



INNOVATIVE FINANCING SCHEMES (IFS) Are we on the right track?

By the very word *innovative*, the Innovative Financing Schemes (IFS) feature a departure from the traditional lending schemes where access to loanable funds is often dependent on collateral as a measure to mitigate the risk of providing credit. With the objective of further encouraging existing rural lending agents to lend to collateral-short small farmers and fisherfolk, the Agricultural Credit Policy Council (ACPC), with the support of the Department of Agriculture, initiated the development of IFS as a novel strategy for providing better financial backing to farm and fishing-based activities so that productivity in the rural sector could further increase.

THE OLD SCHOOL

The *pump-priming* or the supply-led approach – generally characterized by the establishment of specialized financial institutions and the infusion of loanable funds in advance of established demand – continues to be popularly viewed as an effective lever to promote rural development. However, economic planners and policy makers in general, observe that this strategy so far has not really improved credit accessibility in the rural areas, particularly since both lenders and borrowers continue to have insufficient access to information about each other. This has led to the following problems arising from issues of moral hazard and adverse selection:

- 1) The specialized financial institutions still fail to reach their supposed beneficiaries – the rural poor. The banks, in particular, are even noted to be increasingly steering away from involvement with rural borrowers, with the evident exceptions of the prime or big clients – who, typically, are the

ones capable of meeting collateral and equity requirements. Based on the reports compiled by ACPC, only 1.08 percent of the total loans granted by the banking system in 2001 went to the agri-sector, or 3.97 percent on the average since 1986;

- 2) Many small borrowers also avoid borrowing from formal sources because of the perception that the transaction cost of borrowing from these institutions is too high;
- 3) Survival of some lending institutions are being threatened because of loan delinquencies and defaults caused by dole-our perceptions and collection problems.
- 4) Meanwhile, other incentives, like credit guarantee schemes, which were introduced as measures to further encourage lenders to raise their exposures have so far only worked as collateral-supplementing and not collateral-substituting instruments.

In the end, therefore, the supposed benefits of a supply-driven campaign – such as income transfers resulting from negative real interest rates (which often characterize loans from government programs), and, in some instances, even uncollected loans – were in effect again reaped by big borrowers. Consequently, this led to the emergence of badly fragmented financial markets.

SOME INNOVATIVE APPROACHES

A. The Special Agricultural Financing Window (SAFW)

The inability of the government to sustain its existing subsidy programs on farms and fishery inputs and its failure to increase credit access because of declining participation in agri-production lending of the private sector over the period 1996 to 1998 (see figure below) prompted the issuance of DA Special Order No. 438 (series of 1999). This was aimed at shifting the DA's existing modalities of delivering farm and fishing inputs – including the distribution of seeds, planting materials, poultry, livestock and fingerlings, irrigation and post-harvest equipment – to that of a credit delivery approach.

The government has set some assumptions in formulating the scheme. Some of the crucial ones are:

- 1) Loans will be based on absorptive capacity, taking into consideration the targeted borrowers' lack of collateral;
- 2) To enhance credit access, lenders, especially the private ones, need intermediary incentives, particularly those that can directly reduce their lending risk - like credit guarantees; and
- 3) Crop insurance should be strengthened because its ineffectiveness only adds to the reluctance of end-borrowers to obtain a loan.

Capital Requirement & The Rationale of De-Collateralization

Capitalization requirements in small-scale farming and fishing include those for equipment and inputs like fertilizers, pesticides and other chemical products, farm labor (during planting season, growing, harvest and post-harvest periods), feeds (for fish-cage and livestock), supplements, pens and structures, nets, fishing vessel (motorized or non-motorized), storage facility, etc. These are vital for obtaining a yield that will increase the farmer's capacity to repay their loans. The problem usually comes in when a lender would require collateral as a security measure in case of non-repayment. Collateral comes in different forms: land title, house, lot, jewelry, appliances and other valuable properties commensurate to the amount of loan. Often, however, rural folk either have none of these or have already mortgaged them for other loans.

Before, very few informal lenders required collateral from their borrowers – unlike formal institutions,

which are known for collateral-based lending. More recently, however, it has been noted that even traders and input suppliers are already asking for collateral to secure their loans. For small borrowers, this is an unfortunate development given that majority of them depend mainly on these two particular loan sources (not only do they supply farm inputs and other support services, they also serve as ready markets for the borrowers' farm/fish produce).

This is why it is crucial that innovative financing schemes be designed, adopting such core principles as the *de-collateralization* of loans, active role of the private sector (which has greater liquidity) and better risk management.

The Strategy and Financing Instruments

The existing IFS adopt strategies that are focused primarily on: 1) re-allocating the risks involved in lending to the institutions that can manage these (credit risks) better, 2) providing additional liquidity to rural lending agents to enable them to lend more, and 3) bridging the information gap between the urban supplier and rural demanders of funds to facilitate the flow of financing.

There are two financing facilities used to encourage the lending agents,¹ namely: 1) rediscounting for banks, wherein promissory notes issued by sub-borrowers of banks can be rediscounted up to as much as 100 percent of the face value and 2) credit line or rediscounting for all other types of lending agents like the above while the credit line shall work for re-lending to sub-borrowers.

Land Bank will provide liquidity assistance to rural lenders in two (2) modes. One, by rediscounting eligible loans of rural lenders from 85 percent to 100 percent of the loan's face value, and two, by giving credit lines to non-bank lending agents. QUEDANCOR will provide up to 85 percent credit guarantee cover on the non-collateralized farmer/ fisherfolk loan portfolio of accredited banks/lending agents.

Status of SAFW Funds

As of April 2003, the approved SAFW loans have already reached P131.556M which will be released through the Land Bank of the Philippines. On the other hand, QUEDANCOR has approved PhP

¹ Banks, cooperatives duly recognized by the Cooperative Development Authority (CDA), agricultural-based enterprises, non-governmental organizations, people's organizations and other institutions with separate juridical personality, input suppliers and dealers.

20.336M loan guarantee coverage in the NCR and Cebu. The approved/released loans are mainly for hybrid corn production, farm machinery and equipment, purchase of fertilizer and other farm inputs and various other agri-projects.

TABLE 1. STATUS OF SAFW LOANS APPROVED AND RELEASED THROUGH LAND BANK AS OF 30 APRIL 2003

ACCOUNT NAME	LINE APPROVED (IN PHP M)	LOAN RELEASED (IN PHP M)
Marcela Farms, Inc. (LBP)	10.0	None Yet
Honda Motor World Lending Investors, Inc. (LBP)	37.0	11.996
SPS Sancvictores, Irma & Arnold (Bukidnon)	20.056	5.0
Confederation of Sugar Producers Coops (LBP)	35.0	31.45
RB of Dao (Iloilo)	2.0	None Yet
RB San Rafael (Bulacan)	10.0	None Yet
RB of Porac (LBP)	10.0	None Yet
Capiz Agri-Multipurpose Cooperative	3.0	None yet
RB of Anilao (Iloilo)	4.5	None Yet
Total	131.556	48.446

Among the accredited lending agents, the Honda Motor World Lending Investors, Inc. (Cebu) has the highest credit line under the scheme to date (Table 1), amounting to P37M. The first loan release, meanwhile, is to the Confederation of Sugar Producers Coops (Negros Occidental) with P31.45M or 89.9 percent of their total credit line. QUEDANCOR, on the other hand, has already released P336,000 in the NCR.

Private Sector Response to the SAFW

As a result of ACPC's roadshow-promotion activities from January 2002 to April 2003, lenders from various regions signified their willingness to participate in the scheme and avail of a total of almost P324M through the LBP Window, and P137M through QUEDANCOR, for re-lending (Table 2).

Around 59 percent of the 137 institutions that attended the orientation symposia expressed interest in availing of loans through LBP. The remaining wants to avail of loans through QUEDANCOR. Majority of the institutions that participated in the symposia comes from Region 5.

For the second semester of 2002 alone, institutions from Region 2 already expressed willingness to avail of P102M from the SAFW – the highest among the six regions visited by the ACPC IFS Team over that period. This is followed by the demand registered by institutions coming from Region 3 (P60.3M).

Meanwhile, institutions from other regions visited over the 3rd Quarter, particularly in the south, indicated a total demand amounting to P67M – representing a 148 percent increase. Early this year, on the other hand, a total of PhP 41M loan intention from Regions 4 and 5 was indicated.

TABLE 2. LOAN INTENTIONS OF PROSPECTIVE LENDING AGENTS IFS-SAFW ROADSHOWS JAN-APRIL 2003

AREAS COVERED	LBP WINDOW		QUEDANCOR	
	NO.	AMT (PHP M)	NO.	AMT (PHP M)
JAN TO JUNE 2002				
REGIONS 1 & CAR	8	11.45	7	12.2
REGION 3	8	60.3	4	7.0
JULY TO SEPT 2002				
REGION 2	10	102.0	6	22.0
REGION 6A-ILOILO	11	33.0	9	13.3
REGION 6B-NEGROS OCC.	4	24.0	4	19.0
REGION 7	3	8.0	0	0.0
REGIONS 9,10 & CARAGA	11	62.0	9	44.5
MARCH TO APRIL 2003				
REGION 4A & 4B	10	3.0	4	3.0
REGION 5	16	19.50	13	15.50
TOTAL	81	323.25	56	136.50

B. The Rural Household Business Financing Scheme (RHBF)

Still underway, this scheme is also a joint effort between DA-ACPC and the Land Bank of the Philippines aimed at providing financial support to any viable short-term income generating activity/s of the target end-borrowers (i.e., small farming, fishing, livestock and poultry raising households). As opposed to a project-based financing scheme, RHBF will attempt to tailor-fit financing to the rural household's cash flow. Lending agents are encouraged to finance the households for farm diversification and off-farm/non-farm micro-enterprises in this scheme.

Similar to the SAFW, the RHBF follows certain criteria to establish the eligibility of lending agents:

- 1) Must be accredited by Land Bank;
- 2) Willing and able to assign a Loan Officer who shall supervise RHBF-funded projects;
- 3) Must commit its core credit staff to undergo and apply RHBF trainings/seminars and approaches; and

- 4) Implement savings mobilization among the target beneficiaries.

In August 2002, the ACPC group conducted a survey in 5 provinces (Agusan del Norte, Iloilo, Leyte, Pangasinan, and Surigao del Norte) to (a) come-up with a basis for the development of training modules intended for participating institutions in designing the appropriate credit schemes for collateral-short farmers and fisherfolk, and (b) gather quantitative data on the market characteristics, particularly on the household cash flow, socio-economic profile and other information on lowland farming and fisheries households. The results, which are expected to come out early next year, will be used as the bases in the formulation of the implementing guidelines of the RHBF.

OTHER SCHEMES IN THE WORKS

Other innovative schemes for different disadvantaged sectors also continue to be developed by ACPC. Some of the IFS that have been conceptualized and are currently undergoing negotiations for implementation arrangements are the following:

The IFS for Peace and Agricultural Development for Affected and Displaced Communities in Armed Conflict Situation is a joint effort of the DA, LBP, Quedancor, ACPC, Office of the Presidential Adviser on Peace Process (OPAPP) and the Philippine Crop Insurance Corporation (PCIC). The main objective of this IFS is (a) to promote lasting peace and sustained agricultural development in areas of armed conflict and (b) to help affected and displaced communities to return to normal and productive lives by providing assistance through a package of appropriate credit and financing schemes. The project will be implemented over a period of three (3) years, hopefully starting in year 2003. Five provinces initially being eyed for the piloting of the project are Nueva Ecija, Camarines Sur, Bohol, Samar, and Surigao del Sur.

Another credit scheme in the pipeline is the **Gintuang Masaganang Ani-Modernization Opportunity Towards Indigenous People's Vision and Techniques for Empowerment Schemes**

(GMA-MOTIVATES). This scheme, on the other hand, has the objectives of:

- 1) Reducing poverty and uplifting the incomes of indigenous people by developing a viable credit and financing program; and
- 2) Developing a program that recognizes, preserves and strengthens their traditions, institutions and way of life.

This project has sub-components in lending and rediscounting, insurance and guarantee, savings mobilization, enterprise development, technical assistance, market research and product development, and institution building. The intention is to implement the scheme over a period of two (2) years.

CONCLUSION

The development of **Innovative Financing Schemes** is one of the frontiers ACPC has been strongly supporting to stimulate greater growth in the rural economy. The volatile nature of the agriculture sector and the systemic risks often associated with agricultural lending requires continued innovation in designing financial products that can (a) meet the peculiar needs of the sector and (b) consequently be adopted by either government or private rural financial institutions.

Notwithstanding the development of these schemes, though, it should always be emphasized that enhancing the availability of rural credit should still be appropriately supported by improved technology, infrastructures, inputs, extension services and markets to make it more effective and beneficial. In other words, it is still the rule that credit alone does not work.

Making a comprehensive assessment at this point of the effectiveness of the IFS may still be too early. However, the IFS Group of the ACPC has already noted that preliminary indicators suggest some favorable outcomes. Are we on the right track? Based on this initial feedback, clearly yes.

Your comments are valuable inputs to our future publications. Please call or write: Agricultural Credit Policy Council 3/F Agustin I Bldg., Emerald Avenue, Ortigas Center, Pasig City Tel. Nos. 6343320/21, 6363390/91 E-mail Address: info@acpc.gov.ph