

## Microfinance

Microfinance, for the purposes of this PACAP technokit, shall be defined as the provision of financial services to lower income members of the population. It usually involves not only loans, but also savings, insurance, and cash transfer services.

Microfinance shall be differentiated from other similar concepts such as microlending, microcredit, and micro-enterprise in the sense that it includes a savings component. For some, this is referred to as capital build-up. Microcredit involves purely loans.

Microfinance here is also differentiated from production loan. The latter is used for agricultural purposes. Microfinance is always paid through cash while production loans may be paid for in kind. Terms for financing production loans often depend on the seasonality of crops being produced by the beneficiary farmers.





## Introduction

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This module is intended to serve as a guide for PACAP staff who are tasked to appraise microfinance proposals submitted to PACAP for funding. It presents some principles in appraising proposals on microfinance although some of the principles described here may also be used to appraise proposals on microlending.

While certain standards are presented here, these are meant as considerations rather than mandatory criteria in appraising proposals submitted for PACAP funding. While some microfinance proposals are merely components of bigger proposals, the same considerations are made in appraising these proposals.

Each consideration will have a description and the generally-accepted standard or a description of how PACAP looks at a given criterion or consideration. Computations and methodologies should likewise be included.



# Some considerations in Appraising Microfinance Proposals

## *Scope and scale of a proponent's organization and operation*

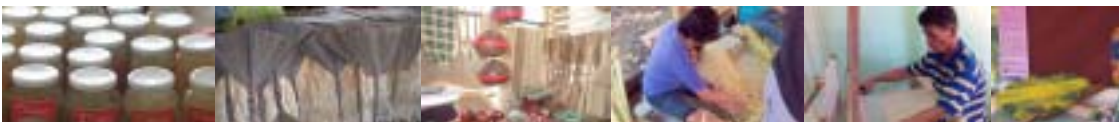
The scope and scale of an organization includes the following:

- Size and length of operation

The size and length of operation of a microfinance organization gives a picture of the stability and sustainability of the organization. Generally, the longer it has been in operation, the likelier it is to be stable. For PACAP, an organization should have been in operation for at least two years to be considered for funding.

- Geographical reach

The geographical reach gives a picture of its potential client base and market reach. Depending on the mandate of the organization, a wide geographical reach may be seen as a great market potential or a diluted market, while a small geographical reach may be a focused market or a very limited one.



Geographical reach is also significant in considering its implications on the monitoring of the project.

- Organizational structure & Governance

The organizational structure gives an idea of the flow of decision-making and governance. In decision-making, it may help to look at the regularity of board meetings and how major decisions are arrived at.

The structure also gives an idea of where checks and balances lie, if there are any. This would include the maintenance of an internal or external auditor. According to the Performance Standards established by the National Credit Council of the Philippines, the auditor should be one who is recognized by the Cooperative Development Agency (CDA) for cooperatives and certified by the Philippine Institute for Certified Public Accountants (PICPA) for NGOs.

The proponent should also be able to demonstrate a track record in microfinance operations for at least 2 years. In the case of organizations that are fairly new to the field of



## 6 **GUIDE TO APPRAISING MICROFINANCE PROPOSALS**

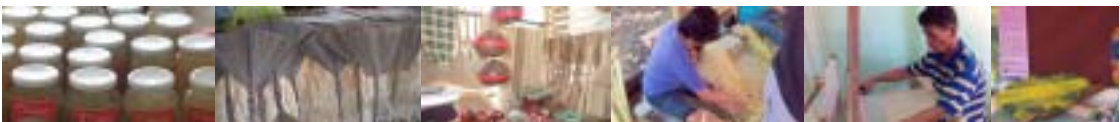
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microfinance, the organization should be able to present their track record in their field of endeavor or in their chosen industry.

- List of officers & their backgrounds

Combined with the organizational structure, the list of officers will give an idea of the professionalism of the organization as a whole. It may help to check the officers' educational background, training and experience. For the officers in particular, look at their management expertise. The question to ask here is, 'are they equipped to do what they are doing?'

Aside from the officers, the appraiser may also wish to look at the staff complement of the organization. In addition to looking at their training and experiences, it is useful to look at their relationship to officers of the organization. It usually not a sign of good governance to have members of the same family working within the same financial organization.



### *Portfolio Management*

When appraising proposals for PACAP funding, a proponent's discussion of their portfolio management may be considered the main ingredient of the proposal. The proponent's portfolio management shows the organization's lending and collection practices and will give the appraiser an idea if it fits within PACAP's definition of microfinance, is consistent with PACAP's strategic guidance framework, and has a high potential of success as opposed to the risk.

In looking at the proponent's portfolio management, it is essential to check the following:

- *Approach*

The approach is how the proponent delivers or intends to deliver credit and financing services to their clients. This may refer to a financing model established by other organizations such as the group approach, the solidarity approach, village banking approach, ASA, individual lending, Grameen or cooperative banking (For definitions of these approaches, please refer to Module 3 – References), or it may be a model established by the proponent itself.



For organizations that have been in operation for at least two years, the proponent should be able to present how it has effectively applied any given model in its operations.

- *Collection schedule, repayment term and collection efficiency*

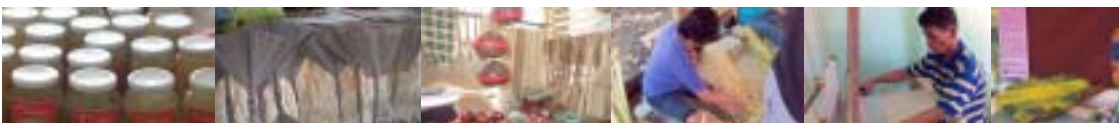
Microfinance follows the principle of small payment. Repayment schemes should be in frequent small amounts. Frequency and manner of repayment of credit provided should be presented.

Microfinance schemes with ballooning payments where the amortizations increase over time, are usually not within the purview of PACAP's scope of funding.

A proponent's collection efficiency is also significant in that it shows an aspect of the organization's financial sustainability. An organization should minimize delinquency in their loans.

- *Portfolio at Risk & Risk Management*

The Portfolio at Risk (PAR) is the percentage of loans handled by the organization that have



arrears in relation to the total outstanding loans at the time. If the PAR is small, this is an indication of satisfactory collection efficiency and also sustainability.

Computation:

$$\frac{\text{Balance of loans with at least 1 day missed payment}}{\text{Total Loans Outstanding}}$$

Standard: PAR=1 ; 5%

Source: PESO rating scheme, DOF-NCC

- *Capital build-up/savings scheme*

The savings component is part of a microfinance scheme. There are two kinds: fixed (compulsory) savings or flexible savings (small amounts, frequency but withdrawable).

- *Monitoring scheme*

A monitoring scheme should have baseline information or benchmarks on which to base future evaluations.

In microfinance, there is a so-called beneficiary index: housing, income, asset. These indices are called poverty scores. These should be attached to the proposal.



- *Interest rates*

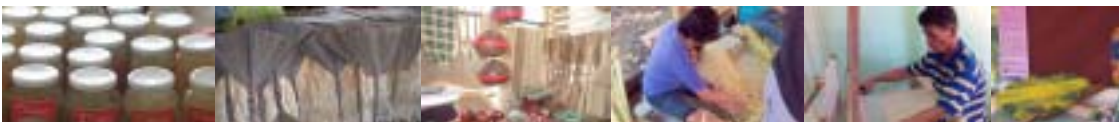
In microfinance, interest rates should still be at par with market rates, ranging from 2-3% per month as of publication date. It should be reasonable and to the extent possible, with only minimal additional charges (e.g., service fee, membership fee, contribution fee).

Some questions to be asked include: will the interest rate be passed on to the client.? Will it carry a market-oriented interest rate?

In addition, it may also be worthy to consider that others consider a comfortable profit margin as being equivalent to or more than the inflation rate. Below the inflation rate, an organization may not be able to cover the real cost of funds, even if it grows. Inflation may erode the real value of an organization's savings over time and consequently, the value of its profit. In addition, unstable inflation may distort investment and consumption decisions.

Inflation rate in the Philippines was placed at 2.4% as of May, 2007

*Source: Consumer Price Index, NSO  
(The Table on the Consumer Price Index will be attached to Module 3 – Key References to Microfinance or may be found at ([www.census.gov.ph](http://www.census.gov.ph)))*





Don't Forget

What documents to look for:

- projected cash flow
- audited financial statements (past two years)
- amortization schedule
- calendar
- beneficiary index/poverty scores

### *Operational Self-Sufficiency (OSS)/Track Record*

Operational self-sufficiency (OSS) refers to the capacity of the proponent to sustain its own operations through its revenues.

Computation:

$$\frac{\text{Interest income from loans} + \text{service fees} + \text{filing fees} + \text{fines, penalties, surcharges}}{\text{Financing costs} + \text{administrative costs}}$$

Standard: > 120%

Source: PESO rating scheme, DOF-NCC

### *Financial Self-Sufficiency (FSS)*

Financial self-sufficiency gives the appraiser a picture of the organization's long-term sustainability.



Computation:

$$\frac{\text{Operating revenue}}{\text{Financial Expense} + \text{Loan Loss Provision Expense} + \text{Adjusted Expenses}}$$

Standard: > 100%

Source: PESO rating scheme, DOF-NCC



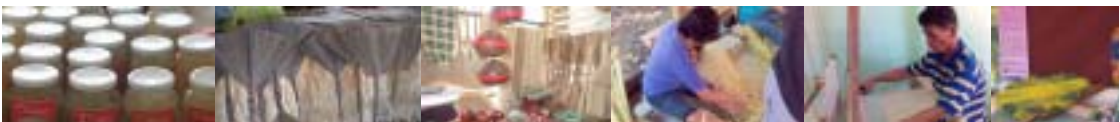
Don't Forget

**What documents to look for:**

- **projected cash flow**
- **audited financial statements (past two years)**

### *Client Base/Target Population*

The client base of the proponent is the population group or the segment of the population the proponent is mandated to serve or which the proponent reaches with its financing services. Quite often, microfinance targets the poorest of the poor. For the purposes of PACAP however, a microfinance proponent should be serving the so-called “entrepreneurial poor”. The entrepreneurial poor refers in general to that segment of the population that is not necessarily defined by their income but their potential to earn through entrepreneurship.



It may also help to look at how a proponent selects his target clientele/population segment. Was a formal process undertaken to segment the population? What tools did the proponent use? The proponent should be able to justify how targeting this particular sector fits their mandate and the needs of the community.



Don't Forget

**What documents to look for:**

- Clients profile / Profile of intended beneficiaries

### *Outreach/Social Dimension of the Project*

Outreach is related to the client base of the project. The proponent's project should be able to identify the target number of clients and show the socio-economic status of these clients and how they stand to benefit from the project being proposed and what they stand to benefit from it.

### *Contribution to Environmental Sustainability/ Environmental Aspect*

The proposal must be able to identify positive and negative impacts (whether direct or indirect) which



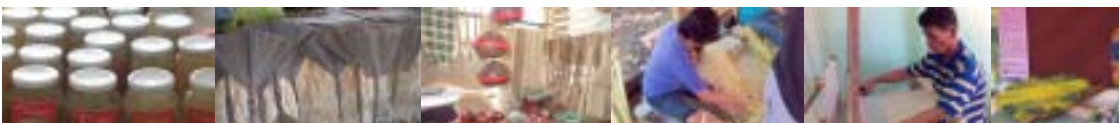
the project may have on the environment. It should provide mechanisms to minimize or avoid negative impacts on the environment.

### *Gender-responsiveness*

The proposal should be able to present gender-aggregated data on the stakeholders of the project such as percentage or participating women and men in project implementation, management and decision-making bodies, gender division of labor, gender access over resources and benefits, etc. It should promote equitable participation of women and men.

Aside from the presentation of data, the proposal should be able to show how the project promotes to gender equality and does not contribute to the multiple burden of women. It should also show how it contributes to transformative relations and empowerment of women through the improvement of their economic status.

In addition, the proposal must show that the project does not contribute to the engagement of child labor.



*“Capacity to share the risk”, Project Counterparting and Equity*

An organization that has been in operation for at least two years and is sustainable financially and operationally should be able to show why they would need the funding from PACAP, compared to implementing the proposed project on their own.

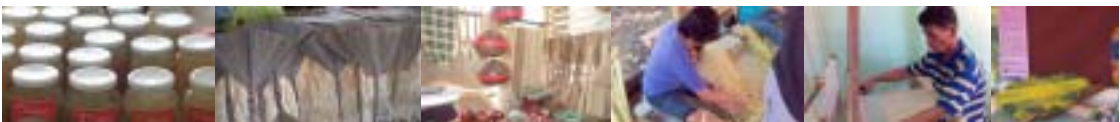
A proponent must be able to show how they intend to share the risk by providing a project counterpart or equity to the proposed funding from PACAP. Project counterparting and provision of equity helps ensure ownership and greater responsibility in the management of funds by the project proponent.

Project counterparts may be in kind or in sharing percentages of expenses of the project proposed. A 50% equity on the proponent’s loan fund is also preferable.



*“Donor funds should complement private capital, not compete with it. Donors provide grants, loans, and equity for microfinance. Such support should be temporary. It should be used to build the capacity of microfinance providers; to develop supporting infrastructure like rating agencies, credit bureaus, and audit capacity; and to support experimentation. In some cases, serving sparse or difficult-to-reach populations can require longer-term donor support. Donors should try to integrate microfinance with the rest of the financial system. They should use experts with a track record of success when designing and implementing projects. They should set clear performance targets that must be met before funding is continued. Every project should have a realistic plan for reaching a point where the donor’s support is no longer needed.”*

*Source : Consultative Group to Assist the Poor, Key Principles of Microfinance*



## References:

*National Credit Council*. Performance Standards for all Types of Microfinance Institutions in the Philippines (PESO), 1992.

*PACAP*. Project Design Document for the Capiz-Roxas Islamic Credit Center (no year indicated in the document)

*Hellerstein, Rebecca* for The Federal Reserve Bank of Boston ([www.bos.frb.org](http://www.bos.frb.org)). The Impact of Inflation. Winter 1997.

*The Bank of Canada* ([www.bankofcanada.ca](http://www.bankofcanada.ca)). The Benefits of Low Inflation. January 2000.

*Consumer Price Index of the Philippines, 1957-2007*, National Statistics Office ([www.census.gov.ph](http://www.census.gov.ph))

*Interview with Luis Carillo*, COOP-NATTCO, January 2007

*Interview with Ed Garcia*, Microfinance Council of the Philippines, January 2007

*Interview with Rolly Panganiban*, Pag-Inupdanay, January 2007

