



PROVIDING FERTILE GROUND FOR LENDING IN THE PHILIPPINES

CARD SME BANK

Synopsis

Primary investors:

- International Finance Corporation (IFC)
- CARD SME Bank
- Canadian International Development Agency (through IFC)

Value chain or sector: N/A

Country: Philippines

Type of risk addressed: Business model risks associated with agri-SME lending

Type of blended finance instruments:

Concessional debt
Technical assistance (grant and DFI own account finance)

Executive summary

A thrift bank in the Philippines called CARD SME Bank saw an opportunity to expand access to finance for small-scale farmers, for whom bank loans are usually out of reach. CARD SME (Center for Agricultural and Rural Development – Small and Medium Enterprises) Bank partnered with the International Finance Corporation (IFC) to implement two projects: one for technical advisory services and the other a concessional loan package. Together, these initiatives strengthened CARD SME Bank's lending portfolio and promoted financial inclusion in a severely underserved market. One sign of success: the number of loans the bank disbursed to farmers increased more than tenfold in four years.

This study aims to illustrate how blended finance can help open up new opportunities for smallholder farmers and agribusinesses and remove some of the obstacles that stymie growth in the agricultural sector. It was commissioned by the Smallholder Agri-Finance Investment Network (SAFIN) and the Organisation for Economic Co-operation and Development (OECD).

Introduction

Agriculture accounts for more than a third of the workforce in the Philippines—mostly rural workers engaged in farming, fishing and livestock raising—but the sector contributes only about 9.3% of GDP, according to

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World Bank data for 2018. Farmers have difficulty obtaining the bank financing they would need to adopt new technology, buy equipment, or upgrade facilities to improve their productivity and grow their businesses.

Banks often require complex documentary procedures and collateral. Many farmers cannot comply because their businesses are informally run and have no financial systems in place. Because farmers usually do not own the land they till, they lack assets to serve as collateral. The vulnerability of their crops to extreme weather events such as typhoons and flooding also jeopardizes farmers' capacity to repay loans. Overall, farmers are considered to have low creditworthiness, and agriculture lending is perceived as a risky business. Hence, despite a law mandating banks to allocate a certain percentage of their loan portfolio to agriculture, banks would rather pay a penalty than risk lending to farmers. Because of the lack of access to finance, farmers resort to middlemen who exact higher interest rates or take the option to purchase their produce at a below-market price. CARD SME Bank partnered with IFC to address this market failure and provide farmers with access to finance.

Partnership with IFC

IFC is the private sector investment arm of the World Bank Group, offering financing, investment and advisory services to financial institutions and businesses in developing countries to achieve sustainable growth. IFC has a broad and diverse reach in the agriculture sector, global expertise and experience in helping clients address risks and identify opportunities. CARD SME Bank, for its part, is a thrift bank which strives to be a sustainable financial and capacity-building institution by providing integrated microfinance and SME development services to an expanding membership base. The bank—formerly the Rural Bank of Sto. Tomas (Batangas), Inc., which CARD Mutually Reinforcing Institutions (CARD MRI) acquired in 2007—helps facilitate the transition of micro-entrepreneurs to small businesses and addresses gaps not being filled by commercial banks.

IFC and CARD SME Bank have been a perfect fit because both organizations share the same mission of increasing farmers' and agribusinesses' access to credit and creating markets and investments in the underserved agricultural sector. Under its Global Agri-Financing Advisory Program, IFC provides advisory services to create or expand the agri-finance market and promote financial inclusion of farmers. IFC's approach is to improve productivity and adopt strategies to address business vulnerability and repayment risk, as well as build bank skills for proper credit assessment.

When this project began, CARD SME had a very low percentage of loan disbursements to farmers and agribusinesses—less than 1%. Its major concern was the lack of formal and proper business and financing systems and the repayment risk in this sector. Further, while some of the bank's loan officers are agriculture graduates, they

lacked skills in credit assessment and would turn away from projects that were unfamiliar to them or that they had no confidence in. CARD SME wanted to increase its lending disbursements and enhance its competitiveness in the industry. To do so, it would need to improve the technical skills and capacity of its loan officers on credit assessment, adopt strategies to address borrowers' repayment risk and source funds for relending. IFC's expertise and experience in agricultural financing as well as its international stature could help CARD SME attract private investors and partners.

Blended Finance Approach

CARD SME Bank entered into a partnership with IFC to implement a two-pronged agricultural finance program: first for technical advisory services, in 2013, and second for a concessional loan package, in 2017.

Technical Advisory Services

IFC received a grant from the Canadian International Development Agency (CIDA) to help create markets and reach underserved beneficiaries in the agriculture industry. IFC blended the CIDA concessional financing with its own funds to implement this project. In July 2013, IFC signed a cooperation agreement to help CARD SME Bank design and roll out an agri-finance strategy in the Philippines. This involved evaluating lending opportunities in selected agricultural value chains and then piloting the program in the bank's Lipa Branch in the province of Batangas. The engagement included a study of the agricultural industry around Lipa City, to determine the most suitable crops and agribusinesses given local environmental conditions.

In addition, a credit scoring tool—called a Profit Planner—was developed to assess viability of each crop and understand the production cycles, so that the bank could custom-fit a repayment scheme. Loan officers and other relevant staff were trained on credit assessment and the use of the credit scoring tool. This added knowledge made the loan officers more confident in assessing credits and recommending which loans to grant. Linking the repayment schedule to the production cycle minimized repayment risks. As a result of the intervention, both loan disbursements and the number of client farmers and agribusinesses the bank served grew considerably.

These are the basic components of the agri-finance advisory project:

- strategy and execution capabilities—review of internal organization, lending operations, credit delivery process and bank staff capability;
- market study—segmentation, identification of appropriate agriculture-related products and services for the area, market scoping;
- delivery channels—development of financial products suitable to the type of agribusiness;

- credit risk management—credit scoring tools for each crop and agribusiness, training of bank staff on credit assessment;
- custom-fit repayment—analysis of production cycles to be able to offer seasonal loan and repayment schedules for seasonal crops, along with short- to medium-term loans for long-gestation crops and livestock; and
- crop insurance to address typhoon-related risks faced by both farmers and the lender.

Following the successful implementation at the Lipa Branch in Batangas, IFC and CARD SME Bank signed a Phase II agri-finance cooperation agreement in January 2015. The project aimed to support CARD SME Bank in replicating the Lipa model in four other regional branches: Naga City, Bulacan, San Pablo City and Tagaytay.

Concessional Loan Package

In December 2016, IFC provided a seven-year loan package to CARD SME Bank of \$ 4 million, equivalent at the time to 160 million Philippine pesos (PHP), at competitive market rates. The proceeds of the loan were blended with CARD SME Bank funds and packaged for agri-lending to serve more farmer-beneficiaries. The fresh infusion of funds enabled CARD SME Bank to offer varied lending terms and packages for farmers depending on their needs. Term loans would have fixed terms of three months to three years, with loanable amounts ranging from PHP 30,000 to 5 million. Repayment is tailored to the production cycle. Farmers can tap into revolving credit lines ranging from PHP 200,000 to 2 million, valid for one year and renewable annually. Promissory note terms range from 90 days (minimum) to 180 days (maximum), with interest at the prevailing rate discounted in advance for three months and the principal payable upon maturity. CARD SME Bank's loan disbursement following the infusion grew by 241% in one year, from PHP 51.7 million in 2016 to PHP 176 million in 2017. (See Table 1.)

Impact

The technical advisory and lending support of IFC helped CARD SME Bank grow its agricultural financing portfolio and promoted greater financial inclusion of small farmers and agribusinesses. Before the IFC intervention, CARD SME Bank had no benchmarks and was hesitant to lend to farmers because they were not perceived to be creditworthy. The credit assessment tool proved to be useful and built the confidence of the loan officers in making recommendations on loan approvals. The tool also improved borrowers' knowledge of suitable products and cycles to improve production and generate increased income. Custom-fit repayment was adopted as a risk management strategy that proved effective in avoiding default.

The experience of one CARD SME Bank client—a vegetable farmer named Romy—illustrates the real-world impact of these changes. From an initial loan of PHP 40,000 in 2016, Romy started to grow his business. Within three years, his good standing made him eligible for a higher loan amount of PHP 300,000 to expand his business by leasing additional lands, purchasing more seeds and other farm inputs, improving his marketing strategy and transporting his produce faster (and therefore in a fresher state) to consumers. This illustrates how financing is key to improving the productivity of the agriculture sector.

Table 1. Loan disbursements (in Philippine pesos)

	2014	2015	2016	2017	2018
Agriloan disbursements					
Direct loans to farmers	10,990,000	23,850,000	44,227,561	148,393,000	248,905,000
Loans to agriculture-related businesses	3,100,000	8,900,000	7,440,720	27,800,000	32,220,000
TOTAL	14,090,000	32,750,000	51,668,281	176,193,000	281,125,000
% Increase	-	132.4%	57.8%	241.0%	59.6%
Agricultural loans as % of total bank loan disbursed	0.51%	0.61%	0.59%	1.69%	5.57%
No. of borrowers					
Direct loans to farmers	50	135	277	406	583
Loans to agriculture-related businesses	5	19	20	39	29
TOTAL	55	154	297	445	612
% Increase	-	180.0%	92.9%	49.8%	37.5%

Source: CARD SME Bank

Access to finance has enabled farmers to expand production, input supply, marketing, and transportation, and in general to improve their income. CARD SME Bank's financing comes with access to technical advisory services to enhance awareness of new technology, innovations, and production and marketing strategies. The bank adopted an inclusive approach by enabling all household members who are involved in the agriculture business to participate. Borrowers are also required to attend meetings to share skills and knowledge or raise agriculture-related issues, as well as to enhance their financial literacy.

Under the IFC advisory arrangement, CARD SME Bank staff received training in such areas as agri-lending potential, crop and livestock production, loan analysis, credit risk assessment and marketing strategies. As of this writing, 31 staff members—including regional directors, area managers, assistant vice presidents, loan officers, credit analysts and others—have participated in such training; 18 of the participants (58%) are women.

All agri-finance clients have received informal training and advisory services conducted during loan officers' project and client visits. Additionally, five CARD SME Bank clients or account holders have been invited to various knowledge-sharing events and public forums to share their experiences with agri-finance.

With the successful implementation of this program, CARD SME Bank was able to reach underserved small-scale farmers and agribusinesses. The program contributed to the achievement of Sustainable Development Goals on zero hunger and on gender equality by improving agricultural productivity and incomes of small-scale farmers and food producers, and women in particular, through access to knowledge, information and other productive resources and inputs, financial services, markets and opportunities for adding value.

Lessons learned

Blended concessional finance is an effective way to reach the agricultural sector, which commercial banks have traditionally found difficult to serve. In this case, CIDA concessional finance supported the IFC blended finance project, specifically the technical advisory services provided to CARD SME Bank. This program helped catalyze agri-finance market development, promote financial inclusion for small-scale farmers and bring about development impact. The IFC support built the capacity of bank staff to assess projects and improved farmers' technical ability to manage risks and improve productivity. It also helped address repayment risks through custom-fit payment schedules and minimized vulnerability to weather conditions by identifying suitable crops to cultivate. This enabled CARD SME Bank to have greater assurance in lending to the agriculture sector. The CIDA/IFC blended finance support to CARD SME Bank helped overcome financial barriers, which resulted in increased loan disbursements to more borrowers.

By the end of the technical advisory project, once all institutional adjustments and risk mitigation strategies were in place, CARD SME Bank and IFC were able to demonstrate the commercial viability of lending to farmers. IFC offered a concessional loan package of PHP 160 million to CARD SME Bank, which the latter blended with its own funds to relend to farmers. While the package is at competitive market rates, IFC offers a longer repayment term and value-added advisory services resulting from the institutions' established business relationship. The combination of technical assistance and concessional financing has given this project added impact.

From a broader perspective, this experience has shown that blended finance can be a critical tool to address market failures and demonstrate the commercial viability of the agricultural sector. This is an important sector in the Philippines for job creation and food security; however, it has made a minimal contribution to GDP due to lack of land tenure, financial exclusion, and lack of access to technology. Commercial banks have remained hesitant to serve what is considered high-risk sector, despite the legal mandate to allocate a percentage of their loan portfolio to agriculture.

To be most effective, blended finance should not distort the market or compete with the private sector; rather, it should be used to catalyze other investment. In this case, the blended finance investment was partly used to carry out the type of study that can be too costly for banks to take on alone—namely, an analysis of the agriculture sector and the associated risks that had led to market failure. The funds also supported CARD SME Bank in procuring the advisory services of technical experts with deep experience in the industry and knowledge of global best practices. (Fees for the technical experts were split by CARD SME Bank and IFC.) The implementation of recommended strategic measures established a sound environment in which CARD SME Bank could manage risks and make agricultural loans viable.

This project demonstrated that lending to farmers can indeed be a profitable and sustainable business. IFC's involvement as a disciplined investor subscribing to high performance standards gives comfort to other commercial banks to venture into this sector. Structured properly, so as to avoid market distortion, blended finance projects can encourage and help build the confidence of commercial banks to lend to the agriculture sector, thus opening up new markets.

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About

This case study is part of an effort by the Smallholder and Agri-SME Finance and Investment Network (SAFIN), the Inter-American Development Bank (IDB) and the Organization for Economic Co-operation and Development (OECD) to document the use of blended finance to strengthen agri-SME finance supply.

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