64598

THE APEX CFI FEASIBILITY STUDY: AN INDEPENDENT ASSESSMENT

Final Report

Bureau for Private Enterprise
U.S. Agency for International Development

Prepared for: *USAID/Philippines*

Sponsored by: *Private Enterprise Development Support Project II*
Project Number 940-2028.03
Prime Contractor: Arthur Young

April 1989

Arthur Young
A MEMBER OF ARTHUR YOUNG INTERNATIONAL

TABLE OF CONTENTS

ACRONYMS

ACPC	Agricultural Credit Policy Council
AMC	Area Marketing Cooperatives
BANGKOOP	Cooperative Rural Banks Federation of the Philippines
BFnG	Bagong Pagkain ng Bayan
CALF	Comprehensive Agricultural Loan Fund
CARP	Comprehensive Agrarian Reform Program
CCFDI	Central Cooperative Finance Development, Inc.
CDA	Cooperative Development Authority
CFI	Cooperative Financial Intermediary
CGF	Cooperative Guarantee Fund
CRB	Cooperative Rural Banks
CUNA	Credit Union National Associates
DBAP	Development Bankers Association of the Philippines
FFF	Federation of Free Farmers
GFSME	Guarantee Fund for Small and Medium Enterprises
LBP	Land Bank of the Philippines
NAMVESCO	National Market Vendors Cooperative Service Federation, Inc.
NATCCO	National Association of Training Centers for Cooperatives, Inc.
PCB	Private Commercial Bank
PCIC	The Philippine Crop Insurance Corporation
PFCCI	Philippine Federation of Credit Cooperatives, Inc.
QGFB	Quedan Guarantee Fund Board
RB	Rural Bank
RBAP	Rural Bankers Association of the Philippines
RFM	Rural Financial Markets
SCCP	Supreme Cooperative Council of the Philippines
WCCU	World Council of Credit Unions

EXECUTIVE SUMMARY

Based on extensive discussions with representatives of the Philippine Government and the financial and cooperative sectors, followed by lengthy internal deliberations, the team has come to the conclusion that neither the proposed Apex CFI as presented in the Feasibility Study, nor its prototype, the recently organized Central Cooperative Finance Development, Inc. (CCFDI) are viable concepts. The main reasons involve perceived lack of membership support, inappropriate organizational structure, capitalization problems and unsupported financial projections. The team therefore recommends that USAID not provide financial or other support to CCFDI for the time being.

Instead, it is recommended that continued financial assistance be given to the cooperative sector for organizational development and training. The team also recommends that policy dialogue be initiated with appropriate officials to address certain specific observations and concerns which were expressed during its visit, in particular, current credit policies pursued by the Land Bank of the Philippines, savings mobilization and rural credit delivery problems.

In examining the proposed Apex CFI, as well as the newly formed Central Cooperative Finance Development, Inc., the team reached the following conclusions:

1. <u>"TOP DOWN" APPROACH</u>: The approach to forming the organization appears to be "top-down". This opinion has been expressed by all the major credit union associations, who chose not to join the CCFDI. It would appear that a substantial amount of work should be done to build up the various cooperative organizations before the promotion of an Apex Bank. The feasibility study appears to create an enormous centralized bureaucratic structure with a lot of people before the organization is ready to absorb the financing and proposed assistance. This is not the logical way that organizations develop; they should develop from simple structures to more complex forms as the organization gradually increases its expertise.

2. <u>INADEQUATE INTERNAL CAPITALIZATION</u>: The requirement for resources from the cooperative movement is insufficient. The proposed seed capital of 10% is an inadequate contribution from members, and in fact, may contribute to political maneuvering within the organization. A one-to-one matching contribution scheme requiring equal amounts of external and internal capital would be preferred and would be indicative of greater internal commitment to the idea.

3. <u>FRAGMENTATION OF COOPERATIVE ORGANIZATIONS</u>: The cooperative organization within the proposed structure is too fragmented and too different in objectives. The credit co-ops resist outside interference and appear to be organizations of persons of smaller incomes committed to self help concepts. The sugar co-ops at the other extreme are well-to-do planters who apparently use the cooperative form of business organization when there are some distinct benefits, such as tax benefits. The electrical cooperatives were formed by the government to extend the electrification program and the large majority of these are already delinquent in their payment to the NEA. The number of housing cooperatives appears to be very small. Combining such diverse interests in one body is likely to lead to friction. In fact this friction has already arisen, with the credit co-ops refusing to join the CCFDI.

All of the cooperative groups are extremely different; they were formed for different reasons and have different needs. At some point, some of these needs may converge, such as the need for a cooperative bank. At present, it would appear these groups are too diverse. The argument that an Apex Bank will help "unite" the cooperative movement is difficult to accept. It may even create further fragmentation if it generates internal squabbles related to the use of funds. It would be much better to establish unity first within each of the cooperative sub-sectors, where there is at least a base for developing common understanding. Such unified approaches are clearly being attempted by the credit co-ops, including attempts at central funding and interlending.

4. <u>DECISION OF THE CREDIT COOPERATIVES NOT TO JOIN THE APEX BANK STRUCTURE</u>: Three credit union associations have chosen not to join the Apex Bank. These associations would have been one of the pillars of an Apex CFI because of their demonstrated success in the rural areas. Their reasons for not joining the Apex Bank are the following:

a. The CCFDI was formed without sufficient discussion with the proposed members, and therefore was too much a "top-down" approach.

b. Many of the proposed cooperative members of the Apex Bank are not "true cooperatives" (e.g. electric cooperatives or transport cooperatives, which according to the credit union associations were organized by the government).

c. The funds of the CCFDI could be "captured" by large vested interests that gain control of the board.

d. The credit unions already have their own central finance and interlending schemes.

5. UNCLEAR PLAN FOR OBTAINING MANAGEMENT EXPERTISE: It is unclear where the Apex organization will obtain its management expertise. Clearly, such expertise will be difficult to find. The proposed structure merely creates the boxes on the organizational chart, but does not deal with the more complex issue of where to find the people to fill positions.

6. LACK OF ATTEMPTS TO BUILD ON EXISTING EFFORTS IN FINANCIAL INTERMEDIATION: The proposed Apex Bank does not build on existing efforts and experiences. In fact, several of the credit union groups already have central funding and interlending schemes. These schemes clearly resulted from substantial study of how to manage such funds. It is these efforts that should form the seed of an Apex Bank. Once these various interlending schemes are operating, it may be possible to combine the schemes.

7. FLAWS IN ORGANIZATIONAL STRUCTURE: There are serious flaws in the organizational structure, such as the large board size. To a great extent, this is due to the diverse groups in the proposed bank. However, it will guarantee membership on the board of cooperative groups that are severely lacking in management skills. Patronage-based board representation can lead to jockeying to control the board by groups securing loans. This will lead to the unhealthy situation of big borrowers having undue influence on the board.

8. LACK OF EFFECTIVE DEMAND: At present, the "effective demand" for credit to co-ops is limited, far less than the projections in the study. This is especially true taking into account that the credit unions are presently choosing not to join the bank, and the fact that the large majority of electrical cooperatives are not viable. This does not negate the idea of an Apex Bank for cooperatives, but it does indicate the scope of the proposed Apex Bank is far too large in its initial stages.

9. NOT A TRUE FINANCIAL INTERMEDIARY: The proposed Apex organization is not designed as a true financial intermediary, but rather as a conduit for foreign and Philippine government funds. Although the importance of interlending is mentioned, it would appear the study is emphasizing the financing of individual cooperative projects, and to a much lesser extent, the management of liquidity. The management of short term cash flows is an extremely important task of an Apex type institution; there are substantial efficiencies that can be obtained by better management and movement of existing liquidity. The study concentrates more on the injection of new liquidity, as opposed to the management of existing liquidity.

10. LACK OF EMPHASIS ON SAVINGS: The proposed Apex CFI organization does not focus sufficient attention on the generation of additional liquidity from savings. In fact, the liability structure of the organization after the fifth year of operation is

projected to have only P 65 million from deposits and P 870 million from external borrowings. These two sources, plus equity (mainly government and USAID contributions) are to support P 1,180 million in lending. In a three year period, deposits are to grow three-fold, and outside borrowings ten-fold. If the Apex Bank were to develop savings programs from its members organizations, the excess liquidity from the member organizations plus possible deposits from outside the Apex Bank could be used to help fund the lending operation, thus decreasing the need for external loans.

11. QUESTIONABLE FINANCIAL ANALYSIS: The assumptions underlying the financial analysis are unstated. Based on the data presented, the financial analysis is highly questionable. Some of the apparent flaws are:

(a) overstated "effective" loan demand;

(b) absence of loan loss provisions; and

(c) inadequate capitalization.

Making different assumptions leads to the conclusion that the organization cannot be profitable within the stipulated time frame. These assumptions are stated in the main body of the report. Several of the key new assumptions allow for a more modest growth in loan portfolio, restrict outside borrowings to approximately 20% of loans outstanding and add a 20% loan loss provision. These new provisions result in a progressively increasing loss over the five year period, requiring a continuous injection of new capital. These assumptions may be overly conservative and far different from the "implicit" assumptions in the study, but they are judged to be closer to the likely "real" scenario to emerge in the new Apex Bank.

I. INTRODUCTION

A. The Original Scope of Work

The objective of the team as stated in USAID cables is to carry out a second review of the Apex Proposal to assist USAID to make a determination whether the proposal is feasible. The statement of work is as follows:

"THE TEAM SHOULD REVIEW THE SUBJECT PROPOSAL AS WELL AS ASSESS THE CURRENT STATE OF THE PHILIPPINE RURAL FINANCIAL SYSTEM AND RECOMMEND TO USAID:

1. WHETHER IT SHOULD UNDERTAKE ADDITIONAL DESIGN WORK ON THE SUBJECT PROPOSAL;

2. ADDITIONAL FACTORS WHICH NEED TO BE CONSIDERED IF FURTHER DESIGN WORK IS UNDERTAKEN; AND

3. OTHER ACTIVITIES WHICH MIGHT BE UNDERTAKEN TO IMPROVE THE FLOW OF MARKET-BASED CREDIT IN THE RURAL SECTOR."

Specifically, the team should:

-- Review and assess the proposal's financial analysis to ascertain whether it is complete and methodologically correct, and whether the data utilized are adequate. If it is determined that additional financial analysis is required, the scope and magnitude of the analysis should be specified.

-- Review available information on rural financial markets in the Philippines and interview officers of Philippine financial institutions to determine the potential availability of credit for cooperatives.

-- Review information in the proposal and other relevant documents, as well as carry out interviews with cooperative federations to estimate an order of magnitude of potential effective demand (i.e., demand which reflects ability to repay, market pricing of funds, and meets the overall tests of bankability) for credit by cooperatives.

-- Investigate the interest/ability of cooperatives (excluding housing and consumer cooperatives) to make equity contributions to an apex cooperative financial institution.

-- Assess the adequacy of the proposed structure of the Apex cooperative financial institution in light of the current viability of rural credit institutions and cooperative federations which would be directly associated with an Apex operation.

B. Clarifications in the Scope of Work

A review of the scope of work with USAID officials immediately after the team's arrival in the Philippines resulted in the following clarifications to the scope of work which are reflected in the current study:

1. The first priority was to review the Apex CFI Feasibility Study itself, particularly financial assumptions and projections. Regarding this task, it was agreed that a comprehensive "effective demand" study, which would require field work and review of primary data, could not be conducted in the time that the team was in country. Accordingly, the aim of the present study is to review the data available and make a reasonable statement regarding effective demand.

2. The second issue to be addressed was the viability of the Apex concept as distinct from the study itself. This is a somewhat subtle difference from the first task since, in theory, there could be serious errors in the study which would not necessarily mitigate the validity of, or need for an Apex CFI. In undertaking this task, it was agreed that strengthening of cooperative institutions including the Apex CFI should be viewed as a means to accomplish an end, the creation of efficient rural financial intermediation systems.

Obviously, a substantial amount of work can go into an exercise of this nature. It was also agreed, however, that time constraints the team faced would limit the analysis that could be undertaken in this area. In responding to these questions, the team would concentrate on secondary data available and on interviews with a wide array of individuals in the cooperative movement, the private sector and the government.

Fortunately, the team had the opportunity to interview a large number of individuals which provided a rich source of opinions on the 1986 study and the broader issues to be addressed. These individuals are listed in Appendix I. It was also fortunate that substantial data and analyses on rural financial markets, the cooperative movement in the Philippines and other relevant information had already been developed by the GOP, USAID, and the cooperative movement itself.

In summary, considering time limitations and the substantial amount of work already done, the team viewed its role not as one of undertaking a major quantitative analysis of cooperative and rural financial markets, but rather as providing an unbiased re-examination of the feasibility study based on currently available information.

In addition, the team set as its objectives:

* to synthesize the opinions and recommendations received from various sectors;

* to arrive at some conclusions as to the validity of the Apex CFI concept and the relative importance of cooperatives in rural finance; and

* to suggest some alternatives how else rural credit delivery could be improved or made more efficient.

II. BACKGROUND

A. Summary of the Apex CFI Feasibility Study

In June 1987, USAID/Philippines contracted a consortium of U.S. Cooperative institutions to determine the need for and feasibility of establishing a viable cooperative financing institution in the Philippines. The objective of the study was to provide answers to the following questions:

1. Is credit availability the major cause of the poor performance of the Philippine cooperatives?

2. If not, what other major factors affect that performance, and what is being done or can be done to address those factors?

3. If credit availability is a major factor, what should be the key elements of an effective program for providing cooperative financing services? How could the needed services best be delivered and, if effectively delivered, to what extent would this program provide both the necessary and sufficient conditions for the success of the cooperative movement?

The study was carried out over a thirteen week period from June to August 1987, by representatives of the following U.S. Cooperative organizations:

1. The National Rural Electric Cooperative Association (prime contractor);

2. Agricultural Cooperative Development International;

3. The National Cooperative Business Association;

4. The World Council of Credit Unions, Inc.; and

5. The Cooperative Housing Foundation.

This U.S. team, which contributed approximately 12 person months of work, was backed by Philippine cooperative specialists who contributed approximately 20 person months to the team's level of effort. The team conducted interviews with government officials, cooperative leaders and other private sector individuals associated with finance and cooperatives from various sectors. Selective visits were made to cooperatives throughout the country. The team also reviewed macroeconomic information and cooperative-related data.

Its major conclusions were the following:

1. Where past efforts to promote co-ops in the Philippines had encountered difficulties, one of the principal causes was "top-down" directed development approaches that did not have real grass-roots support.

2. There is "an unequivocal need" for an Apex Cooperative Financial Intermediary (CFI). Deemed by the team as the best means to serve the cooperative sector, the Apex CFI would provide credit as well as other services such as technical assistance and training.

3. The Philippine cooperative movement enthusiastically supports the establishment of such an institution.

4. There exists sufficient credit demand on the part of the cooperatives to profitably support the Apex CFI.

5. The CFI should operate without subsidies and should be "subject to the same cost factors and charging the same interest on loans as any other private sector bank in the Philippines."

6. Financial projections indicated that a "very viable" and sustainable CFI program could be developed within 5 years with grass-roots support from cooperatives in the form of initial paid-in capital, combined with some initial and one-team external seed capital injections.

7. The CFI would be capitalized by an initial contribution of co-op members of P 10 million, plus approximately P 60 million from the integration of reflows from another USAID-supported project with the Philippine Government, and approximately P 50 million from monetized assistance under the U.S. Government Section 416 program. Although over 90% of the original capitalization would come from external assistance, the study contemplated that this assistance would be serviced with interest at market rates and be fully repaid within 20 years. Hence, this original contribution was perceived more as a long-term loan than equity participation. The study emphasized that there should not be a continued dependence on the Philippine Government or USAID capital and that eventually, the CFI should be able to issue and sell its own debt paper in the public money market.

8. The study proposed that a U.S. cooperative development organization take the lead in making a written proposal to USAID to assist the Philippine co-ops in the establishment of the CFI.

B. Summary of Comments On the Apex CFI Study

USAID/Philippines circulated the study to a wide array of Philippine institutions, including the government, the cooperative movement, and the private sector, as well as to rural financial market experts from the U.S. and the Philippines, and AID/Washington. These individuals and institutions were asked to analyze the proposal and to provide specific comments on its technical and financial merits.

The response to the study was substantial. At least a dozen individuals provided comments, some in considerable depth. The overall response appears to reflect the long history of cooperative development efforts in the Philippines and the importance attached to developing efficient financial markets in the country. The numerous Filipino responses, whether one agrees with them or not, speak well for the interest in cooperatives and, more specifically, rural finance issues in the country.

Several of the responses welcomed the idea of an Apex financial intermediary for cooperatives. It is fair to state, however, that the overwhelming response was negative, at least under the assumptions made in the study. The most important common themes and issues were:

1. The study provided a good summary of the history of the Philippine cooperative movement and, in particular, an incisive analysis of many of the problems that had beset the movement and previous efforts to strengthen the cooperative system (mostly public sector-inspired). Of particular importance was the long and unfortunate history of "top-down" paternalistic programs which had resulted in many failed efforts.

2. Although the study had accurately identified many of the problems that had afflicted cooperatives in the Philippines, the proposed approach to establishing an Apex CFI appeared to embody the same basic flaws which would lead to a repetition of past mistakes: its reliance on external funding, little capital at risk for member organizations and hence a tendency to perceive external capital and loans as a government grant or subsidy by member co-ops and ultimate borrowers. Moreover, several respondents questioned the grass-roots support within the co-op movement for a CFI and suggested that this be carefully analyzed before going through with any proposal.

3. Considerable concern was expressed about the study's data presentations and financial projections and related assumptions.

4. Of special concern to many reviewers were assumptions and calculations of demand for cooperative credit. Specifically, it was felt that the study incorrectly treated the "need" or "desire" for credit on the part of coops interchangeably with the concept of effective demand, i.e., credit demand by co-ops that have the capacity to manage debt and that are therefore "bankable" borrowers of sufficient quality to ensure orderly debt servicing and loan repayment. In the final analysis, demand is an elastic concept and "effective credit demand" depends on the formulation of credit criteria; any attempt to quantify such effective demand is futile.

5. An Apex organization can only be as strong as its base. Yet, according to numerous respondents, the Philippine cooperative movement is not mature enough to support an Apex facility at this time. The question was raised whether institutions such as Cooperative Rural Banks could handle substantially greater amounts of credit. Also some questioned the management capabilities that the movement could bring to bear on running an Apex CFI.

6. The scope of the Apex CFI was much too broad, encompassing the entire cooperative movement, including some sectors that are regarded as outside the cooperative sphere by many in the sector, for example, electric and sugar cooperatives.

7. Strong reservations were expressed about the organizational structure of the proposed CFI, with its large unwieldy board of directors and the overall level of resources devoted to credit policy, supervision and management.

8. Perhaps the most serious concern was that rather than being a true feasibility analysis which looked at all other possible alternatives, the study was a biased advocacy piece for establishing the proposed Apex facility and for cooperative development <u>per se</u>. It was argued, for example, that the study did not convincingly demonstrate that credit was indeed the major problem facing Philippine cooperatives.

Many of these concerns were shared by USAID and key individuals and institutions within the GOP. Within the cooperative sector, there was a generally favorable and enthusiastic response, although several key cooperative federations such as the Philippine Federation of Credit Cooperatives, Inc. (PFCCI), the National Market Vendors Cooperative Service Federation, Inc. (NAMVESCO), the National Association of Training Centers for Cooperatives, Inc. (NATCCO), and the Federation of Free Farmers (FFF) did not support the idea or expressed concerns about the concept as proposed.

C. Recent Developments in the Cooperative Movement

Several events have transpired during the past two years that are directly related to cooperatives and to the potential role of USAID in cooperative development. These are as follows:

1. the formation of the CCFDI in December 1988;

2. legislation in the Philippine Congress related to cooperatives;

3. the USAID Cooperative Project with Credit Union National Association (CUNA); and

4. a proposal submitted to USAID by the U.S. Overseas Cooperative Development Committee to seek funding for the first stage of developing the Apex Bank/CCFDI.

Each of these would undoubtedly influence the environment under which an Apex CFI would work and therefore, has implications for its viability and for its operations if it is implemented.

C.1. Establishment of the Central Cooperative Finance Development, Inc. (CCFDI)

In December 1988, the Supreme Cooperative Council of the Philippines (SCCP) as the umbrella organization for all cooperatives in the Philippines, legally established the CCFDI to serve as an Apex finance and technical assistance organization for cooperatives. The CCFDI is essentially the same concept as the Apex CFI proposed in the 1986 study. Since that time, the SCCP has undertaken what it describes as a comprehensive grass roots campaign to obtain support for the Apex idea with reportedly enthusiastic support from the grass-roots level. It expects to have a subscribed capital of P 5,000,000 by the end of 1989. Currently, P 1,000,000 is subscribed, and P 360,000 is paid-up. The capitalization program of the CCFDI appears to be similar to the one presented in the 1986 study. Member cooperatives will make initial contributions, but the bulk of the start-up capital is expected to come from the GOP and/or foreign contributions.

As with the 1986 study, the CCFDI idea is not fully supported by all members of the cooperative community. In particular, it has been resisted by the Philippine Federation of Credit Cooperatives, Inc. (PFCCI), the National Market Vendors Cooperative Service Federation, Inc. (NAMVESCO), the Confederation of Cooperatives, Inc. (NATCCO), and the Federation of Free Farmers (FFF). These four organizations made a joint statement reported in the local newspapers:

"The proponents of the Apex Bank have chosen to disregard the financing schemes already started by privately initiated co-ops on which to build further funding programs..."

"The plan's "top-down" approach violates the basic cooperative principles of self-reliance and democratic participation by members and encourages opportunistic dependence. It will thus likely repeat the gigantic failures of past co-op development programs."

The same article noted that the proposed Apex for all cooperatives was formulated with minimal participation by the majority of the cooperative movement members. The article said that the CCFDI is being pushed by some so-called co-op leaders and sectoral groups, many of which are not true cooperatives.

C.2. Recent Legislation related to Cooperatives

1. The New Constitution (1986) calls for the creation by Congress of an Agency to promote the viability and growth of cooperatives as instruments of social justice and economic development (Art. XII Section 15).

2. The Senate approved in May 1988, a Bill creating the "Cooperative Development Authority" (CDA) to take over all responsibilities of the Bureau of Agricultural Cooperative Development, which is being abolished. All functions of promotion, registration and regulation of all cooperatives will be centralized in the CDA.

3. The House has recently passed a new Bill known as the "Cooperative Code of the Philippines", which in Chapter III specifically provides for the establishment and registration of Cooperative Banks, including Cooperative Rural Banks. The purpose of such banks is "to facilitate the operation of cooperatives by furnishing credit for the cooperative movement at the national and local levels." These banks may:

   - carry on banking and credit business for the co-ops;
   - receive financial aid for the co-ops;
   - mobilize savings for co-ops;
   - act as balancing medium of co-op surplus funds;
   - borrow money from other banks;
   - supervise lending and collection of funds by the member cooperatives;
   - provide training for co-ops;
   - rediscount notes with the Central Bank, Land Bank, etc.; and
   - receive deposits from government banks and government-owned corporations.

4. In addition, there will be registered one central bank at the national level to serve as the central bank for cooperatives, subject to approval by the Central Bank of the Philippines.

C.3. The USAID Cooperative Project with CUNA

On October 1, 1988, USAID/Philippines entered into a grant agreement with the Credit Union National Association, Inc. (CUNA) whose purpose is to establish a self-sustaining private cooperative sector financial system by enhancing the institutional capabilities of the PFCCI through a technical assistance program. The key objective of the grant is to assist the PFCCI in covering from internal income sources all core operating and financial costs. In addition, the grant aims to have 95% of all participating Regional Leagues and provincial chapters operating on a self-sustaining basis. The cooperating group in this project is the World Council of Credit Unions (WOCU), as executing agent for CUNA.

C.4. OCDC Proposal to USAID For the Initial Funding for the Apex CFI

In April 1988, the U.S. Overseas Cooperative Development Committee submitted a proposal to USAID. The title of the proposal was: "To Establish an Apex Cooperative Financial Intermediary in the Philippines". The funds requested were $952,104 in U.S. dollars and $452,960 in local currency. The OCDC proposed to "undertake a five component program with the objective of strengthening the institutional, financial and economic structure of the Philippine cooperatives as successful private sector businesses. The proposed program includes:

1. further analysis of the Apex Bank organization, technical assistance programs, market surveys and self-sufficiency;

2. institutional development including unfinished legal issues, operational manuals, loan forms, management systems and other activities for creating the CFI;

3. model lending programs to test loan instruments and procedures;

4. technical assistance in critical areas of institution building; and

5. training of key CFI staff and personnel of lower level financial intermediaries and member-borrowers."

This proposal also attempted to address some of the critiques of the original study:

1. Reconsider the size of the Board of Directors; and

2. Allow all cooperatives to become members, but ensure that membership does not confer an automatic right to borrow.

III. ASSESSMENT OF THE FEASIBILITY STUDY

The assessment of the feasibility study is divided into three sections: financial considerations, demand projections and organization structure.

A. Financial Considerations

A.1. Comments on Financial Projections

The feasibility study contains a balance sheet, income statement and cash flow projections over a 5 year period. These projections appear to be based on past trends of lending requirements and liquidity management in the cooperative sectors. No explanations are provided of the nature of these trends and their contributing factors; it is also unclear whether these trends will continue. In particular the following questions arise:

Loan portfolio: The loan portfolio is shown to grow from $1,214 M in the first year to $59,000 M in the fifth year. No supporting information is provided to justify such a spectacular rate of growth. This growth rate would be remarkable considering the dearth of qualifying borrower cooperatives and cooperative rural banks, and the lack of interest on the part of the credit union cooperatives to participate in the CFI.

Investment in Securities: The original investment of $1,394M, which seems justified, increases to $2,500 M in year two. No explanation is provided for the increase in these investments, although it may be just a temporary measure to place excess funds (capital infusion from USAID is not immediately used for lending purposes). In the third year, this investment declines to $105 M, and in the fifth year, expands to $455 M. The purpose of these investments in securities, whether they are simply placements of temporary excess funds or are held for longer terms, is not indicated; again, the assumptions should be clearly stated.

Deposit portfolio: This appears modest and overly conservative. It should be expected that member cooperatives will have savings mobilization drives, supported by the Apex Bank. Although not all of these member savings could be deposited with the Apex, it is conceivable that the Apex could generate more deposits than indicated from this and other sources. Other sources may be government bodies or the general public. In the feasibility study, no specific plan is presented as to how these deposits will be raised.

Borrowings: These are shown to increase tenfold over three years, from $4,000 M to $43,500 M in year five. The basis for these borrowing projections is unclear nor is it evident whether such borrowings are to be from local commercial banks, foreign financial institutions or member cooperatives.

Interest on loans: No details have been provided about anticipated interest rates levels and other factors affecting this major source of income. If, as mentioned earlier, the projected loan levels will have to be scaled down significantly, this income would be substantially lower and probably not adequate to support the CFI's continued profitability.

Interest expense: Without further details, the amounts shown cannot be evaluated as to their reasonableness. Also it should be considered that this expense includes interest payable on borrowings as well as on deposits, at different rates.

Total expenses: A major omission appears to be the necessity to provide for loan losses, which would likely be substantial in the CFI's earlier years.

In an attempt to present a more realistic picture of the proposed CFI the following assumptions have been made:

The Balance Sheet:

1. Liquidity has been maintained at a level somewhat higher than usual. The main reason for this is the proportionately greater liquidity exposure in the early years. This aspect is the more important one as the CFI is perceived as a Central Bank for the cooperative system and as such, needs to be able to act as "Lender of Last Resort."

2. Loan portfolio growth has been projected to double loans outstanding every year. This is probably a conservative estimate but is considered prudent to avoid excessive exposure in the early years. Loan volume could be permitted to grow more rapidly, once credit policies and loan procedures have been determined, implemented and absorbed.

3. "Borrowings" have been projected at approximately 20% of loans outstanding. This would include 10% short term external market borrowings. This projection also appears conservative as the CFI is expected to be able to borrow additional funds as it becomes an accepted money market participant.

4. Capital accounts: To simplify the projections, the eight different capital accounts have been combined into one Common Stock account, supplemented by Loan Loss provisions and profit and loss balances.

The Income Statement

1. Interest income from loans was estimated at an average rate of 18% per annum on loans outstanding (year end balances have been taken as average annual loans outstanding).

2. Interest from investments has been projected at a rate of 12% per annum.

3. Interest expense includes interest payable on deposits, projected at 12% per annum, and interest on borrowings at 10% per annum.

4. Loan loss provisions have been made at 20% of year-end loans outstanding, which seems prudent considering the nature and quality of borrowers.

Based on these above assumptions, the balance sheet and income statement projections, detailed on page 15 C and 15 D of the original study, have been restated as shown on Appendices VII and VIII.

Comments on the Restated Projections

The following major differences are evident:

1. Overall the size of the proposed CFI becomes considerably more modest, as underlined by the reduced loan portfolio and borrowings.

2. As a result, both interest income and interest expense are significantly lower.

3. A 20% loan loss provision has been added.

Reviewing the new projections it is obvious that the proposed CFI would not be a profitable proposition and would not be financially viable without a substantial grant to cover start up costs and sustain the first few year's operations. An alternative would be to expand its activities and to allow it to undertake a wider scope of perhaps commercial banking type activities. This would diversify its sources of income by adding fee based revenue, make it less dependent on interest earnings.

Another solution would be for the CFI to raise long term capital from government or public sources. This however would require an established record of successful operations and capital financial planning.

Time constraints did not permit the team to go into considerable detail to evaluate the validity of the assumptions made and to assess whether the proposed CFI could be made into a viable proposition. This would require further market surveys as to effective cooperative loan demand and deposit mobilization potential. It would also entail consideration of anticipated interest and inflation levels as well as available long term loan and capital resources. However it seems clear that the CFI cannot be expected to become financially self-sustaining unless its sources of income can be expanded. If its economic justification is solely dependent on the interest margins between lending and borrowing operations, it would seem highly unlikely that a profitability trend can be established.

A.2. Comments on Proposed Capitalization

The study approached the issue of equity capitalization from the standpoint of initial start-up or seed capital, supplemented by a gradual build up of equity from internal membership contributions. The following equity capital sources are proposed:

1. Initially 100 cooperatives are expected to invest P 100,000 ($5,000) each, for a total of $500,000.

2. Additionally, borrowing members would be required to invest 10% of any amounts borrowed.

3. Seed capital of P 100,000,000 ($5 million) would be required to commence operations, to be provided by:

   a. the Philippine government through conversion of its P 57,942,000 (approx. $2,500 M) investment in the CMP project;

   b. USAID through P 50,000,000 ($2,500 M) monetization of Section 416 Food AID.

Both a and b are to be serviced as debt. They are "to be repurchased by CFI after five years and fully repurchased within 20 years." It was assumed that with this substantial capital base, the CFI would not be dependent on any further government or donor support.

The above equity capitalization plan is considered overly ambitious under the prevailing market conditions. It is by no means assured that the $500,000 can be raised through initial cooperative investments. Additionally, both the Philippine Government and USAID seed funding is unlikely to be forthcoming in the amounts indicated, at least not at the present time.

In addition, the requirement for resources from the cooperative movement is insufficient. The ratio of 1 part internal capital to 10 parts external capital indicates excessive reliance on external sources. To ensure membership commitment to the new organization, it would be highly desirable to increase the members own equity in relation to external funding, preferably on a 50-50 basis.

The proposed plan relies heavily on external borrowing as a source of loanable funds; however, in order borrow, it is necessary to establish a sufficient capital base. The study does not provide a first plan of how external capital markets can be tapped. It will undoubtedly be a minimum requirement to establish an ongoing line of credit with a formal financial institution, such as the Land Bank or a private commercial bank. But, it is by no means certain that the equity base proposed in the report will be sufficient to justify external borrowings, and in fact collateral or guarantee support will probably still be necessary.

The report seems to downplay the potential of utilizing savings as a potential source of loanable funds. In fact, the liability structure of the organization after the fifth year of operation is projected to have only P 65 Million from deposits and P 870 from external borrowings. These two sources, plus equity are to support P 1,180 in lending. This would mean 74% of loans are funded from external borrowing. Because of the uncertainly of obtaining external borrowing, it would seem prudent to examine the potential to raise more funds through deposit mobilization.

Based on the uncertain ties outlined above, it would appear necessary to scale down the planned operation to within available resources which in turn is likely to make the CFI financially non-viable.

B. Demand Projections

B.1. Credit Need Versus Effective Demand

The study does not distinguish between credit need and effective credit demand. This has been pointed out in several critiques of the study, and it would appear the critiques are valid on this point. The "need" or "desire" for credit may be infinite, especially if credit is perceived simply as the availability of funds with unclear obligations on the part of the borrower.

The "effective demand" for credit can be defined more rigidly as the existence of "bankable" projects by cooperatives that have the capacity to manage debt. This by definition will be less than credit need. As "effective" demand is really a function of credit criteria, established by lenders, such demand cannot be realistically estimated.

B.2. Lack of Assumptions in Making Projections

A summary table of credit "need" by sector is presented, and projections by sector are made for each of five years (page 272 of the feasibility study). By sector, the potential loan demand for the next five years is shown as follows:

	(Millions of Pesos)
Agriculture (including CRB's).........	P 10,396.7
Credit................................	P 7,186.1
Electric..............................	P 1,100.0
Housing...............................	P 2,880.0
Multi-Purpose.........................	P 105.5
Service...............................	P 331.6
TOTAL	P 21,999.9

The assumptions used for making the projections are not stated. In addition, it was also stated that the team would consider "potential absorptive capacity (effective demand) based upon a conservative estimate of the number of viable cooperative entities and their average size loan needs on a moving basis over a five-year period." The current condition of cooperatives, as some of the comments below demonstrate, make it appear the figures are anything but conservative.

It is clear from the figures given on page 272, that loan demand is expected to grow by a minimum of 20% per year. This of course will become exceedingly more difficult as the loan base increases. Projected growth rates of greater than 20% per annum are certainly not conservative. Again, the basis for making projections of this magnitude is not stated.

In Table 27 on page 272, it is not clear that the "Totals" column can be obtained by adding sectors across the years. The demand for maximum sources of loanable funds can be obtained from noting the amount of credit outstanding in Year five ($6.2 Billion). Some portion of this amount of loans outstanding would be financed by the Apex Bank. If it is necessary to project the total Peso value of all loans extended during the five year period, then this depends on assumptions made regarding the term of the average loan, and therefore loan turnover. No such assumptions are stated however.

B.3. Non-Viability and Limited Viability of Cooperatives in Certain Key Sectors and the Current Decision of the Credit Cooperatives Not To Join

The credit cooperative sector is projected to provide one-third of total demand, yet from our discussions, a majority of the credit unions are currently not planning to join the system. Thus immediately, one-third of this projected demand becomes highly questionable. These credit union loans are short-term, allowing rapid turnover of funds, and by historical experience, far more likely to be repaid than most of the other cooperative sectors.

The electric cooperatives are projected to provide P 1.1 Billion in credit demand, but it is reported the largest percentage of these organizations are in arrears in their payments to the NEA, and could not be judged bankable. The study notes that one-third of the Rural Electrical Cooperatives are bankable, a figure that was considered too high by a World Bank representative. Data on the true situation are of course difficult to obtain, given the noted poor bookkeeping practices. However, from a consolidated point of view, the past lending has clearly been a disaster. The report makes mention of "economic" reasons for the non-repayment, while other views have noted the widespread "politicization" of the REC's as contributing to the situation. From the information presented to this team, loans in this sector would pose extremely high risks at present; there probably is very little effective demand in this sector.

The housing cooperatives are to provide P 2,880 Million of effective demand. Yet the study gives no information on the financial condition of any of the housing cooperatives. We have been told that only two of the cooperatives may be viable. Since the study lists two viable and eight nearly viable, we can only guess the true situation. If the P 2,880 Million includes the "nearly viable", then the actual "bankable co-ops" may only be 20% of P 2,880 or P 576 Million.

Within the agricultural cooperative sector, the sugar cooperatives are to provide P 7.8 Billion, or 75% of the agricultural cooperative demand. From our discussions, at least the credit unions would have strong objections to loaning to this sector, which would have need of larger agri-business loans. It was noted that many of these organizations were formed as cooperatives for tax purposes, but in fact as noted in a newspaper article last year, some are considering switching to corporate status, since there are no more tax benefits for cooperatives. At least, it would appear many of these organizations could qualify for commercial bank loans. There probably is effective demand in this sector, if in fact the sugar cooperatives retain their cooperative status.

The study implies that the remainder of the demand for credit in the agricultural sector will come from Cooperative Rural Banks. The overall financial condition of the Cooperative Rural Banks is not good. Twenty-one out of the twenty nine CRBs had past due ratios higher than 35%. However, because of the likelihood that most old loans in arrears are still carried on the books, it is necessary to look at other data. Loans outstanding were P 200.2 Million in 1984, P 241.7 Million in 1985, P 272.4 Million in 1986, and P 301.4 Million in 1987. This indicates a growth in loans outstanding of P 41 Million in 1985, P 30 Million in 1986, and P 29 Million in 1987.

These actual past trends are compared to the study's projections of a growth in loans outstanding of P 65 million in the second year after the project, P 78 Million in the third year, P 90 Million in the fourth year, and P 116 Million in the fifth year (at which time total outstandings are projected at P 676.8 Million). The substantial differences between past and proposed trends indicate a system that could potentially grow too fast before it is adequately prepared to handle such growth rates.

In summary, the figures on demand presented in the study are highly suspect. It is beyond the scope of this study to re-estimate effective demand. In fact, the enormous number of assumptions that would go into such estimations could always be challenged by persons with different views.

A much more realistic approach is simply to look at institutional capability. It can be safely assumed in the Philippines with the dearth of formal financial institutions in the rural areas, that well-run financial intermediaries will find more than adequate client base to support their overhead through lending, deposits, and other banking services, as long as the pricing of these services are not overly regulated by the government. The relevant question to ask is therefore, what is the institutional strength of the proposed clients (cooperatives and cooperative banks) and also what is the institutional strength of the lender Apex? Given this information, how much lending could the Apex rationally do now, and what is a logical expected growth rate in lending? When the question of effective demand is addressed in this fashion, the institutional problems of the cooperatives noted above clearly indicate the P 22 Billion presented in the study is greatly overstated.

C. <u>Organizational Structure</u>

1. The board is too large and unwieldy in size. It invites the possibility of continual in-fighting and jockeying for position. This is especially true if the concept of patronage representation is followed.

The idea proposed in the study is to have 36 members on the board. Twelve members would conform to sectoral representation (two from the credit cooperatives, two from the agricultural cooperatives, two from the housing cooperatives, two from the service cooperatives and two from the other sectors). From our knowledge of Philippine cooperatives, it will be difficult to define what is the meaning of the service cooperatives, who should constitute the "other" cooperatives, why aren't the Cooperative Rural Banks considered one sectoral category, etc. These questions will be difficult to answer.

Twelve additional members will be chosen, one each coming from each of the 12 political regions of the country or whatever other regional boundaries which may be established by CFI. This will also be challenged, especially if as a result of the drawing of boundaries, certain sectors are over-represented.

Twelve of the board members are to be proportioned among the cooperative sectors based upon each sector's patronage of the CFI. Patronage appears to mean borrowing, such that the more a cooperative sector borrows, the more it gains control of the board. This concept could lead to disastrous consequences, with certain powerful sectors, such as the sugar cooperatives, borrowing in larger amounts, and therefore gaining control of the board. Once they have control, they can re-define policies related to lending, "leniency" in the case of non-repayment, etc.
The study realizes the problems inherent in such a large board, and therefore proposes an executive committee of nine members, to be chosen from among the 36.

In fact, it is probably better if the large board were to be 9-12 persons, without any need for the executive committee. Proposed 3-4 year terms may be reduced to 2-3 year terms, reducing chances of influence based on seniority.

The best control over the possibility of domination by the board, is to ensure that management functions independently from the board ~~and that all books and accounts are open for inspection by any~~ members.

2. It is not stated in the report how the Board of Directors is to be elected. This will be quite difficult, considering the diverse nature of the various cooperatives. It may be possible for the various federations to elect their nominee if sectoral

representation is used. Regional representation would require a different election process. Patronage representation is easy to determine, but very dangerous for reasons already mentioned.

3. The proposed technical assistance and training functions of the Apex organization appear to be non-revenue functions. The study does not suggest charging members fees for these services and assumes grants will be available to pay for these functions. This weakness is corrected in a later proposal to USAID which says that the technical assistance grants are temporary and such assistance will be paid through a fee structure in the later stages. No specific recommendations are made regarding the feasibility of charging such fees, and whether in fact a large enough fee structure could be created to pay for the large technical assistance efforts being contemplated.

4. The idea of simultaneously opening up both the central office and one area office in Cebu appears to be an enormous burden for a new organization. If in fact the Western Visayas are areas of concentrated cooperative activities, the feasibility of making the Cebu office act as both the central and regional office in the initial stages should have been examined. This would build on the existing situation and avoid many of the enormous start-up costs being proposed.

5. The proposed number of employees for the start-up phase (before the Revenue Producing Phase) is too large, therefore making it more difficult to eventually achieve profitability. It is proposed to start with 26 employees at the Central Office and 14 employees at the regional office during the first year of operation. It is unclear whether all these people will be fully occupied the first year. A much better approach would be to hire first only a CEO, with one or two support staff. This person would first put together a manpower plan which would gradually phase-in staffing as positions and clear work tasks are specified.

IV. ASSESSMENT OF THE APEX CFI CONCEPT

The previous section indicated that most of the reservations expressed about the Apex CFI concept are valid and that such an institution does not appear to be viable at this time. This still leaves open the question, however, of whether it could be viable in the future, under a different set of circumstances (for example, if there were a strengthened, more mature cooperative base) or what other steps might be taken to effectively utilize cooperatives and other institutions to promote rural development.

To address this issue, Philippine cooperatives must be analyzed in the context of the country's rural financial markets. This section presents a very brief overview of the rural financial system in the context of addressing the broader issue of whether the Apex CFI idea could potentially be valid and what alternative steps, if any should be undertaken.

During the last few years the Philippine government has made considerable progress in assessing past mistakes and revising its agricultural lending policies. A shift from directed credit programs and liberalization of interest rates have characterized this effort. Moreover, the Department of Agriculture's Agricultural Credit Policy Council (ACPC) has provided a solid analytical base for additional policy reforms through its studies and recommendations.

In summarizing something as relatively complex as rural financial markets in a short and simple fashion, one runs the risks of over simplification and broad generalizations, particularly when such voluminous and insightful work has already been done in this area. On the other hand, the team has had the opportunity to meet with a number of people who have for some time thought about the issues of rural development and financial markets as well as cooperative development in the country . The team's work represents the first attempt, since the Apex study was undertaken over two years ago, to synthesize the opinions of development specialist, policy makers and the private financial sector on how cooperatives might be used as a means to strengthen the rural financial sector.

It is generally accepted that the formal financial intermediaries in the rural Philippines do not function well and are not providing adequate banking services to the vast majority of small rural dwellers -- small farmers, traders, market vendors, retailers, etc. While private commercial banks are the most important conduit of credit to the rural sector (they provide over half of all loans outside Metro Manila), it is often pointed out that less than 10% of their portfolio is dedicated to rural lending and that their operations are characterized by net outflows of funds to Metro Manila.

The following types of institutions serve the rural financial markets:

1. Private Rural Banks (RB's);
2. Cooperative Rural Banks (CRB's);
3. Thrift Banks;
4. Private Commercial Banks (PCB's);
5. Specialized Government Banks; and
6. Informal Credit Sector (including cooperatives).

A short description of each of the institutional types follows in Part A below. The purpose of this description is to have some background to shed light on the feasibility of the Apex Cooperative Concept in the rural financial markets. Part B below summarizes the recent GOP initiative in the Comprehensive Agricultural Loan Guarantee Program. Part C summarizes an initiative by USAID Washington in providing loan guarantees. Part D uses the information in the above three sections, and summarizes the perceived role of an Apex CFI in the context of Rural Financial Markets.

A. Overview of Rural Financial Markets

A.1. Rural Banks (RB's)

The Rural Banking system was initiated in 1952; by 1980, over 1000 such community-based family-owned banks had been established with assistance from the government. Today some 850 of these banks continue to be active and 96% of the banks are situated in rural areas, making the Rural Banking system the largest network of rural financial institutions in the country. Rural Banks are represented at the national level by the Rural Bankers Association of the Philippines (RBAP).

During the last decade they have been the predominant source of institutional credit for small farmers. As of 1987, the Rural Banks made 12.8% of all agricultural loans during the year.

As noted by the Secretary of Agriculture, the Rural Banks were provided a host of privileges and subsidies by the past government. This was consistent with the government's view of "supply-leading" credit - providing loans to targeted sectors. The government did not provide the proper incentives so the banks could act as true financial intermediaries - mobilizing deposits and savings and transforming them into loans for any viable enterprise.

The government's position of fostering low priced credit (through such programs as the Masagana 99), combined with high risk loans carrying high transaction cost for lender as well as borrower, gradually led to a deterioration in the RB loan portfolios. The closing of rural banks accelerated, and by 1986, only 856 were left in operation. Of these, only 232 banks were adjudged by the Central Bank to be in good financial standing, thus qualifying for rediscounting.

The precarious position of the Rural Banks led to the creation of a Rehabilitation program. Basically, the Rural Banks must infuse new capital, bringing the Risk Asset Ratio(Net Worth/Loans Outstanding) to 10% before being eligible to participate. They then can choose to restructure their debts with the Central Bank, or the arrears may be converted into government equity in the RB (held by the Land Bank). As of March 1989, 67 Rural Banks (including seven Cooperative Rural Banks) had applied for the rehabilitation through the conversion of arrearages into Land Bank Equity. It is expected that a large number of the remaining Rural Banks will not be able to meet the minimum capital requirement, and will therefore by forced to close. The system will definitely shrink, but the idea is to have a smaller number (perhaps only 500-600) of healthy Rural Banks.

A.2. Cooperative Rural Banks (CRB's)

Cooperative Rural Banks were initiated in 1972 when it was decided that the management of credit and the supply/marketing functions of the cooperatives had to be separated. Area Marketing Cooperatives (AMC's) were established to handle cooperative business activities while CRB's were to handle credit delivery to cooperative farmer members. As of today, 29 CRB's are organized in a Cooperative Rural Banks Federation of the Philippines (BANGKOOP). The Land Bank currently holds 49% of the equity of the CRB's.

Despite the rapid growth of the CRB system, these banks suffer from the same problems inherent to the RB's: over-reliance on concessional government funds, lack of efficient loan servicing and staffing problems. The CRB's are eligible for the rehabilitation program along with the private Rural Banks.

A.3. Thrift Banks

As of May 1987, there were 114 Thrift Banks which included 42 Private development banks, seven savings and mortgage banks and 65 stock savings and loan associations. Thrift Banks have overall been profitable, although the private development banks had a consolidated loss in 1986, and the stock savings and loan associations had a loss in 1985.

The Private Development Bank's are mostly concerned with agricultural finance and date back to 1980. They have historically relied on the DBP for financing but recently have become more internally funded. They are supported by the Development Bankers Association of the Philippines (DBAP), an Apex organization at the national level.

The Private Development Banks have some 700 Branches, with at least 50% in the rural areas. The PDB's have shown some promise of profitability and may be able to expand in the field of commercial agri-finance.

A.4. Private Commercial Banks (PCB's)

The Private Commercial Banking system represents the largest network of banking facilities in the country. It is important to note, however, that more than 60% of its branches are located in urban areas. The PCB's hold at least 55% of total bank assets with 28 domestic banks and four branches of foreign banks.

It was recently reported in the national press that total bank credit to agricultural production reached P 29.4 billion ($1.47 billion) in 1988 representing a 7% growth from the 1987 level; this growth is in line with the overall credit expansion extended by the banking system. Commercial banks continued to pour in the bulk of this total agricultural production credit at 78%. It was also stated that most of this formal credit went to food commodities, supporting mainly credit expansion in fisheries (16%), rice (13%) and fruits/vegetables/root crops(13%). Export crops received 36% of total farm credit disbursements, somewhat below 1987 volume. The proportion of agricultural loans to total loans from the banking system remained at 7.2%.

Although there are some banks in poor operational and financial condition, the PCB's are expected to continue strong growth in the coming years, with the expected further liberalization of the economic environment.

To improve commercial bank lending to rural areas and particularly agriculture, the government has undertaken a number of initiatives. It has tried legislating increased lending through policies such as the Agri/Agra requirement that banks have no less than 25% of their loan portfolios in agriculture, including 10% to land reform beneficiaries. The government has also attempted to force banks to lend up to 70% of their deposits in the areas where they are received. While well intentioned, these measures are inefficient, increase the cost of intermediation, and at any rate, a consensus exists even among supporters that they have not worked. There are currently several attempts to make the requirement more "effective". Bill 317 currently before the Congress will require that banks that do not meet the requirement invest in low yield Land Bank debt obligations. The Land Bank will in turn use these funds for on lending. There is a general feeling, however, that the Agri/Agra requirement will be eliminated in the near future.

Our interviews indicated there are currently few PCB's loaning for cooperatives. There appear to be several reasons for this:

1. PCB's in general have the perception cooperatives are not sound;

2. The organizational structure of cooperatives is more difficult to deal with than the corporate form;

3. Cooperatives are often in rural areas where PCB's have no branches;

4. Cooperatives are considered poor credit risks; the perception is they are unable to service debt obligations in an orderly fashion; and

5. Cooperatives often are unable to produce reliable financial information to enable PCB's to assess credit risk.

A.5. Specialized Government Banks

Out of the three Government Banks, the Philippine National Bank, the Development Bank of the Philippines and The Land Bank of the Philippines, the latter is most involved in agricultural finance.

The Land Bank of the Philippines (LBP) was originally established in 1963, as a government owned bank to finance the transfer of land titles from landlords to tenants. In 1973, it was reorganized and became involved in various programs designed to promote the economic welfare of agrarian reform beneficiaries. Several new programs were instituted to provide financial, technical and managerial assistance to small farmers (those with two hectares or less).

As the financing arm for the Comprehensive Agrarian Reform Program (CARP), LBP performs a unique social mission to provide financial assistance for three essential operations of this reform:

(a) the transfer of agricultural lands from landowners to tenant farmers;

(b) the shifting of capital of farmer landowners to industry and productive enterprise; and

(c) the improvement of productivity of farmer beneficiaries.

Since 1987, LBP has made various attempts to improve its services; it began to restructure its fundamental business of credit extension and investment stimulation in a way that could respond more quickly to serve a greater number of its major constituency (rice and corn farmer beneficiaries), and other farmers, falling under the demands of an enlarged agrarian reform. It broadened its credit delivery system to include rural banks, cooperative rural banks and farmers' cooperatives as credit intermediaries to serve the needs for farm production inputs and facilities. It also established an outlet for trading the new 10 Year Land Bank Bonds, opening an investment opportunity for old and new landowners/bondholders.

As to its commercial banking activities, it focused on prime corporate names, in efforts to broaden its revenue base to include export receipts, deposit balances and fee based income.

Financial Highlights

(in P MM)	Loans & Discounts	Invest-ments	Other Assets	Total Assets	Net Earnings
1985	6,743	3,368	2,915	13,026	470
1986	5,437	6,304	4,016	15,757	386
1987	5,457	4,377	2,799	12,633	286

In 1988, LBP launched a major shift and decided to emphasize the wholesale credit delivery sector, instead of the retail sector. Because of its new emphasis on wholesale banking (8% of their loans were wholesale in 1987 vs. 60% in 1988, a dramatic one year shift), the LBP has also been aggressively promoting its credit programs with intermediaries, including cooperatives. Where intermediaries do not exist, either because of isolated rural conditions or because previous lending programs undermined existing institutions, they have organized cooperatives and other farmer organizations themselves. For example, LBP figures indicated that in 1988, they registered 261 new co-ops or farmer organizations which benefitted over 20,000 small farmers vs. 20 cooperatives in 1987. LBP officials indicated that their long-term goal is to have approximately 1,500 cooperatives and farmer organization serving the credit and other needs of small farmers throughout the country. LB provides funds to intermediaries at 12% per annum. Interest on retailing operations is approximately 15%. It was also reported that additional one time fees of 5% are levied on loans disbursed.

While it is difficult to gauge how effective middle management and field level support is, Land Bank upper management appears to be top notch. They are also attempting to design some innovative approaches. For example, they are in the process of designing a program for rural microlenders, really a form of informal lending. While reservations have been expressed in this paper about the difficulties and inherent contradictions in trying to formalize informal lending, such approaches are certainly worth exploring. Management is also trying to ensure that loans are adequately supervised and that the bank makes it clear to borrowers that they are a serious financial intermediary determined to ensure repayment. In sum, they believe that despite the pressures they face as a result of the past, the mistakes of the past can be avoided with good, hard nosed management. They are particularly proud of their performance in 1988: 89% repayment on retail operations and 90% on wholesale operations.

The team is considerably less sanguine about the Land Bank's prospects and the impact their operations might have on the rural sector. Good management cannot compensate for a policy of using financial intermediaries as vehicles to deliver credit, particularly when those funds are being provided at below cost (even though such subsidies are much lower than in previous programs). In effect, many of the criticisms that were made about the 1987 Apex CFI apply to the Land Bank as an Apex facility. The Land Bank is moving into wholesaling before any retail mechanisms are in place.

The idea of organizing cooperatives for the disbursement of credit is unlikely to work. These "co-ops" may be little more than "groups". There may be some administrative cost saving by dealing with fewer accounts, but these savings are often offset by large increases in arrearages. Groups cut across the normal bank-customer relationship such that the bank loses contact with its customers. The only exception may be groups or cooperatives which were not organized from the outside.

As learned time and time again, cooperatives are organized from within, not from the outside. The Land Bank's approach to organizing cooperatives will work against building a strong cooperative base, and thus will indirectly weaken the foundations of an Apex Cooperative Bank.

The team believes that the stage is being set for a major crisis that could severely undermine financial reforms. LBP is extending credit wholesale at subsidized rates, which will discourage the utilization by retailers of internal savings mobilization. LBP is also using cooperative organizations as retailers which are extremely weak. The likely result in the longer run is non-repayment of loans and enforcing views in the rural areas that credit does not really have to be repaid. This does not appear very different from past government strategies related to credit.

A.6. <u>The Informal Credit Sector (Including Cooperatives)</u>

This group is estimated to provide some 50-65% of rural credit demand; it is a diverse group consisting of finance companies, credit/savings associations, money lenders, traders, family members, pawn shops and cooperative credit unions.

Among this group, the credit unions have shown the most consistent growth, as they have outperformed all other types of cooperative societies. The credit unions in fact are very different than the other members of the group, for their resources come from member savings. In addition, some of the credit unions operate very much like small banks, with well developed book-keeping and other operating systems.

This group also includes the so-called "middle-man". Despite the traditional bad name of the "middle man", the research undertaken in the Philippines as well as other countries indicates that for the most part informal credit channels do provide needed financial services in the rural areas, often at reasonable borrowing costs. The credits supplied are not always in the form of cash, but sometimes selling goods (ie. farm inputs) with payment at a later date. Indeed, various institutions ranging from USAID/Philippines to the GOP and private banks are analyzing ways to enhance informal lending as well as ensuring that it is equitable. Care should be taken in this area. One government institution told the team that they wanted to find an innovative way to "formalize" informal lending. This, if not handled correctly, is likely to go nowhere and drain a lot of resources.

As to the role of cooperatives in overall credit delivery, it would seem that the best way to assist them in this effort is to provide training and management support. The cooperative sector can play a very constructive role in the distribution of credit, but not as an instrument of government policy to transfer resources or as a conduit for disbursement of donor funds. Their perceived major value is in the areas of savings mobilization, liquidity management and organizational support for individual members.

B. GOP Initiative: The Calf Program

One of the major initiatives in recent years to promote greater commercial bank lending has been the shift from direct government agricultural lending to programs under which government funds guarantee private financial flows to rural areas and important sectors of the economy such as small and medium scale enterprises. In December 1986, the GOP reorganized its agricultural lending portfolio by consolidating 20 out of 46 separate lending program into the Comprehensive Agricultural Loan Fund (CALF) as a guarantee facility (CALF actually consists of four guarantee programs). Included among these is a Cooperative Development Guarantee Fund, although little use has been made of this specific facility to date.

This guarantee fund was the result of a major examination of the role of government in agricultural lending and rural financial markets in general. This review, led in large part by the Department of Agriculture's Agricultural Credit Policy Council, was prompted by the perceived failure of past government credit programs characterized by a historical repayment rate as low as 48% in 1986 and overall administrative costs exceeding 64% of the loan.

The CALF was established because many of the previous credit funds were not utilized effectively. For example, most programs were plagued by high administration costs of the inter-agency committees handling the funds on a part-time basis. The GOP also believes that a guarantee facility, because of its potential to leverage a high volume of private sector financing, works better than a credit program in inducing credit reflows to small farmers and rural areas.

The CALF is administered by the Department of Agriculture's Agricultural Credit Policy Council (ACPC). Funds are channelled through four separate facilities: The Philippine Crop Insurance Corporation (PCIC) (for production needs of small farmers and farmers associations); the Quedan Guarantee Fund Board (QGFB) (specializing in warehouse-related guarantees for grains and other storable agricultural commodities); the Bagong Pagkain ng Bayan (BPnG) (which guarantees loans to local government units from the private banking system); and the Guarantee Fund for Small and Medium Enterprises (GFSME) (which focuses on guarantees for small and medium-sized agricultural projects). This latter program is particularly relevant since the program also includes a Cooperative Guarantee Fund (CGF).

During its first operational year (approximately October 1987 to October 1988) the combined CALF facilities guaranteed approximately US $5.25 million. Average loan sizes ranged from $350 under the PCIC-CALF program to approximately $500,000 under the QGFB-CALF window. Guarantees to cooperative organizations have so far been small.

Despite the low use of the CALF by cooperatives to date (one co-op leader referred to the program during the team's interview as the "still-born CALF"), it is extremely relevant for the co-op sector and in assessing the Apex concept, because the GOP is determined to make guarantee programs its mechanism for direct participation in rural financial markets in the future. This implies, among other things, that the GOP is unlikely to support direct capitalization or the provision of loan funds for an Apex CFI. This however does not mean that the CALF and an Apex facility are mutually exclusive. On the assumption that the CALF will continue to operate and in fact will increase its guarantee volume, an Apex CFI type organization could supplement CALF's activities by providing direct credit to the cooperative sector, sometimes backed by the CALF guarantees.

C. <u>USAID Initiative: The Bureau for Private Enterprise Loan Guarantee Program</u>

The following summary of this program was prepared by the USAID/Office of Capital Development:

AID, through its Bureau for Private Enterprise, finances facilities in private banks in a number of countries, including the Philippines, which guarantee up to 50 percent of the principal amount of eligible subloans made by local banks, to qualifying private sub- borrowers. The money loaned by the local banks comes from their own funds and must not be provided under government credit programs. The AID funds are from a world-wide private enterprise revolving fund managed by AID's Private Enterprise Bureau and hence are not taken from the bilateral assistance package for the Philippines.

The guarantee facilities have been established in four banks in the Philippines: Far East Bank ($2 million), Metropolitan Bank and Trust Company (Metro Bank) ($2.1 million), Philippine Commercial International Bank (PCIB) ($2.4 million) and Bank of the Philippine Islands ($2.4 million).

One of AID's objectives in the Philippines as well as that of the GOP is to stimulate lending to small and medium enterprises. Accordingly, eligible sub-borrowers are firms with assets that do not exceed the equivalent of $1 million. Furthermore, to meet the rural development strategy of both AID and the GOP, eligible sub borrowers under the Metro Bank and PCIB projects must have most of their operations outside Metro Manila; eligible subloans under the Far East Bank project must finance export oriented activities. Individual subloans must not exceed the equivalent of $500,000. Eligibility is determined by the Philippine banks, in accordance with the parameters they have agreed to with AID.

The Government of the Philippines has no direct role in this activity. However, Philippine banks must obtain Central Bank concurrence to participate in the program because of the foreign exchange outflow implications of the guarantee fees paid by the local banks.

The A.I.D. funds are lent to U.S. intermediaries: Rainier National Bank for the Far East PCIB Bank projects and Mellon Bank in the case of Metro Bank. The U.S. intermediary issues a standby letter of credit upon which the Philippine bank may draw in the event of default by a sub-borrower. The U.S. intermediary is not at risk; it deducts the amount paid to the Philippine bank in the event of draw down on the standby L/C from the amount that it owes AID. Since the guarantee covers 50 percent of the principal amount of subloans, A.I.D. and the Philippine bank share the risk equally. The participating Philippine banks pay A.I.D. a negotiated guarantee fee. For example, Metro Bank has paid A.I.D. an initial, flat, facility fee of $2,625, and will pay a guarantee fee of 1.5 percent per annum of the aggregate amount of subloan coverage outstanding under the standby facility. Metro Bank is also responsible for paying fees charged by the U.S. bank for the issuance of standby L/Cs up to .25 percent per annum on the outstanding principal amount of the standby L/Cs.

D. Apex CFI's Perceived Role in Rural Financial Markets

The information above has been presented to provide an appropriate setting for asking the question of whether the Apex CFI concept is valid. It should be noted that another question, whether credit is in fact the major problem facing cooperatives and the rural sector, is not particularly relevant for the present study. While a great deal has been written on the issue, the answer is a simple "no". There is sufficient evidence that a proper policy environment, including appropriate commodity and factor prices, transportation and other variables are more important than credit per se. The costs of credit are also only a small percentage of overall production costs. Nonetheless, no one argues that credit is not important, or that a sound rural financial market does not greatly assist rural development. Hence, the question of whether and how an Apex CFI can strengthen rural financial markets is appropriate.

The current setting of the Philippine financial markets leads us to conclude that an Apex CFI could eventually be very important in enhancing rural development in the Philippines. Informal lenders are serving a large part of the rural population. The effectiveness and coverage by this group could be enhanced by policy measures, some as simple as permitting intermediates to participate in "agricultural" lending programs. The equity of informal lending operations can also be encouraged through specific interventions. For example, the USAID/Philippines Office of Agriculture is analyzing a program to provide radio marketing information to farmers. This should enhance the bargaining position of farmers vis-a-vis marketing agents and, relatedly, to the terms for credit that they may provide. Over the short run, informal lending merits close attention by USAID and the GOP.

Credit unions, marketing and agricultural farmer organizations and other cooperative organizations can very effectively complement other informal lending. In the region, Japan, Korea, and Taiwan ~~have had very successful experiences with cooperatives in rural~~ lending. Like informal lenders, they have the capacity to inter-link markets (credit, input, output). A marketing co-op can become an agricultural production lender. A cooperative that supplies inputs can implement an in-kind lending program.

Yet, a note of caution should be added. In the past, most government sponsored programs to inter-link financial and commodity markets (like the Area Marketing Cooperative/Cooperative Rural Bank Program) have not worked as anticipated. It is sometimes incorrectly perceived that such inter links of credit/input/output markets lessen the risk of the borrower defaulting, especially since there is a perceived control over the farmer's output. In fact, such programs often fail because they are too complex; involving not only the management of money, but the management, warehousing, transportation and sale of commodities. Thus the risk of borrower default may be less, but the risk of lender default is greatly increased due to organizational complexity.

Cooperatives are already undertaking some innovative programs. For example, as already noted earlier, several credit union federations are undertaking inter-lending programs which contribute to effective intermediation. To date these programs are relatively small. However, the movement is definitely in the right direction in contributing to effective intermediation.

Co-ops and similar organizations are also important in that they can be effective tools to capture rural savings. This has been demonstrated in may countries throughout the world. It should also be noted that, an effective and viable cooperative structure can serve as an alternative to massive government credit efforts of doubtful effectiveness.

In this context, it seems that the development of an Apex bank for cooperatives might make sense at some point in time; it could potentially contribute to providing centralized leadership in the financial affairs of the cooperatives.

In order to be accepted by the membership, such an organization would have to develop from within the movement as need arises, instead of it being imposed on them by government or anyone else. If that can be accomplished, an Apex CFI could provide:

- centralized liquidity for internal and external funds;
- linkage to capital markets through bank credit lines and CB rediscount facilities;
- a catalyst for savings mobilization;
- supervision and audit functions for cooperatives;
- improved control mechanisms for loan processing and disbursement;
- unified cooperative position in the financial markets; and
- a depositary for GOP and/or donor financial support.

Ideally, an organizational structure would be initiated at the provincial level, followed by the regional level and in due course the national level. It is envisaged (and recent legislation detailed in this report makes this possible) that this development would lead to localized "cooperative banks" and later to a "national cooperative bank". It also appears the consensus in cooperative circles that the Land Bank nor the Development Bank of the Philippines are appropriate candidates for this function as they are government owned and already overburdened with execution of GOP financial policy.

The development of such a cooperative base is a long run effort and requires long run commitment. Unfortunately, numerous factors mitigate against taking this long run view. Government is often concerned about immediate political pressures. Solutions must be identified and implemented now. Development agencies face the constraints of moving appropriated funds and meeting five year plans. Similar to the decisions that commercial bankers must make regarding lending to big or small borrowers, the administrative costs of an "impact" major program is much lower than smaller, long run approaches. Leaders of development organizations face constraints to serve their constituency as soon as possible. This is not a statement of criticism. These are real variables faced by institutions working in the development process.

Despite the fact that it ultimately could be very constructive, the Apex CFI idea as presented in the Feasibility Study appears to be a top down, quick-solution approach in spite of statements to the effect that it would be implemented gradually. In our opinion, USAID's caution in supporting the Apex idea as presented in the Feasibility study is warranted.

At the same time, there are a number of discrete, small activities that could be undertaken by the Mission that would support the long run strengthening of co-ops as a means to promote financial intermediation and provide services. These are identified in the following section. They essentially involve those organizations that are taking pragmatic approaches with some promise and who could ultimately play a leadership role in the establishment of a true Apex CFI.

V. RECOMMENDATIONS

1. THE APEX BANK CONCEPT

USAID should not become involved in or provide financial support to the newly established CCFDI, perceived as a prototype Apex CFI. Such support would at best be premature and possibly inconsistent with sound business principles of gradual growth.

2. POLICY DIALOGUE and TOPICS FOR FURTHER STUDY

USAID should follow-up the Rural Financial Services Project with a program aimed at improving financial intermediation, particularly savings mobilization. To accomplish this, USAID could design a financial sector program assistance package, possibly in conjunction with the World Bank. Some of the issues/topics to be addressed in such dialogue/study are the following:

a. Re-examine Land Bank credit policies

The current thrust of LBP programs is promoting more wholesaling and less retailing of rural credit. The aim is clearly to put out massive amounts of rural credit to farmers for agricultural production. Since insufficient retailers are available, the LBP proposes (and is in fact starting) to organize "cooperatives" for the purpose of credit delivery. These "cooperatives" may be little more than "groups". There may be some administrative cost savings by dealing with fewer accounts, but these savings are often offset by large increases in arrearages. Groups cut across the normal bank-customer relationship such that the bank loses contact with its customers. The only exception to this general statement is if certain groups or cooperatives have some history and were not organized by outsiders. The LBP approach appears to be a high risk strategy that may repeat past mistakes.

b. Move from loaning for agricultural production to loaning for all viable rural enterprises

Although the government has recently moved away from targeted lending for particular crops to a general purpose production credit, there nonetheless is still an implicit form of credit targeting in place by emphasizing "farmers" and "production credit". Without denying the importance of farmers and production credit, it should also be noted that there are many other categories of bankable borrowers in the rural areas. Of particular interest should be the trade and retail/wholesale sector, which inevitably support the agricultural production sector.

c. Savings mobilization

Policies and strategies should be discussed to find ways to encourage savings mobilization by all forms of financial intermediaries. Currently the institutional mechanisms to save are simply not in place. It should be noted that farmers and rural dwellers ordinarily have a need to save before they have a need to borrow. In the case of farmers, if a farm family can build up sufficient savings, they are not forced into ""distress sales" at periods of low prices because of their need for cash. Rural savings can also have an impact on other Government rural policies. For example, any increase in the farmer's ability to hold their product off the markets at periods of low price cuts down the amount the GOP must buy to support the floor price on that commodity.

d. Strengthen supervision of rural financial intermediaries

It has been noted by many observers that the supervision of Rural Banks by the Central Bank has been weak. The proposed Senate Bill 880 ("THE RURAL FINANCIAL SYSTEM ACT") proposed to make the Land Bank the Apex Bank for the Rural Banks, Cooperative Rural Banks, Private Development Banks and farmers organizations. Among its functions, the LBP is supposed to have an "institutional building" role. Based on discussions and reports, it is questionable whether LBP can perform such a role. The same act allows LBP to contract for the performance of such services. Contracting with outside private accounting firms may be an approach to examine.

e. Examine ways to encourage additional formal financial intermediaries to operate in the rural areas

While Manila may be overbanked, rural areas are not and 50% of municipalities have no banking offices at all. This lack of rural financial institutions should be addressed by eliminating policies that restrict the number of banks and bank branches and by examining potential "market-supporting" incentives to encourage banks to operate in the rural areas.

3. SPECIFIC RECOMMENDATIONS ON COOPERATIVES

USAID should continue support of indigenous cooperative activities that are in line with the general reform of rural financial service delivery systems. Some of the existing and potential activities are:

a. USAID should continue its support for the PFCCI, particularly as it has developed an interlending scheme that appears to operate satisfactorily.

b. USAID should consider supporting another cooperative, NAMVESCO (National Market Vendors Cooperative Service Federation, Inc.) which has developed sound internal policies, appears well structured and has developed interlending schemes. It has expressed particular need for some financial support in the area of organization and training which appears justified and needed for further growth.

c. USAID should consider assigning specialists under the Rural Financial Services project to analyze the various interlending schemes that have been developed by the credit cooperative sectors, with the intention of determining whether these systems can be further streamlined or replicated in other rural financial service areas. In addition, assuming credit cooperative support, the feasibility of consolidating the interlending schemes could be examined. The credit unions themselves are examining ways their associations could join together. The consolidation of such schemes should not necessarily be encouraged, but at least the idea should be explored. This could form the basis for a Mini-Apex CFI and could eventually lead to an Apex CFI or Cooperative Bank with its own corporate charter, serving different types of cooperatives.

d. USAID should generally provide support for training and organizational development efforts to assist in developing cooperative infrastructure and management, and improve their access to sources of formal credit.

LIST OF APPENDICES

Appendix I
(Report: 3.23.89)

List of Principal Person Contacted

	Name	Designation	Agency
A.	Government Sectors		
1.	Sony Vistan	President	Land Bank of the Philippines (LBP)
2.	Rosalina de la Paz-Magat	Asst. Vice President (Farmers assistance Grp.)	Land Bank of the Philippines (LBP)
3.	Severino B. Vergara	Asst. Vice President Rural Banking Dept.	Land Bank of the Philippines (LBP)
4.	Roberto F. de Ocampo	Vice Chairman	Development Bank of Philippines (DBP)
5.	Bruce Tolentino	Executive Director	Agricultural Credit Policy Council (ACPC) Dept. of Agriculture
6.	Clemente E. Terso, Jr.	Director	Bureau of Agricultural Cooperatives Devt. Dept. of Agriculture
B.	Cooperative Sector		
7.	Jaime P. Asuncion	President	Cooperative Union of the Phils. Inc. (CUP)
8.	Arcadio S. Lozada (Ret. Gen.)	Secretary General	Cooperative Union of the Phils., Inc. (CUP)
9.	Hon. Manuel P. Manahan	Chairman	Supreme Cooperative Council of the Phils. ~~(SCCP)~~
10.	Atty. Caesar Querubim	Chairman	Central Cooperative Finance Devt., Inc.
11.	Atty. Florencio S. Corral	Secretary	Central Cooperative Finance Devt., Inc.
12.	Romulo M. Villamin	General Manager	National Confederation of Cooperatives, Inc. (NATCCO)

13.	James N. Robertson	Executive Officer	National Market Vendors Cooperatives Service Federation, Inc. (NAMVESCO)
14.	Fr. B.A. Jayoma	Chief, Executive Officer	Phil. Federation of Credit Coopertives, Inc. (PFCCI)
15.	E. R. Harding	Financial Management and Planning Advisor	World Council of Credit Unions, Inc. (WOCU)
16.	Richard L. Lowe	ORS-Development and Training Specialist	World Council of Credit Unions, Inc. (WOCU)
17.	Antonio H. Arcillana	Regional Program Director	Agricultural Cooperative Development International (ACDI)
18.	Jaime D. Chua	Program Officer	Agricultural Cooperative Development International (ACDI)

C. <u>Commercial Banking Sector</u>

19.	Dan R. Heldridge	Vice President	Citibank (International Finance Inst.)
20.	Joey A. Bermudez	Vice President	Phil. Commercial International Bank (PCIB)
21.	Rodrigo Supena	Vice President	Bank of the Philippine Islands/Agribank
22.	Ramon Y. Sy	Chairman/CEO	United Coconut Planters Banks (UCPB)

D. <u>Others</u>

23.	Mark A. Van Steenwyk	President	Pacific Agriservices Inc.
24.	Robert Hood	Sr. Project Economist	Asian Development Bank
25.	Robert C. Vogel	Executive Director	The Inter-America Mgt. Consulting Corp. (IMCC)
26.	Dale W. Adams	Professor, Agr. Economics	Ohio State University
27.	Peter Wallace	President	AYC Consultants, Inc.

Appendix: II
(Report: 3/23/89)

List of Principal Reference Materials

1. Cooperatives in the Philippines
   (Study of Past Performance, Current Status and Future Trends)-
   Mark A. Van Steenwyk (May 1987)

2. The Comprehensive Agricultural Loan Fund and Agriculutral Credit Policy
   Agricultural Credit Policy Council (ACPC) - (February 1989)

3. Assessment of the Philippine Ecoromic Reform Progam,
   Evaluation of USAID Program Assistance and Future Recommendations
   Development Economics Group
   Louis Berger Intenational, Inc. (December 1988)

4. Study on Strategies for the Expansion of Banking Services
   in the Rural Area (Volume I) -
   Central Bank of the Philippines (September 1987)

5. Agricultural Finance and the Rediscount Window of the Central Bank
   Inter-American Management Consulting Corporation (January 1988)

6. Financial Sector Study Volume I - Main Report
   IBRD 7177 - PM (August 1988)

7. Cooperatives as Instruments of Development,
   Status, and Future Direction
   Agricultural Credit Policy Council (ACPC) (August 1987)

8. Study on the Framework of the Cooperative Financial Program
   Technical Board for Agricultural Credit Presidential
   Committee on Agricultural Credit (June 1988)

9. Consultancy Report on the Philippines:
   Innovative Approaches to Cooperative Management Finance
   and Trade Projects
   Crane, Temme, Bergfolk, Novak (October 1988)

~~10. Strenghthening Domestic Capital Formation through~~
   the Philippine Credit Cooperative System
   World Council of Credit Unions (October 1987)

11. Marketing and Credit Linkages
   Donald Larsen (December 1988)

12. Perspective Plan for Agricultural
Cooperative Development 1988-2003
ICA CUP (July 1988)

13. Rural Financial Markets, A Review of Literature
Philippine Institute for Development Studies

14. The Integrated Cooperative System of the Philippines,
Status, Thrust and Direction
Agricultural Credit and Coopertive Institute
University of the Philippines (December 1988)

15. Informal Finance in Rural Areas of the Philippines
The Ohio State University
Dale W. Adams, Professor (February 1989)

16. Philippine Fural Financial Markets
Mark A. Van Steenwyk (June 1985)

17. Updated Medium-Term Philippine Development Plan (1988-1992) -
National Economic and Development Authority (JUne 1988)

18. The Poor in Agriculture, Their Number, Whereabouts
and Characteristics
Natural Economic and Development Authority

19. Staff Appraisal Report Philippines -
Agricultural Credit Project,
The World Bank (May 1985)

20. Proposal to Establish an Apex Cooperative
Financial Intermediary in the Philippines
U.S. Overseas Cooperative Development Committee,
Washington (April 1988)

Appendix III
(Report: 3/23/89)

Outline of Philippine Cooperative Sector

Government Initiatives

1. Federation of Electric Cooperatives in the Philippines
2. Federation of Transport Cooperatives
3. Federation of Cooperative Rural Banks (BANGKOOP)
4. Cooperative Marketing Program (CMP)
5. Cooperation Insurance System of the Philippines (CISP)
6. Cooperative Union of the Philippines (CUP)
7. National Union of Samahang Nayon (PKSN) (Village Associations)

Non-Government Initiatives

1. Philippine Federation of Credit Cooperative, Inc. (PFCCI)
2. National Confederation of Cooperatives (NATCCO)
3. Natural Market Vendors and Service Cooperatives (NAMVESCO)

Appendix IV
(Report: 3/23/89)

Background on CCDFI

This organization was initiated by the Supreme Cooperative Council of the Philippines (SCCP), an umbrella organization for all cooperative sectors, and was organized along the lines of the APEX CFI concept. It was incorporated on December 10, 1988 as a Non-Bank Financial Institution, owned and operated by its cooperative members. It is open to all registered cooperatives in the country and aims to mobilize the use of the cooperatives own resources and to improve their access to external funding sources.

Specifically it has the following objectives:

- To serve as a catalyst for organizational development;
- To consolidate resources and assist in meeting members' demand for credit;
- To stimulate savings mobilization;
- To coordinate external financing;
- To act as a conduit for capital inflows;
- To strengthen the borrowing power of the rural sector.

It plans to use member equity investments to fund loan programs and to earn money market rates of return on temporary cash surpluses.

CCFDI will run as a corporation but will adhere to all key cooperative principles. It is controlled by an elected Board of Trustees which in turn appoints an Executive Management.

Funding is raised through:

1) member equity

2) development grants

3) sale of commercial paper

Authorized capital is $5 MM (₱100 MM) divided into common and preferred stock, supplemented by membership fees. Its main purpose is to provide institutional (wholesale) finance to its member cooperatives.

Appendix V
(Report: 3/23/89)

BACKGROUND ON
NATIONAL CONFEDERATION OF COOPERATIVES, INC. (NATCCO)

Natcco is a tertiary level organization, consisting of 5 Regional Development Centers (RDC). The latter are secondary structures with direct relationships to their members, serving some 400 primary cooperatives. Natcco was established in 1977 as a coordinating arm of the RDC's for training and education. Currently, the RDC's have implemented several programs, including training, audit, consultancy, central fund, intercoop trading, small scale industry (agro-based), research and some form of credit-life cooperative insurance.

Statistics:

Number of Coop affiliates:	388
Average membership of affiliates:	780
Total individual membership:	302,640

Type of Affiliates:

Credit Cooperatives	204
Multipurpose Cooperatives	96
Consumer Cooperatives	58

Individual Membership by occupation:

Farmers	50.1%
Government employees	12.6%
Self-employed	12.3%
Others	25.0%

Average Assets of affiliates:	₱2.11 M	(US$105M)
Total Assets (100%):	₱2.13 B	(US$106 MM)
Total Liabilities (39%):	₱830 B	(US$41 MM)
Net Worth (61%):	₱1.30 B	(US$65 MM)

Natcco receives some financial support on a peso for peso matching basis from the Canadian Cooperative Association which during the last two years has also assisted in staffing training and development. Natcco has been successful in the establishment of a Central Fund, based on the idea that there are surplus funds among cooperatives in different areas and/or at different times. Thus the Central Fund (CF) is a financing intermediary at the regional and national level, which pools available funds for re-lending in times of financial need. This is a relatively new development towards a more efficient allocation of resources, providing improved service to its members; a frequently used term is "institutionalized self-financing." Natcco has been able to mobilize significant resources into the CF, presently reaching $1,600 M. This Central Fund came about for three main reasons:

a) In 1979 the large cooperatives started to accept savings deposits in addition to fixed maturity term deposits. This required greater liquidity which was traditionally kept in liquid bank accounts.

b) Management realized that farmers would be better served by multipurpose cooperatives, which could provide credit as well as inputs and marketing facilities; this meant diversification.

c) The cooperatives have been growing substantially since 1986. Average asset size per cooperative has doubled, which means more member demand for services. It also involves tapping external borrowings when needed. Since commercial bank credit was not generally accessible to the cooperatives, they were forced to develop their own financing system, like the CF, which is regarded as a first steps toward formal cooperative banking.

Funding for the CF comes from equity contributions, external borrowings and grants, which are used for liquidity, production loans and investments in new projects. The National Central Fund (NCF) supports the Regional CF's and provides external linkages. This may offer the possibility at a later date to link up with a financial institutions for a credit line. The CF has a separately elected Board of Directors and independent management. It is a more efficient allocation of resources and it seeks to lay the foundation for the development of a cooperative bank.

As to credit exposure, the interlinking of the provision of credit with other services (marketing assistance, liquidity supplementing etc.), improves the likelihood of full loan repayment, as the lenders are borrowers themselves. This "reciprocity" facilitates consideration of loan requests which can be acted upon in a week or ten days. It also lowers transactions cost and reduces credit risk. Overall, the CF seeems to have good growth potential and could play an important role in the development of cooperative financing.

BACKGROUND ON (NATIONAL MARKET VENDORS COOPERATIVES SERVICES FEDERATION, INC.) (NAMVESCO)

NAMVESCO was registered on August 29, 1979 with the objective to serve the various needs of the market vendors and to assist in the solution of the many problems faced by the market vendor sector.

Generally a market vendor cooperative is a credit cooperative, capitalized by the individual shares of its members. It grants loans to members on the basis of their (equity) deposits at interest rates below prevailing commercial bank rates.

The Cooperative is owned by the market vendors and interest is paid on the capital owned by each member. A member can normally obtain two or three times his fixed deposit as a loan from his cooperative. NAMVESCO's on-going activities involve the promotion and organization of new vendor cooperatives, appliance procurement for members (by buying in bulk at substantial discounts) and interlending activities , whereby members can borrow funds, repayable in six monthly installments at 9% per annum. It has significantly accelerated the vendor cooperative movement by conducting training and educational activities (pre-membership seminars, etc). It has also prepared a 5-year development plan and was instrumental in bringing about the inclusion of cooperatives in the New Constitution of the Philippines, adopted in October 1986. The following statistical data on its membership are of interest:

Total member organizations	44
Total individual members	12,136
Total Assets (1987)	₱133,768,429
Total Fixed Deposits (1987)	71,768,659
Total Savings Deposits (1987)	26,588,037
Total Loans Released (1987)	311,119,158
Total Number of loans released	40,255
Net Savings (1987)	7,389,580

Appendix #[illegible]
(Report: 3.23.[illegible])

Projected Balance Sheets

Revised [illegible]

(in ₱000)

RESOURCES	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Cash/Due from banks	1,431	19,003	10,422	[illegible]	14,45[illegible]	[illegible]
Investment in Securities	37,167	17,000	3,328	22,[illegible]	2[illegible],242	54,4[illegible]
Loans and Discounts	15,000	30,000	60,000	12[illegible],000	24[illegible],000	48[illegible],000
Pref. Stock Investment	6,512	5,535	4,558	3,[illegible]	[illegible]	[illegible]
Furniture, etc.	-	3,645	5,332	3,9[illegible]	4,[illegible]	[illegible]
TOTAL RESOURCES	60,110	75,183	84,140	[illegible]	[illegible]	[illegible]
LIABILITIES + CAPITAL						
LIABILITIES:						
Deposits	-	-	15,000	30,000	[illegible]	[illegible]
Borrowings	-	-	15,000	25,000	[illegible]	[illegible]
TOTAL LIABILITIES			30,000	55,000	[illegible]	[illegible]
CAPITAL ACCOUNTS						
Common Stock	60,110	75,890	62,525	11[illegible],456	[illegible]	[illegible]
Loan Loss Provisions	-	3,000	9,000	[illegible]	[illegible]	[illegible]
Rev. Cap. Fund (P+L)	-	(3,707)	(17,385)	[illegible]	[illegible]	4,[illegible]
TOTAL CAPITAL ACCOUNTS	60,110	75,183	54,140	[illegible]	[illegible]	[illegible]
TOTAL LIABILITIES + CAPITAL	60,100	75,183	84,140	15[illegible],[illegible]	[illegible]	[illegible]

Appendix VIII
(Report: 3/23/89)

Projected Income Statements

Revised: 3/89

(in ₱000)

INCOME:	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5
Interest on loans	2,700	5,400	10,800	21,600	43,200
Interest on investments	4,460	2,040	459	2,644	2,904
TOTAL INCOME:	7,160	7,440	11,259	24,244	46,104
EXPENSES:					
Interest Expense	-	-	3,300	6,100	9,800
Salaries, etc.	4,918	8,564	10,047	12,415	15,209
Depreciation	405	1,434	1,453	1,829	1,843
Office Rentals	396	792	792	900	1,008
Travelling Expenses	1,017	1,641	2,128	3,337	5,092
Commissions	-	540	1,180	2,840	5,600
Repairs/Maintenance	300	540	540	750	750
Office Supplies	116	233	233	252	272
Loan Lost Provisions	3,000	6,000	12,000	24,000	48,000
Miscellaneous	715	1,374	1,637	2,231	2,976
TOTAL EXPENSES:	10,867	21,118	33,310	54,654	90,550
NET INCOME (LOSS)	(3,707)	(13,678)	(22,051)	(30,410)	(44,446)

BACKGROUND NOTES TO THE REPORT

The PEDS Project

This study was conducted under the Private Enterprise Development Support Project. The PEDS Project is a five year (FY88 - FY92) $20 million project managed by the Bureau for Private Enterprise. The PEDS Project is designed to provide a wide range of expertise in private sector development. Areas of technical assistance include the following:

- Policy analysis related to private sector development
- Sector assessments and analyses
- USAID private sector strategy development
- Legal and regulatory analysis and reform
- Small-scale business development
- Trade promotion
- Investment promotion
- Free trade zone development
- Financial institutions and instruments
- Management and financial training
- The role of women in private enterprise
- Applications of MAPS: Manual for Action in the Private Sector

USAID Missions have the resources of thirteen contractors available to them through the PEDS Project.

- Arthur Young (prime)
- SRI International
- Management Systems International
- The Services Group
- Trade and Development, Inc.
- Multinational Strategies
- J.E. Austin Associates
- Ferris & Company
- Metametrics
- Elliot Berg Associates
- Robert Carlson Ass.
- Ronco
- Dimpex Associates

The Consultancy

The purpose of this study is to provide USAID/Philippines with an independent assessment of the Apex CFI Feasibility Study. The team, consisting of James Kern, Rolf Bolt and Danila Cruz-DePaula, ~~conducted the field work for the study over a three week period in~~ March 1989.

The Authors

James R. Kern, Consultant for Arthur Young

Mr. Kern served as the rural credit specialist for this study. During the past four years, he has worked with the Harvard Institute for International Development to initiate a major rural credit program in Indonesia. From 1973-83, he worked for Resources Management International to provide technical assistance in various aspects of design and implementation of provincial credit policy and projects. He also served as the director of a program to train Peace Corps Volunteers for Philippine agriculture and rural credit projects. Mr. Kern holds a Ph.D. and an M.P.A. in Public and International Administration from the University of Pittsburgh and a B.S. from Cornell University. He speaks fluent Tagalog and Cebuano.

Rolf F. H. Bolt, Consultant for Arthur Young

Rolf Bolt served as the financial specialist for the study. He is an international banker with over 25 years of experience. Most recently, he served as the Business Banking Officer for Boa Van Nuys Management Group; previously, he was the Senior Credit Examination Officer for Boa's Hong Kong operations. Mr. Bolt spent 21 years of his banking career with the Bank of America in various management positions. He holds a degree from the Willem Lodewyk Gymnasium in Holland.

Mr. Danila Cruz-DePaula also contributed to the report.