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Microfinancing in Rural Areas: It's Sustainability

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Abstract: **The study looked into microfinancing in rural areas its sustainability. Surveymethod of research was used. Borrowers of the studied rural banks were also randomly selected and interviewed using a survey instrument. Rural banks offering microfinance loans have common charges levied to borrowers. The respondents of the study are limited only to rural banks offering microfinance loans. Results showed that collection rate from microfinance loans of these banks declined in a span of three years. This lead to rural banks adopting strategies in collection namely group back-up and withdrawals of clients saving to cope their amortization. Respondents are entirely vendors thus payment of loans is determined through sales performance. Other reasons include occurrence of typhoon and illness of the vendor as borrower. Rural banks must also design contingencies on the aspect of the borrowers other than Loan management model that ensures loan funds are invested directly in productive business must be carefully monitored among personnel to increase bank measures on default payments.**

Keywords: **Microfinancing, Rural Banks, Rural Area, default payments.**

1. INTRODUCTION

Microfinance plays a vital role in providing the poor like small farmers, fishermen, and micro-entrepreneurs with access to credit and helping them improve their lives by encouraging entrepreneurial activity (Arch, 2005; Bhatt & Tang, 2011; Khandker, 1996; Llanto, 2004). It has proven to be a potent tool for poverty reduction by helping the poor families increase their income, smooth consumption, build assets, and reduce their vulnerabilities in times of contingencies and economic shocks (Micu, 2010). As an industry, microfinance has grown tremendously over the past decades, with players offering financial services to those who previously marginalized (Arch, 2005). According to Micu (2010), it now reaches more to than 100 million poor people all over the world through a combined portfolio of billions. Philippine government has long recognized the critical role of microfinance in its poverty alleviation efforts. Key development is the formulation in 1997 of the National Strategy for Microfinance, which listed the following principles as the foundations of the government's microfinance policies like enabling policy environment that facilitates the increased participation of the private sector in microfinance, market-oriented financial and credit policies, nonparticipation of government line agencies in the implementation of credit / guarantee programs, and greater role of the private sector MFIs in the provision of financial services. These principles served as a guidepost for subsequent policies and regulations that were put in place to help microfinance industry players achieve their twin goals of outreach and financial sustainability.

Microfinance institutions are established to meet financial needs of the society in which they operate. In most developing countries, capital requirements of business enterprise greatly exceed financial resources owned by the individual entrepreneurs. Government through the central bank in such countries is therefore expected to encourage and assist the establishment of banks in order to meet the credit needs of the economy. Behind this program is to meet the credit needs of the community. Such institutions in different parts of developing countries seem to mean that a strategy would contribute substantially to the rate of economic development.

Rural banks shall be organized in the form of stock corporations. Upon consultation with the rural banks in the area, duly established cooperatives and corporations primarily organize to hold equities in rural banks may organize a rural bank and/or subscribe to the shares of stock of any rural bank: Provided, that a cooperative or corporation owning or controlling the whole or majority of the voting stock of the rural bank shall be subject to special examination and to such rules and regulations as the Monetary Board may prescribe. With exception of shareholdings of corporations organized primarily to hold equities in rural banks as provided for under Section 12-C of Republic Act 337, as amended, and of

Filipino-controlled domestic banks, the capital stock of any rural bank shall be fully owned and held directly or indirectly by citizens of the Philippines or corporations, associations or cooperatives qualified under Philippine laws to own and hold such capital stock. National strategy for microfinance has four principles policies such as; provision of an enabling policy environment to facilitate increased participation of the private sector; adaptation of market oriented financial and credit policies; non participation of government line agencies in the implementation of credit and guarantee program and greater role of the private sector in the delivery of the financial service to the poor.Those most exposed and most vulnerable to climate change and coastal hazards are those in the outskirts of Mindanao. This means their access to networks and formal lending institutions alike rural banks has to be available.

The study describes the access of borrowers in the outskirts of Mindanao to Microfinance Institutions, describe the actual charges of rural banks between those offering micro financing and those that do not, how widespread are the default borrowers, hat the Rural Banks do for default paying borrowers, reasons for Default payments of borrowers

2. THEORETICAL CONSIDERATION

Microfinance loans represent small loans granted to the basic sectors such as farmer-peasant, artisanal fisherfolks, workers in the formal and informal sectors, migrant workers, indigenous people, cultural communities, women, persons with disability, senior citizens, victims of calamities and disasters, youth and students, children, and urban poor as stated in the Social Reform and Poverty Alleviation Act of 1997 or RA 8425. Microfinance loans also include their loans granted to the poor and low-income households for their microenterprises. The maximum principal amount of microfinance loans shall not exceed P150, 000.00 and may be amortized on a daily, weekly, semi-monthly or monthly basis depending on the cash flow conditions of borrowers. This type of loan is usually unsecured, offered in a duration of 180 days and often requires guarantees of one or more persons.

Microfinance is widely known as a provision of financial services such as credit, saving, deposit, insurance and repayment services to those who are deprived of accessing into conventional financial services because they are poor and they cannot offer collateral (Ledgerwood 1998; Littlefield, Murduch, and Hashemi 2003; Robinson. 2001). The underlying logic is that through extending financial services, low income people will have the ability to participate in the economic market and exploit entrepreneurial opportunities through start-up new businesses extending current business or introducing new activities. Subsequently, they will be able to combat the poverty and satisfy their households' needs independently and consistently. Microfinance institutions will have the ability to develop their capacity through imposing a small ratio of interest on the given loans. A large size of microfinance studies from various disciplines suggest that microfinance has significant impact on poverty reduction as well as household wellbeing at deferent levels such as asset acquisition, household nutrition, health, food security, children education, women's empowerment, and social cohesion (Armendáriz and Morduch 2005). However, recently the impact of microfinance has been questioned and many studies argue that the impact of microfinance is divergent between positive, no impact and even negative impact (Ganlea, Afriyie, and Segbefia 2015). The literature acclaims that the impact of microfinance works differently from one context to others and the impact is dependent on the population density, attitudes to debt, group-cohesion, enterprise development, financial literacy, financial service providers and other (Aghion, and Morduch 2005). Microfinance plays an important role in socioeconomic development of poor and low income people especially women (Al-mamun et al. 2014; Al-Shami et al. 2013). Despite, the significant impact of microfinance which was highlighted by several studies, the majority of these studies were conducted in rural areas and used simple statistic tools such as T test, Mann-Whitney which is exposure to several weaknesses such as bias selection and the lack of controlling the effect of demographic characteristics (Hashemi et al. 1996).

Economic developments, which are complex and multidimensional, have resulted in the development (World Bank 2000). Theories describe tools and strategies for making development goals achievable to start with early views about the nature of economic prosperity. Microfinance programs were transforming themselves into microfinance models by imposing financial sustainability as one of their objectives and extending their clients generally poor people, not just the poor in the agricultural sector (Glaubitt et al, 2006; Hamada, 2010).

3. METHODOLOGY

This study utilized the descriptive survey method. There were two types of questionnaires used. The first questionnaire was for bank managers or their representatives to describe their microfinance loan offerings. Another questionnaire was used for the borrower to determine their payments and reasons if unable to pay.

Initially, the author identified the entire microfinancing institutions in the outskirts of Mindanao more exposed to coastal hazards and climate change. Of the 28 banks, only 13 managers responded. Table 1 shows the distribution of respondents by region in the outskirts of Mindanao.

Table 1: Distribution of Respondents, 2016 to 2017

Region		**No. of Respondents by Type**	
Designation	**Official Name**	**No. of Rural Banks Interviewed**	**No. of Borrowers Interviewed**
IX	Zamboanga Peninsula	4	45
X	Northern Mindanao	2	15
XI	Davao Region	3	15
XII	SOCCKSARGEN (South Cotabato, Cotabato, Sultan Kudarat, Sarangani and General Santos City)	1	15
XIII	CARAGA (Caraga Administrative Region)	3	15
Total		13	105

Source: Survey of the study

Seven (54%) of the total 13 rural banks who responded in the survey engaged in offering microfinancing loans. On the other hand, the remaining six rural banks did not engage in microfinancing loans.

The following rural banks responded the survey questionnaires Rizal Bank Inc.- Mapang Rizal, Zamboanga del Norte, Siocon Rural Bank - Siocon Zamboanga del Norte, Banco Dipolog - Dipolog City, Rural Bank of Jimenez - Jimenez, Misamis Occidental, Enterprise Bank - Agusan del Sur, Partner Rural Bank – Pigcawayan, Cotabato City, Cantilan Bank – Surigao del Sur.

4. RESULTS AND DISCUSSIONS

Based on the survey conducted, the distribution of rural banks in the outskirts of Mindanao is sparsely distributed. This shows almost inaccessibility of the subsistent sectors to microfinancing loans. Figure 1 shows the distribution of the banks across regions.

Table 2: Access to Rural Banks with Microfinance Loans Offered

	Rural Bank Interviewed		
Region	RB Offering MF	RB Offering MF	Total
Region IX	1	3	4
Region X	1	1	2
Region XI	2	1	3
Region XII	0	1	1
Region XIII	2	1	3
Total	6	7	13

Net proceeds from loans applied are important among microfinance borrowers. Table 3 shows the comparative charges of rural banks when offering microfinance and when offering microfinance. Common deductions made by rural banks offering microfinancing include interest rate of 2%, services charges of 5%, savings of 5%, and insurance fees of 5%. The notarial fees and insurance are fixed amount charged by lender regardless of amount of loan applied.

Table 3: Rural Banks Based on Charges to Loan Amount Applied

Types of Charges in Proportion to Total Amount Borrowed	Rural Banks Offering Microfinance Loan
	% Charged to Borrower
Interest rates	2
Service Charges	5
Savings	5
Insurance Fees	1
Other fees and charges	Fixed amount for Notarial and Insurance Fees

Collection rate of rural banks become low on the next succeeding years of their operations, as trend indicates that in 2011 which is the starting year of their operations they got a high or a hundred percent collection rate up to the next year of operation but on the three last year their collection rate were become low but it's not the problem with MFIs, since banks has their policies to withdraw savings of clients if they cannot cope their amortization, upon release and in their amortization clients are obliged to save for the future instead but when collection rate has problem and they cannot pay their obligations banks withdraw their savings and also banks required among members that there should be group or individual responsibility among member if one of their members wont able to pay their obligation co-members will contribute for the amount not paid by each member.

Through years of operations collection rate become low for some reason among clients that they encounter problems like they don't have income because of typhoon and their sale become low, while there are those diverting their payment for illness, personal consumption and unusual food expenses. Loan default in microfinance sectors could arise from business related characteristics (Awoke, 2004).

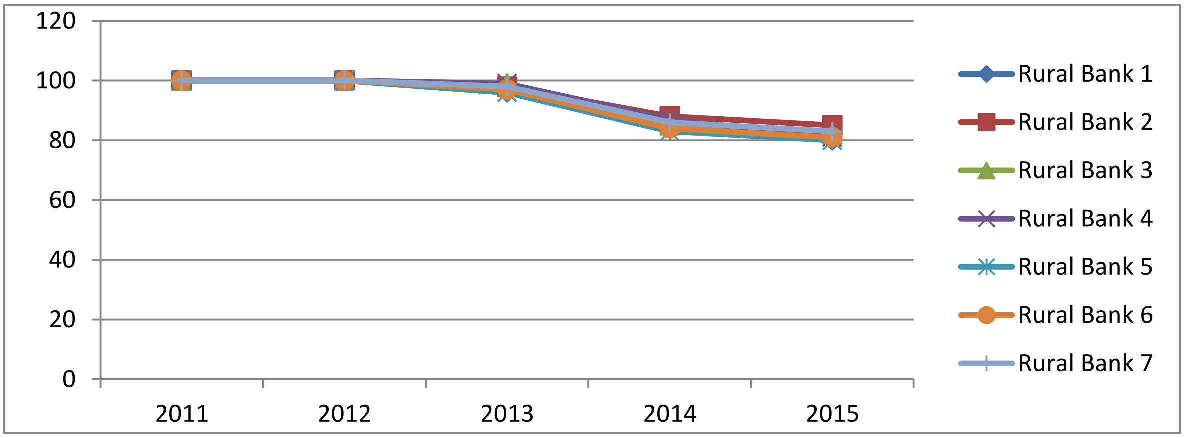

Figure 1: Trend of Collection Rate among Rural Banks

Savings withdrawals among clients savings to cope their amortization when problem arises it is shown on table that majority of banks measure on default payment is savings withdrawals and if clients' savings not enough for their amortization group back-up will the next remedies among banks. Clients were not able to pay their obligations for some reason as presented to the other table on this research. Loan delinquency and default payment affects the sustainability of the institution, lowers the morale of staff, and increases operational cost of the institution. Disbursing loans that are not getting paid can affect the poor by creating a culture of non-payment of loans and thus discouraging Microfinance Institutions from giving loan to the poor (Rosenberg, 2010). It is common to hear Microfinance Institutions declare communities as "no-go-areas" because such communities have gained notoriety of not paying loans. Defaulting beneficiaries are denied access to future loans, penalty interest payments are charged on outstanding loans, threat of legal action and harassments by loan officers. In particular, potential beneficiaries cannot access loans when loan repayments are not forth coming. This would invariably defeat the objective of the program which is to make credit accessible to the productive in the informal sector. An institution with a manageable delinquency rate of below 5% is well placed to source external funds for its operations (Hirsch et al., 2005). A high rate of delinquency would be a hindrance for potential donors to support.

Table 4: Measures of Rural Bank on Default Payments

Rural Bank's Measure	Borrowers Imposed with the Rural Bank Measure	
	Freq	%
Savings Withdrawal	91	87
Group Back Up	14	13
Total	105	100

Table 5 shows that majority of the respondents are affected by typhoon it is the reasons why clients were not able to pay their obligations for the reasons that they cannot leave their houses to sell and they have limited clients to buy their products, one day that they cannot engaged in business is a loss of income and it is a reason for a default payment. Loan is delinquent when a payment is late (CGAP, 1999).

Table 5: Distribution of Borrowers Exposed to Specific Calamity or Hazard

Climate Hazard or Calamity	Borrowers Exposed to the Specific Climate Hazard or Calamity	
	Freq	%
Typhoon	51	49
El Niño	27	26
Flood	11	10
Land Slide	9	9
Heavy Rains	7	7
Total	105	100

Illness of borrower, personal consumption and unusual non-food expenses are the reasons why clients were not able to pay their obligation. Microfinance clients used their payments because of unpredicted problems arise in their family and they cannot deny that they prioritized their household expenses than their payment in microfinance institutions. Loan default can be defined as the inability of a borrower to fulfill his or her loan obligation when due. High default rates in microfinance lending should be of major concern to policy makers in developing countries, because of its unintended negative impacts on micro financing. Microfinance institutions all over the world including Ghana are faced with the challenge of loan default/delinquency. Effective management of delinquency/default, it is critical for MFIs to understand and focus more on the internal causes of delinquency which they have more control over. Kohansal and Mansoori (2009) equally agree with Warue (2012) when they said Most of the defaults arose from poor management procedures, loan diversion and unwillingness to repay loans. This paper therefore proposes two innovative solutions to reduce business loan defaults among MFIs in Ghana : Innovative product design and delivery and Effective loan management model.

Table 6: Reason for Not Paying the Loans

Household Expenses Where Supposed Payments of Loans Were Spent	Borrowers Who Mentioned the Specific Item as Reason for Not Paying the Loans	
	Freq	%
Illness of Borrower	35	33
Personal Consumption	43	41
Unusual Non-Food Expenses	27	26
Total	105	100

Policy Recommendation on Micro Financing of Rural Banks:

Lower Interest Rate and other service charges; develop of a microfinance friendly policy and regulatory environment – Capacity building within the BSP and the banking sector – Promotion and advocacy efforts, a transparent as regards deductions (BSP CIRCULAR NO. 730 - Truth and Transparent Loan Pricing and Disclosure). Enhance group back-up policy and savings withdrawals among members for good credit standing. It is declared the policy of the State to promote capital market development and savings mobilization by establishing a legal and regulatory framework plan for persons, comprised of voluntary personal savings and investments, the potential contribution of a long-term fiscal sustainability through the, provision of long-term financing and reduction of social pension benefits (RA 9505) . The total amount of loans, credit accommodations and guarantees prescribed may be increased by an additional ten percent (10%) of the net worth, loans and other credit accommodations secured by obligations and fully guaranteed by the government as to the payment of principal and interest. BSP **CIRCULAR NO. 622Series of 2008** Pursuant to Monetary Board Resolution No. 1087 dated 21 August 2008, the provisions of safe and sound banking/business practices, a bank shall grant loans or other credit accommodations only in amounts and for the periods of time essential for the effective completion of the operation to be financed. Before granting loans or other credit accommodations, a bank must ascertain that the borrower, co-maker, endorser, shall obtain adequate information on his/their credit standing and financial capacities. A co-maker is a person who, by contract, promises to pay another person's (principal borrower) loan if that person fails to do so, co-maker if the principal borrower is unable to pay: Collect the full amount of the loan, including interests and other charges, from the co-maker; or Sue the co-maker along with the principal borrower in an attempt to collect payment; and Demand the payment of late fees or collection costs from the co-maker

5. FINDINGS

Micro-finance Institutions deduct service charges of 5%, savings 5%, 20.00 pesos notarial fee and 1% insurance from client loan releases and 1.5% and some MFIs charges 2% interest rate. Most of MFIs have 100% collection rate from the start of their operation until second year of operations but on the third and succeeding year's collection rate became low due to the default payment of clients. Collection measures among MFIs to cover default payment is group back-up or other remedies like savings withdrawals. Majority of clients in MFIs were not able to pay their obligations due to low income or sales, and some other reason that clients were not able to pay their obligations are typhoon, natural calamities, and terrorism Low sales or low income are the top of reasons why clients fail to pay their obligations to Micro Finance Institutions and the typhoon and other calamities are considered second reason for failure of payments of obligation.

It is also observed that some microfinance institutions offer higher loans to those clients with good standing payment in the programs

6. CONCLUSION

Microfinance being offered to the less fortunate individuals to elevate their standard of living but majority of Microfinance Institutions deducted high charges to clients' loans to cover some loses and other expenditures encored in their operation. Microfinance Institutions have 100% collection rate from the start of heir operation for some reasons that the MFIs cover default payment they force group back-up or savings withdrawals among members who cannot pay their obligations. Clients of Microfinance were not able to pay their obligations due to low income or sales, and some other reason that clients were not able to pay their obligations are typhoon, natural calamities, and terrorism are the major reasons why they cannot pay their obligations

7. RECOMMENDATIONS

Extend microfinance program to the poorest among the pooror to those clients who want to avail of a loan grant but they don't have existing business and no capital to start with, banks should closely monitor the clients, release them loan with low amount or minimal amount for them to easily pay on and manage to pay. Loan management model that ensures loan funds are invested directly in productive business assets minimizing if not avoiding diversion and default and educate clients to financial management and literacy. Microfinance Institutions must conduct loan utilization check if loan proceeds are not diverted

Output of the Study:

➢ Adopt extension program on Microfinance Literacy possible topics:

❖ Financial Management

❖ Bookkeeping

❖ Proper Loan Utilization

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