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# Guerilla Banking

As I look back at my banking career, I have come to realize that my institutional affiliation is progressively getting smaller, going back to my days with the World Bank, the largest multilateral development financial institution in the world. After my stint with this venerable institution, I joined the Development Bank of the Philippines, a much smaller organization by any reckoning, but arguably still the largest development financial institution in the country. I now find myself heading Philippine Veterans Bank, PVB for short, an even smaller organization. Based on my career trajectory, it will take a few years before I can work my way down to becoming a rural banker.

But not if I can help it. At PVB, we have set as one of our top priorities the forging of a long-term, strategic partnership with the rural banking industry, that is mutually beneficial to all concerned parties. For PVB, it is key to becoming a serious player in the lucrative payment services business. For rural banks, the pay-off will be the diversification of their earnings streams, to include both asset-based and fee-based revenues. For the country in general, the proposed strategic partnership with the rural banking industry will usher in *financial inclusion,* the delivery of basic banking services to the unserved and the underserved.

## Environmental Scan

Few rural banks can operate profitably in today's operating environment, acting independently and without expert advise. Their near total dependency on *spread income* has become their undoing in today's asset-short, low-interest regime. Years of benign neglect and lax regulatory supervision, up until recently, has weakened their balance sheets, leading to serious capital impairment in many cases. Unable to afford and attract competent professionals to join them, the typical rural bank, with its limited resources, small market and a moribund organization, simply could not cope with threats, both internal and external, while trying to fend-off predatory encroachments from larger competitors out to eat their lunch.

**Conclusions & Recommendations**

Against this backdrop, the rural banking industry is perceived by many, regulators included, as having outlived its usefulness, and appears to be on the verge of extinction. Unless it mends itself, this could very well be the fate of the industry, especially if the individual rural banks are left to their own resources. Rural banks need help to be able to diversify and augment their revenue streams, safely and sustainably. They also need technology resources to go into new and lucrative service businesses, presently beyond their means and capabilities. Finally, together with the rest of the industry, they need to form strategic alliances among their ranks, and constitute themselves into a formidable force in payment services, leveraging on and deriving synergies from their strong grassroots presence and infrastructure.

**The PVB Initiative**

It is in this context that PVB envisions itself as both a catalyst and partner to rural banks to achieve these very objectives. Because rural banks are akin to small bands of resistance fighters operating in the countryside, we have evolved a new business paradigm, aptly called "guerilla banking". Guerilla banking is about co-opting rather than competing with rural banks in their traditional home turfs, providing them with the means to compete effectively with money center banks through technology empowerment and financial intermediation. It is not unlike the Green Berets, arming and training Afghan tribesmen, to fight and ultimately defeat a vastly superior adversary.

**Leveling the Playing Field**

Because of their locational advantage, particularly in the delivery of money to countryside beneficiaries, banks and money transfer companies have tried to integrate rural banks into their payment network at one time or other. These arrangements have been short-lived, as these parties found it more lucrative to go it alone in due course, while avoiding the highly stringent regulatory impositions, working within the banking system. In most instances, the fee sharing arrangement has been anything but equitable, as rural banks are generally regarded as mere accessories rather than the principal engine for payment deliveries.

This practice continues today, as opportunistic vendors, service providers and larger financial institutions continue to prey on rural banks and take undue advantage of their lack of technical sophistication, to sell products and services that ostensibly enhance their stature and image, but only have incremental benefits to them or their respective customers.

## The Regulatory Imperative

Given the need for a strong grassroots organization to effectively carry out its mandate to promote *financial inclusion*, essential for sustainable growth in developing countries like the Philippines, the eradication or marginalization of the rural banking industry is not in the country's long-term, best interest. In order to foster the kind of operating environment that will encourage entrepreneurial risk taking [1], without sacrificing oversight and effective enforcement, regulators have to strike a balance between the proverbial "carrot and stick". The Philippines is already way behind the curve in the implementation of electronic banking solutions compared to its Asian neighbors, particularly in terms of technology adoption, key to *onboarding* the great unbanked. The present regulatory regime is stacked heavily against banks, compared to unregulated, non-bank service providers, who are only subject to prior licensing or some form of loose regulatory oversight of their operations[2].

## The Infrastructure-as-service Business Model

The general perception that online banking technology provisioning is the exclusive domain of the large foreign software vendors and beyond the affordability of most rural banks is naïve, borne out of a lack of understanding and appreciation of the democratization of information technology services brought about by the *open source revolution*. Third party *infrastructure-as-service* providers, even local ones, now have the capability to build their own proprietary "plug-and-play" turnkey application systems, which they can make available to rural banks in exchange for a share in revenues derived by the latter from *transaction banking* services, conducted at their various branch and MBO counters, on a "pay-as-you-go" basis[3]. PVB intends to become the infrastructure-as-service provider of choice to rural banks.

## Potential Revenues from Fee-Based Services

The two biggest government payout projects that would benefit greatly from the broad-based participation of rural banks are: 1) the disbursements of bi-monthly allotments to 4Ps beneficiaries; and, 2) the planned centralized payroll for all government agencies and

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1 During its halcyon days in the late 50's and early 60's, the rural banking industry flourished and prospered, aided by a pro-active and benevolent regulator, which nurtured the industry and promoted a harmonious relationship with its members. The relationship soured after the "Legacy scandal", which forced the BSP to crack down on erring rural banks with an iron hand. The offshoot of this is the rapid downsizing of the industry to its present near marginal existence.

2 Banks and non-banks can actually work together and co-exist harmoniously. Banks can simply co-locate MBOs at merchant premises to provide basic banking services on a fee-sharing basis with their respective host mechants, thus subjecting *online banking* transactions conducted at their counters to regulatory scrutiny.

3 The service neither requires a large upfront investment nor high operating costs, while providing rural banks the means to engage in transaction banking services, hitherto the near exclusive domain of large commercial banks.

instrumentalities. Annual service fee revenues just from 4Ps payouts alone could exceed Php 3.8 billion in a few years, more than what the entire rural banking industry stands to make from spread income from their current lending operations. The 4Ps payout infrastructure can be seamlessly adopted for government payrolls, which could be equally big.

Both the aforesaid payout services are what is known in the literature as "killer applications", or *killer apps* for short. The potential revenues from so-called killer apps are humongous. A third application is international remittance payouts, especially if rural banks can constitute themselves into the most pervasive last mile payment services delivery platform[4]. Other payment services with substantial revenue potential include encashments by cardholders of the major ATM networks, off-premise "on us" balance inquiry and deposit/withdrawal transactions of the rural banks' own deposit customers, microfinance loan and local bills payments, money transfers and remittance pay-outs, among others.

## The Role of Capital Markets

Currently, big and small banks alike have difficulty originating enough good earning assets, given the weak loan demand system-wide. Rural banks, in particular, are worst hit, because of their near total reliance on spread income from loans to keep their heads above water. Currently, there are a number of good *asset classes*, that rural banks can invest in or lend to safely and profitably. Two particular asset classes come to mind, which are ideal for rural banks from a *risk-return* perspective.

Mortgage loans, *credit enhanced* by a sovereign *guaranty wrap*, is a good place to start. Banks and other non-bank financial institutions, able to qualify for a guaranty line from the HGC, can build up a long-term loan portfolio, consisting of *zero-risk weighted* assets[5].

*OFW* loans is another excellent choice. They are among the best performing asset class in the consumer loan portfolio of most commercial and thrift banks. This fact is circumstantial, not accidental. A cardinal rule of credit extension is to lend only to those who can pay. Seafarers and land-based OFWs most certainly have the means to pay.

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[4] BSP places the cost to beneficiaries to claim international remittances proceeds at the branch or ATM counters of their respective depository banks at somewhere between Php 500.00 to Php 550.00, inclusive of *intra-* and *inter-bank* fund transfer charges, multi-leg roundtrip transportation fare and the cost of one meal, not to mention the personal inconvenience of the 5 to 7 hours commute and wait time and the loss of nearly a day's work. The cost to deliver said funds to their very doorsteps can be as low as Php 6.00.

[5] Once they familiarize themselves with the nuances of the HGC guaranty facility, it is not too difficult for rural banks to develop a program to identify and target prospective local borrowers with the necessary payment capacity.

Because the typical rural bank does not have the wherewithal to originate and structure such assets, they have to be packaged by a competent financial intermediary and brought to them all "prepped-up" for immediate execution. That will be PVB's role, as well.

**Parting Advice**

In closing, I would like to impart some words of advice to rural banks, if they are to reap the benefits of our proposed partnership in full. First, do not be *Jurassic*. Meaning to say, embrace modernity and everything that it has to offer, particularly in the area of technology innovation. Second, learn to think "*out-of-the-box*". The regulators are very reasonable people. Although many regulations appear to be stifling at first blush, it is only because, often times, we fail to appreciate its true essence, and give up immediately, instead of coming up with a "win-win" solution, while adhering to the spirit of the law. Third, *defend your turf* vigorously against all comers. You have home court advantage, and in all likelihood, the moral high ground. If you also stay united, you will be a force to reckon with in the industry.

God bless, thank you, and have a good day.