With Transformation to Regulated MFI, What Are the Models of Ownership that Protect Social Mission

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Introduction

Microfinance is considered one of the most effective interventions in our society today in addressing poverty. It brings about the restoration of dignity and self-worth to desperate, broken and impoverished people as livelihood opportunities are made readily available and jobs are being created. In the Philippines, no less than the President of our Republic, Mrs. Gloria Macapagal Arroyo, has recognized the impact of microfinance in addressing poverty. In her 2001 State of the Nation Address, she referred to microfinance as the cornerstone of her administration in eradicating poverty in the country. At the same event, she announced the establishment of the first microfinance-oriented bank in the Philippines and encouraged other NGO-Microfinance Institutions (MFIs) to transform to regulated institutions in order to broaden their reach, access more funds and continue to serve more poor people.

However, the establishment of regulated microfinance institutions is not a new initiative. It has long been advanced by other countries, particularly in Latin America and in some countries in Southeast Asia, which saw the need to provide small loans to the informal sector, the marginalized, the micro-entrepreneurs that constitute the backbone of the developing countries in the hope of supporting their entrepreneurial activities and the creation of wealth. Thus, from the informal financial institutions evolved the regulated MFI. But even as we marvel on how these countries encouraged the establishment of microfinance institutions, many of such organizations have struggled with the difficulty in maintaining their social mission as they evolve to regulated institutions. Studies have shown that in the transition from not–for-profit to regulated status, many institutions' social missions were hard-pressed to remain relevant in the new organizational form.

This paper hopes to identify key areas that need to be considered by a microfinance institution in order to protect its social mission as it transforms into a regulated institution. The key areas identified are lessons learned from our own experience as an organization that took the leap of transformation from a non-profit microfinance institution to a Microfinance-oriented Bank under the supervision of the Central Bank of the Philippines.

I. Knowing the Right Reason; Understanding the Mission

Social mission does not change as organizational structure changes because of growth, size and coverage of an organization. The fulfillment of the mandate primarily rests on a clear vision and mission of the organization and not on organizational changes. Organizational changes, therefore, should be in support to the social mission established by the organization's founders and should not be influenced by what changes the organizational structure may require. It is important to note that organizational changes are undertaken for the purpose of realizing the organizational goals and not to alter them. Thus any changes that are not adoptive to the social mission of the social development institutions, is not worth going into and should not be pursued.

Microfinance institutions, like all social development organizations, should be driven by their social mission. It is the bedrock to which organizations are able to give relevance and meaning to their existence. Compromising the social mission to accommodate external changes alters the very essence of what the organization stands for. Interventions, approaches and methodologies, may over time, change as organizations adopt with time. However, the mission and purpose continue to be the same. An old Chinese proverb says, "Like trees in gusty wind, we sway but stand our ground." I would liken the analogy that organizations are like trees, the branches are their methods and the roots are their mission statements, the foundation from which they stand. Changing organizational mission compromises the existence of the organization just like the tree when uprooted and planted again has its life threatened. We may sway, change our methods according to the wind but let us stand our ground. Like the tree we don't compromise where we stand, the social mission we uphold, lest we fall and perish.

A case in point is presented by Tulay sa Pag-unlad Inc. (TSPI), a microfinance institution since 1981 and considered to be one of the largest MFIs in the Philippines. TSPI was granted a license to establish and operate a bank sometime in the latter part of the 1990s. However, after a thorough evaluation of the banking system and its requirement policies, it decided to forego its license when it realized that the organizational change brought about by the transformation would threaten its core mission of helping the poor. Today, TSPI is at the forefront of advocacy efforts, together with its clients, to influence regulators to establish a new governing body that would look into the nature of social development institutions and their social mission, as a basis for its regulatory framework.

Thus, a microfinance institution, should not transform itself to a regulated MFI only for the sake of transforming itself, for reasons of its possibility, availability or the status it may bring. A thorough study of the governing laws and regulations and their implications needs to be undertaken. In the Philippines, a healthy and thriving environment for microfinance banks to be established exists, something that was not present five years ago. In other countries were banking laws are more restricted and rigid, difficulties may be encountered in the process of transformation. Many are drawn to the transformation process for reasons other than the need to be one. This becomes a danger sign and a fertile ground for losing the organization's social mission. A regulated formal financial institution is a whole new world from that of a microfinance institution (NGO) which is a social development organization, where autonomy and flexibility may be enjoyed by an NGO in pursuing its social mission. Regulated financial institution is completely the opposite, as each and every step it takes, every move it makes, needs concurrence and approval from regulators. A microfinance institution should transform itself to regulated financial institution only because of its practicality in expanding its operations, its usefulness in effectively generating added resources and to complement its growing operations whereas in its present organizational form is unable to do so.

Social missions are fundamental principles that are inalienable and any form of organizational change that threatens their existence, even if how well meaning, should be restrained from being done.

II. Knowing the Ropes; Expanding Your Expertise

The second area that needs to be addressed is the challenge of equipping the board of trustees and the paradigm shift that need to take place in the mind set of the stakeholders on the transition that the organization will be going through from non-profit to for-profit organization, from unregulated to regulated operations.

Microfinance Institutions (NGOs) getting into being regulated MFIs should therefore equip themselves with the knowledge on the how and why of a regulated institution. This cannot be delegated or substituted. It should be noted that full accountability rests upon the board of trustees or directors, and their understanding and knowledge are very critical and important.

An MFI should educate itself in the understanding of governing laws, implementation of banking practices and overall management of a regulated financial institution. It should not solely depend on external expertise in the conduct of its affairs. It may invite, on a minority level, external experts on regulated institutions only for guidance and not for direction.

Any NGO hoping to undergo to the process of transformation as a regulated organization should ask the basic question whether its is willing to go through the whole process of starting up all over again as new MFI, even to be committed to a more difficult task of learning a whole new endeavor. It brings you back through the years where you learned step by step the whole system and process of microfinance. We should refrain from saying to ourselves that a regulated organization is best given to those people in the said business of running a formal financial organization. We should learn to go back when we first started our work in microfinance, when we practically had nothing but the purest of intention of helping the poor. We struggled for the right methodology, the right system and procedure in understanding our client's needs. It was then hard work but we became masters of such field. Similarly, transforming to a regulated MFI this time would be twice as hard to undertake, however, if said transformation process is in line with the realization of the social mission of the organization then, the responsibility of each member of the Board of Trustees or Directors to acquire the skill in governing the new organization is incumbent upon them. We cannot compromise our social mission simply because we are now in a new field of expertise. We preserve it by learning the field where we are to operate. It is simply in allowing ourselves not to be knowledgeable that we lose by default, and we eventually lose what is important to us, our social mission.

This gathering, this Microfinance Summit, is an important event as those who are called to attend come from the different sectors. We see people from the academe, the policy makers, the regulators, those in social development and the private sector, all willing to understand what microfinance is all about and how to further its impact to the poor. This is a learning experience for us all. We learn from each other's experience and expertise. As regulators try to learn from the MFI, we too should learn from them; understand how they operate, how they think and why it is so. Only through a clear understanding of how the regulated MFI operates, and knowing the processes and systems, are we able to take advantage of what it can possibly do to advance our objectives.

One of the misconceptions that continue to hound the microfinance industry, particularly the not-for-profit institutions (NGO), is the mind set that regulated institutions are looked upon on a higher level than the NGO. This general misconception influences the mind set of stakeholders or even the organizational set up when an NGO transforms to a regulated institution. People from the NGO may not be given due credit for their efforts as much as people from the regulated FFI. Formal financial institutions (FFIs) and intermediaries are looked upon with more sophistication and respect than their counterparts. However, one should recognize that NGOs are organizations that work with a great deal of idealism, creativity, and resourcefulness, and their staff often "think outside the box." These qualities are totally different if not opposite from regulated institutions which are conservative, rigid, unyielding and at times unreasonable. This contrasting nature of organizations eventually affects choices in governance, management policies and norms of the organization, and when not properly addressed may result in the misunderstanding of roles and conflict in relationships thus undermining the effectiveness of our social mission.

III. Knowing the Fit; Strengthening the Structure

The third key area that we perceive that needs to be addressed as we protect our social mission in the transformation to a regulated organization is with regards to the structure wherein it is to operate.

a) The Board of Directors Set Up

Protecting social mission is the responsibility of the board of trustees and/or directors. They are the custodians of the mission for which the NGO was established. It is important therefore that said persons remain in control of any organizational structure that the NGO would transform itself into. Organizational changes that would result in the dilution of control or authority resulting to a consensual form of governance brought about by the presence of new stakeholders may result in the deviation of the social mission. It should be understood that the presence of new stakeholders does not necessarily come into the organization because of a shared social mission, though some may be attracted to it, but primarily on protecting their investment. The experience of established microfinance NGO transforming to regulated MFI has shown that as transformation was achieved into a regulated institution, and where the governance of the said institution was made according to the ownership structure, in most cases the NGO loses its control, the social mission from which the NGO has grown is compromised and eventually a falling out of relationship occurs. This may be clearly illustrated in the case of PRODEM and BancoSol wherein the former gave birth to the latter after 6 years of successful operation in microfinance only to end up parting ways, bitterly, because of differences in understanding their social missions. We have a classic case where the NGO was focused on the social dimension and the bank was concerned about the business. Today PRODEM has again given birth to a new regulated financial institution with a board compliment concurrently that of the NGO and well on their way of protecting their social mission.

It is thus recommended that majority of the board of directors should come from the NGO being the parent institution, irregardless of its financial holdings in the regulated financial institution. More than the monetary investment, the social mission, the culture and disciples that it has nurtured over the years constitute a major part of the success that the new regulated financial institution would achieve in time. We cannot help but give due importance to the social mission for which the NGO was established and the formal financial institution would pursue. The reality is that financial institutions are a product of successful NGOs and not the other way around or failed NGOs resulted to regulated financial institutions.

Our experience in Taytay sa Kauswagan, Inc. (TSKI) as we went through the process of transformation to a regulated MFI, we deemed it necessary that majority of the board of the directors of bank , 5 of them, are members of the board of trustees of the NGO. We, however, took in 2 bankers as independent directors and possibly another 2 seats for minority investors. This was a deliberate move on our part to see to it that the social mission for which TSKI was established would be preserved and upheld as it transforms itself to a regulated MFI. Presently, the Board chair of the bank is concurrently the Board chair of the NGO. This experience, or rather practice, is not an isolated case of our organization. It has almost identical similarities with two other leading Microfinance Institutions in the Philippines that went into a regulated institution. One is the Center of Agriculture and Rural Development (CARD), which is the first NGO that established and operated a bank and at present owns 10 rural banks in the Philippines. The president and CEO of the NGO is concurrently the president and CEO of the bank and majority of Board members of the NGO are the Board of Directors of the bank. The other microfinance institution that went into banking is the Negros Women for Tomorrow Foundation (NWTF), where the structure is very much similar to that of CARD wherein, again majority of the Board of Trustees of the NGO are members of the Board of Directors of the bank and where the CEO of both institutions are one and the same. Both institutions, like us, started as non-profit MFIs and eventually became regulated formal financial institutions in the form of banks. In fact, what we are now is partly due to our studies about what they have done. This means control of the bank by the MFI and to some extent having the chief executive officer (CEO) of the MFI as concurrently that of the bank would assure the continuity and preservation of the social mission even as NGO operates as a regulated institution.

The challenge that the board of trustees of the NGO has to face is their ability to respond to the demands of assuming new legal responsibilities as a banker. We realize the fact that enhancing their skills to enable them to govern a regulated financial institution does not come easy and in most cases are difficult tasks required of them. This is indeed a challenge but not impossible to overcome; a price they have to pay for the transition and most of all allowing them to protect the social mission with which the organization was established.

b) The Organizational Set Up

Transforming to a regulated financial institution does not necessarily mean giving up our operation as an NGO and to say the least its existence. A level of reciprocity is required between the NGO and the regulated MFI (Bank). This relationship is clearly illustrated in a "hatchery concept," wherein the NGO implements microfinance operations, and given a time frame of nurturing the clients, transfers them to the bank. The NGO is paid by the bank for its efforts and at its option invests the payment back in the bank. This engagement may extend to the staffing needs of the bank where the NGO supplies competent staffing to the bank. The whole set up is geared towards expanding the social mission of both the NGO and the bank. The NGO is able to expand its work for the poor, the bank finances the expansion.

Conclusion

To some extent, the issue of whether the NGO should transform itself to regulated MFI has been left unresolved due to numerous concerns, foremost of which is losing its social mission. As funds are channeled to microfinance institutions, either from well-meaning private persons, donor agencies or even from clients, the enormity of the task in reaching out to the poor has been overwhelming. As we look at the bigger picture of poverty where approximately 30 percent of the total population is living below the threshold of poverty, the urgency to address this problem becomes very apparent. While NGOs are effective channels for microfinance loans to the poor, yet we see their limitations in operating in a scale that would considerably meet the demands of the poor. This reality is due to the very nature of how their organization is set up. The flow of financial resources is limited, as well-meaning funders and investors are restrained, because of the absence of a legal way to do so. While regulated MFIs are seen to be more of a business concern where the bottom line figures are primarily their known measures for success rather than if usefulness to expand a social development initiative in the realm of formal financial institution, yet it may play a very important role in the provision of an unlimited financial resource for the poor.

As we are confronted by such predicament, the fulfillment of our social mission and the viable vehicle by which we could achieve our goals need to be reconciled. Both may seem to be contrasting parties but the need to balance their role is important to have a chemistry that would greatly impact the poor in their quest for self-reliance and sufficiency. Thus we are to ask the question "Can we transform to regulated MFI without losing our social mission?" I believe we can do so, if we put our hearts into it and are willing to pay the price that would require our utmost commitment and dedication to foster new ideas in attaining the realization of our social mission.