995 and became manager in 1996. He is running as town councilor in his hometown of Malabang in the May election. The bank has hired Mr. Salvador Tan as the new bank manager, effective April 2. Mr. Tan is the uncle of Datu Mitmug’s wife, and has 20 years of experience in commercial banking. He worked for 18 years in MetroBank, first as internal auditor, and then as manager of the Surigao City branch. He briefly joined Equitable-PCI Bank, also as branch manager in Surigao City, before resigning after two years. He claims he was wrongfully charged of fraud, and was later cleared of the charge.

As of December 31, 2000, the bank had P6.9 million in total assets, with P3.5 million in net worth. BSP examiners have indicated that the bank is under-capitalized, but the owners will be able to raise the needed capital. The total loan portfolio is P4.9 million, with a past due ratio of 25.7 percent. *The bank only has 32 total borrowers.* Total deposits are P900,000, with a total of 180 accounts. Net income for the year 2000 amounted to P129,260. The December 31, 2000 income statement does not include the interest expense on the P2.0 million the bank borrowed from LandBank, which in 1999 amount to P332,814. The liquidity ratio (cash+cash in bank/total deposits) at 13.4 percent is less than the ideal of 20 percent.

Parang is a predominantly Muslim community that is considered to be the commercial center for other Muslim-populated municipalities in this part of the province. Unfortunately, neighboring areas are known to be an MILF stronghold. Thus, when fighting broke out between government and the MILF forces in April-June 2000, Parang felt the effects. Business activities slowed down, and a large mass of evacuees appeared in town. The bank suffered because most of its loans were to farmers who could no longer supervise their farms. As such, these borrowers could not keep up with their loan payments.

Currently, the peace and order of the town appear to have gone back to normal and people are hoping that the upcoming peace talks will lead to lasting peace. However, no one is really sure what will happen. For example, LandBank has suspended its lending operations in Parang since last year and has not yet resumed. Likewise, RB Parang has suspended its lending operations. Still, there are many microenterprises in town, concentrated in the public market. The rural bank has no real competition for these clients, since LandBank does not give microfinance loans.

Opportunities for greater outreach to Muslims with help from MABS-M. The bank is most willing to expand its services to Muslims, as it is the strong wish of the bank owner to help fellow Muslim clients. However, the bank owner himself may be contributing to the delinquency rates. The manager claims that he would have filed legal cases against the delinquent borrowers, but that the owner, who was too forgiving, instructed him to give them more time to settle their obligations. With assistance from MABS-M, the bank would be in a good position to win the trust and confidence of Muslim clients in their service area, since the bank itself is Muslim-

owned and operated. MABS-M would be able to help the bank professionalize its staff and project a better image in the town. MABS-M could also assist the new manager, Mr. Tan, by offering capacity development training at all levels. Possible interventions included computerization of records, intensive staff training, the provision of a motorcycle for the loan officer, assisting the bank to mobilize deposits through a raffle promo or other activity, and the standard MABS-M assistance in starting a microfinance unit. Such interventions should contribute to improvements in the overall bank's operations and financial standing.

C1c. Rural Bank of Maranao

Overview. The Rural Bank of Maranao is owned by Dato Paisal Rasuman, a Muslim businessman based in Marawi. He also owns a gas station and some commercial property, and is involved in public works construction and low-cost housing projects. He once served as a member of the board of the Cooperative Bank of Lanao del Sur. He decided to put up his own bank when he met the present bank manager, Edith Obra, who was at that time a consultant to the Cooperative Bank. Dato Rasuman believes that rural banking is profitable if managed properly. He admits to not being knowledgeable about running a bank and would not have ventured into banking without somebody like Mrs. Ombra managing the bank. Mrs. Ombra is a certified public accountant and has taught accounting subjects for several years in private schools in Manila.

In 1998-99, the bank was originally started to serve as a channel for funds from some Malaysian investors who appeared interested in financing low cost housing projects in Marawi. These foreign investors reportedly backed out when peace and order in Mindanao deteriorated last year. The bank has since had no choice but to develop the bank gradually through their own resources and efforts.

In need of additional funding, the bank turned to PCFC and the ERAP Trust Fund (ETF). In June 2000, the bank started its Grameen bank replication program with a P3.0 million loan from PCFC. A few months later in September 2000, it began its group lending program under the ETF with a P1.0 million loan. Previous to these loans, the bank was already lending to individual microentrepreneurs in the city under its Daily Remittance program.

Both Dato Rasuman and Mrs. Ombra consider it a challenge and part of the bank's mission to prove that Muslims (Maranaos) can successfully manage a bank, especially after the 16 Muslim-owned banks in Lanao del Sur were close by BSP for irregular banking practices. The bank is still a one-unit bank, although its lending operations already cover municipalities outside of Marawi. Most of its agricultural loans, for example, are concentrated about 1.5 hours away in Lumba Bayabao, the hometown of Dato Rasuman.

Opportunities for increasing outreach to Muslim clients with assistance from MABS-M. Microfinance is seen by Mrs. Ombra as an effective scheme for reaching out and lending to more people. She stated that the bank became known to many people only after they began their microfinance lending operation. The bank is now shifting its lending operations in favor of expanding its microfinance programs. One hundred percent of its clients are Muslims, and

currently all of its group-based clients are women. The bank presently has a full-time MFU Supervisor and two account officers. While off to an excellent start with a low 2.4 percent past due rate, the bank can benefit from MABS-M assistance. For example, they may be underpricing their loans, as the rates were set based on commercial rates and not on any break-even analysis or cost allocation basis. Because their bookkeeping is not yet computerized, they only balance the accounts once a month, and loan monitoring is cumbersome and time consuming. They are not monitoring portfolio at risk.

The bank is ostensibly operating using Islamic Banking principles, but in fact is interest-based. The bank markets their services as “profit-sharing” in order to follow Islamic Banking practices. However, the fees charged are calculated using traditional interest methods, and there is no real profit-sharing involved. Payments are the same each week and do not fluctuate based on the profitability of the microenterprise client, and neither does the interest paid on deposits change based on the profitability of the bank. However, being Muslim-owned, the bank has the credibility to market the products successfully to Muslim clients. With their cultural input and perspective, MABS-M can assist in ensuring that the microfinance operations stay profitable at the same time. Additionally, MAB-M could assist them to introduce a microenterprise loan for individuals (as opposed to their current group method).

Working with this bank also offers significant potential opportunities to bring lessons learned about lending to Muslims to other MABS-M participant banks. For example, RB Tacurong stated it might be useful to have the loan terms available in Islamic for Muslim borrowers. In fact, RB Maranao already has done this translation. Additionally, the successful operation of a loan product that conforms to Islamic Banking principles will be of great interest to other Muslim-owned banks such as RB Parang.

Finally, RB Maranao offers significant growth potential. There are only five banks operating in Marawi City: RB Maranao, the Cooperative Bank of Lanao del Sur, PNB, Land Bank, and Amanah Bank. Of these, Amanah Bank is essentially defunct, PNB and Land Bank do not lend to microenterprises, and the Coop Bank of Lanao del Sur has only one unit and appears to be limiting its lending operations because they are having financial problems. As such, RB Maranao has little or no competition for microenterprise clients in a large urban market.

C1d. Rural Bank of Datu Paglas

The information presented here was collected in 1999, and is current through that year. Some facts may have changed since then. Should MABS-M proceed with a Muslim-focused effort in Mindanao, the institutional assessment for RB Datu Paglas should be updated.

Overview. The Rural Bank of Datu Paglas is an affiliate of the Datu Paglas Corporation, a holding company. It is the largest company in the town of Datu Paglas, and has a large interest in the biggest banana plantation in the town. The corporation supplies labor, trucking services, and materials to the banana plantation. The board of directors of the bank is comprised of five members, with the former mayor, Datu Paglas, as the major stockholder with 92 percent of the stock.

As of 1999, the bank was only one unit, with tentative plans to expand to a second branch within 2 years. Most of its 292 borrowing clients were from Datu Paglas, which is 95 percent Muslim. Its priority areas of expansion are the Muslim-dominated nearby towns of Buluan in Maguindanao and Tulunan in North Cotabato. As part of its vision, the bank intends to prove that a bank in a Muslim area can be run successfully. The bank also has education of the Muslim people on the value of savings and the obligations to repay their loans as part of its vision.

Regarding microfinance, they were eager to expand their microenterprise client base. About 60 percent of their deposit base is held by seven large corporate accounts (out of about 400 total). They want to tap smaller depositors because they are more stable and would reduce the risk of relying on so few large deposits for lending capital. They see a large potential microenterprise market in the 2000 or more workers on the banana plantations, though this could put the bank at risk of being vulnerable to fluctuations in the market price of bananas as it probably affects the cash flow and income of these microentrepreneurs.

The bank needs lots of training for the staff – only the manager and the accountant have banking experience. The bank also had more staff than it needed, but had plans to harness them to begin mobilizing more deposits. In part, this is in response to tight liquidity, which in turn is due to inefficient loan collection.

Opportunities for increasing outreach to Muslim clients with assistance from MABS-M. With MABS-M support, RB Datu Paglas could increase the number of Muslim clients it serves. While the bank is small and would also need some capacity development and bank strengthening assistance, they were very interested in microfinance. Being Muslim-owned, they were eager to lend to Muslims and appear to have access to a good-sized market in which they would have no competition. Their entire bank could benefit greatly from the MABS-M approach, as their loan collection system and enforcement of payment schedules was weak. The bank was also willing to charge interest, as long as the loan rates would not be at the level of the five-sixers. However, it would undoubtedly be interested in the Sharia-marketed lending approach that RB Maranao is already doing.

C1e. Discussions with UCPB Rural Bank

UCPB Rural Bank has 16 branches nationwide, eight of which are in Mindanao, including four in Misamis Oriental. They also have one branch in Lamitan on the island of Basilan. While the island is predominantly Muslim, the bank's loan clients are still 80 percent Christian at this branch. All of their lending to Muslims is collateralized, and they have only very limited microfinance operations. Additionally, the branch in Lamitan is largely for deposits – people can deposit money in Lamitan and write a check in Zamboanga, which is a service in high demand because of the risk of transporting a lot of cash in the area. The money on deposit in Lamitan is lent out through loans focused in Zamboanga through a tie up with the UCPB mother bank branch in Zamboanga City.

In the bank at large, a majority of UCPB Rural Bank's lending is done through salary loans to teachers and civil servants. They have special authority to make the deduction in Manila using a coded transaction. As such, the operation is highly centralized and needs few staff. In fact, they did not feel they currently have enough staff to handle a microfinance window. However, because of MABS-M good reputation, the vice president, Wilner Palacios, encouraged us at some point in the future to do a presentation to the board of directors for them to decide whether to participate or not. With MABS-M' assistance, he felt the bank would be willing to start a microfinance program, and would be willing to begin in areas with significant Muslim populations. However, they would not be that interested in starting such a program in Lamitan on Basilan because of the high risks involved. In short, being highly profitable and the second largest rural bank in the country in terms of assets, UCPB rural bank would make an excellent partner for MABS-M. However, it offers limited opportunity to assist in reaching greater numbers of Muslim clients.

C2. Significant Findings

With regard to assisting new banks to significantly increase their outreach to Muslim clients, an analysis of the results of the four institutional assessments reveals the following significant findings relevant to USAID and MABS-M:

All of the relevant rural banks face major institutional challenges. Whether because of the ongoing conflict and displacement of many people in the region, drought, or poor management, the banks in predominantly Muslim areas are in bad shape. One reported extremely high past due rates in excess of 60 percent, two others lack adequate capital, and all are very young or under new or inexperienced management. At least one bank is unable to liquidate the land holdings which have been seized because of non-payment since these are located in high conflict areas with no real estate market or which have restrictions on land sales. Therefore, it is strongly recommended that in working with these banks, MABS-M should offer a broader package of bank strengthening and capacity development assistance, in addition to the standard MABS-M Approach microfinance package.

Rural banks operating in predominantly Muslim areas are small in size. All of the Muslim-owned banks and banks that were assessed and that operate predominantly in Muslim areas have at most 2 units (head office plus one branch). After discussions with BSP, RBAP, and many rural bankers, it appears that there are no larger rural banks operating in predominantly Muslim areas. In fact, few formal financial services of any kind are offered in many such areas. On one hand, this represents a strong opportunity for MABS-M to assist in expanding services to these areas. On the other hand, the small size of these banks will affect the type and level of results that could be attained in any MABS-M effort focused on greater coverage in Muslim areas. For example, if numbers of microenterprise borrowers and depositors would continue to be used as a results target for a Muslim-related effort by MABS-M, then the size of the bank does matter, since the number of bank units is directly related to the market area which the bank can cover.

Additionally, after the pilot phase of the MABS-M program, it should be noted that MABS-M focused on larger banks in order to reach the quantified results targets contained in the contract.

Working with banks that have some sort of branch network has also proven to add significant economies of scale and scope for the MABS-M program. Once a microfinance unit has been successfully installed in the head office of a participant bank, the participant banks themselves have taken on a large portion of work in replicating these efforts in other branches. Such internal branch expansion among participant has in large been behind MABS-M far exceeding its original results targets. Conversely, as with single unit bank PBs such as pilot bank, RB Santo Tomas, growth and expansion is limited to a smaller market area. As such, the microenterprise loan portfolio in these banks reaches a ceiling level, once the immediate market is served. This will also be true of small one-unit rural banks in Muslim areas.

D. General Recommendations

D1. Conducting Further Research

There are a number of issues that were unearthed through this study which will need follow up research. Obtaining this information will enable the MABS-M program to identify the most effective ways to reach a greater number of Muslim clients. We list the issues needing further research below:

Mapping Muslim populations at the community level. The demographic map in Annex A, produced by the GEM project, provides information on Muslim population levels at the regional level. This was useful to MABS-M in focusing the field research of this study. However, in visiting many of the Christian-owned banks in areas with large Muslim communities, it became apparent that they are servicing predominantly Christian communities to the exclusion of nearby Muslim population centers. In fact, there appear to be entire municipalities or towns with majority Muslim populations that have no rural bank coverage but which are within the potential service area of existing Christian-owned rural banks. MABS-M would need this exact demographic information to encourage banks to expand not just to regions with Muslims, but to communities that are predominantly Muslim. There may also be potential partner banks that MABS-M has not yet made contact with, since the RBAP leadership and the traditional rural banking community is virtually all Christian and may not know these other banks.

Identifying the reasons behind alleged higher default rates among Muslim clients of Christian banks. If in fact Muslims are more likely to default on a loan than Christians when borrowing from a Christian-owned bank, the reasons for this need to be carefully studied. Without fully understanding the implications, MABS-M could inadvertently be doing a financial disservice to the Christian-owned rural banks by encouraging them to increase their lending to Muslim clients who might be more difficult to serve. There may be clear reasons for such difficulties, and it may be that certain adjustments in the lending process might reduce the risks involved. Conversely, it may be that lending across cultures is simply too difficult at this point in Mindanao's peace and reconciliation process given the high levels of fear and mistrust between Christians and Muslims. If this is the case, MABS-M would do better to focus its Muslim efforts only on Muslim-owned banks. In either case, more study and analysis is needed.

Developing systems to overcome the average Muslim's low exposure to formal financial services. RB Maranao requires nearly 12 hours of training for each microenterprise client before they extend a loan. In turn, RB Tacurong said they would be more willing to lend to Muslims if they had good systems for training these borrowers on repayment and loan terms. While the level of client training that RB Maranao is offering is probably excessive, MABS-M could identify the exact orientation needs of these clients, and assist banks to design better loan products and client orientation systems that are appropriate to Muslim clients.

D2. Expanding MABS-M Outreach to Muslims

Based on the information that has been gathered, there appear to be a variety of possibilities for MABS-M to expand its outreach to Muslim clients. With appropriate resources (outlined further below), MABS-M could conduct the following major activities:

- *Offer bank strengthening, capacity development, and microfinance-related “MABS-M Approach” assistance to Muslim-owned banks.* There appear to be at least three Muslim-owned banks that are interested in MABS-M assistance: RB Maranao, RB Datu Paglas, and RB Parang. There may be one or two others. These banks offer the best and most immediate avenue for MABS-M to expand its outreach to Muslim clients. All three are unit banks and quite small, but appear to have access to sizable markets. While MABS-M should not offer loan capital or loan guarantees, MABS-M could offer bank strengthening activities and general capacity building technical assistance to these banks. This could include computerization of the MIS system, assistance with past due loan collection, improved treasury management and loan pricing, and improved lending policies and procedures. After a period of bank strengthening and capacity building assistance, banks that showed improvement could be offered the standard package of MABS-M technical assistance and training in microfinance through the MABS-M Approach. In one or two cases, it may be possible to offer both simultaneously.
- *Assist current MABS-M banks to expand to areas with significant Muslim populations.* Of the four MABS-M banks visited, three are potentially interested in expanding their Muslim client base. There are perhaps another three MABS-M banks that may offer other possibilities. As such, MABS-M could assist 3-4 of the most interested current participant banks to expand their service outreach to areas with significant Muslim populations. This assistance would include the traditional MABS-M Approach assistance, with revised products and procedures that would be better suited to Muslim clients. This might include working with the banks to hire a Muslim account officer, to offer a more culturally-friendly loan product, and to start microfinance operations in new municipalities with large Muslim populations. These possibilities will require more discussions with potential banks before implementation would be possible.
- *Invite additional banks in Mindanao to participate in MABS-M, giving higher weighting to those operating in areas with significant Muslim populations and to those already lending to Muslims.* As highlighted in the overview of RB Cotabato City, there may be a few Christian-owned rural banks with large Muslim client bases. However, the bank is in bad financial

shape and would need comprehensive bank strengthening assistance. In other cases, there appear to be some stronger banks such as RB Midsayap or UCPB Rural Bank that might potentially be interested in the traditional MABS-M package of technical assistance and training, but which don't have many existing Muslim clients. However, these banks do operate in some areas with significant Muslim populations. As such, with additional resources, MABS-M could do another bank roll-out in Mindanao, giving higher weighting to banks that have the potential to service Muslim communities. Where needed and justified, the MABS-M Approach could be supplemented with bank strengthening assistance.

D3. Resource Requirements

MABS-M could do all of the above activities by adding funds to the budget to cover the following resource needs:

- Extension of the three employment contracts of current MABS staff not currently planned for extension beyond the original contract end date of September 2001, including the Cagayan area representative. Funds would also be needed to maintain the small Cagayan office for another 2 years.
- Hiring two new mid-level microfinance specialists in Mindanao. Ideally, these two new staff members should be Muslim. Alternatively, a new staff person could be hired for Cebu, and Ara Osop (who is Muslim) could be moved back to Davao.
- Resources to cover the commodities, start-up salaries, and other costs contained in each new participant bank agreement (PBA). To date, the resources outlined in a PBA, which do not include the technical assistance and related costs extended by MABS-M staff, have been about P650,000 each. For banks needing a broader range of bank strengthening assistance, especially improvements in computer hardware and/or software, P1,200,000 would be needed.
- Hiring a second MIS specialist to allow TonTon Petalcorin to stay focused on existing and new banks in Mindanao.
- Funding for study tours to visit and participate in training at nearby Muslim-operated microfinance institutions, such as Bank Rakyat Indonesia (BRI).
- Hiring a senior Muslim microfinance specialist (TCN) from Indonesia or one of the Arab nations to manage or provide input to the Muslim-related efforts. Depending on funding available, this could be a full-time position based in Mindanao, or an expert brought in for targeted short-term assignments, as needed.

These suggested level of resources can be adjusted upwards or downwards in conjunction with the actual combination of Muslim-related activities and results that are requested of MABS-M as part of the program extension.