Golden Horse Microfinance: On the Brink of Bankruptcy

Conrad Vergara, CEO of Golden Horse Microfinance, Inc. (GHMI), was staring blankly at a wall in one of the more popular coffee shops of Cagayan de Oro City (CDOC) after poring over the financial reports he received earlier in the day from Manny Paler, GHMI operations manager. The documents revealed that the company had an alarming number of accounts that were 90 days past due over the past five months. In fact, the number of non-performing loans increased from 75 to 150 out of 500 on the books.

GHMI company headquarters were in Davao City, but Vergara mainly managed the company from CDOC, where he had another business. Each week, he travelled to Davao City to check in with managers and monitor GHMI operations. He only interacted with the company's board of directors once a quarter when he reported on the company's financial performance.

During the company board meeting that was scheduled for the following week, Vergara would have to explain why GHMI had a disappointing quarter. Meanwhile, the board wanted an impressive report. Shareholders were considering investing more in the company as part of its capital-raising campaign, but a bad report could mean they would pull their money and look to more profitable ventures. Vergara had heard that rumors of the company's financial performance had already reached the shareholders' circle. He would have to put their fears to rest.

Published by WDI Publishing, a division of the William Davidson Institute at the University of Michigan.

This case was written by Francis Thaise A. Cimene and Conrado P. Carreon, professors of management, Capitol University, Philippines. This case was prepared to be the basis for class discussion rather than to illustrate either the effective or ineffective handling of a situation. It is based on the story of a real company and was inspired by Carreon's unpublished dissertation. The names of the company and central characters as well as company data are disguised. The authors felt the need to protect the company for ethical reasons. This publication is made possible by the generous support of the American people through the United States Agency for International Development (USAID) under the terms of Cooperative Agreement #AID-492-A-13-00011. Its contents do not necessarily reflect the views of USAID or the U.S. government.

All he could think about were the lines he heard from Teresita Sy-Coson, vice chairwoman of SM Investments Corporation, at a conference he had recently attended: “Surviving during a matter of crisis is a matter of choice. We have learned from our own experience that going into business and staying in it during difficult times is a deliberate choice one makes. You have to want to weather through the tough times.”

The Founding of Golden Horse Microfinance

Vergara could still recall how the company started 10 years ago when he brought up the idea of a microfinance business to his buddies at the CDOC Rotary Club. With his track record of winning and maintaining business, it was not difficult to convince them to give it a go. Besides, in 2004, microfinance was profitable; more and more low-income people were interested in starting small businesses. The trend was triggered by government and private sector initiatives that provided citizens with training in how to attain a livelihood.

Vergara persuaded five of his friends to make a contribution of 1 million PHP (2.2 million USD) each to start the business. With the 5 million PHP (11 million USD) in start-up capital, the company rented a strategically located space in Davao City, and, after two years in business, GHMI was able to buy a lot and building in an even better location.

GHMI was a company that sold stock and had a board of directors made up of local Filipino citizens. It was incorporated under the Securities and Exchange Commission of the Republic of the Philippines, and its vision was to become a strong partner for clients as they went about creating their businesses.

The company provided lending services to companies, individuals, organizations, and other entities that needed funding for a project or endeavor. Many of the loans were collateralized, but all loans were characterized based on degree of risk exposure.

In less than a year, Vergara was able to get the microfinance company into operation. He was also able to persuade Paler, a professor in his master of business administration (MBA) program at one of the more prestigious universities in Mindanao, to quit his job and manage the company’s operations. For the first four years, the company was doing well, with net profits increasing each year. Shareholders reinvested their dividends into the company, expecting higher returns.

From 2008-2011, the company was weighed down by the country’s tightening of money supply brought on by the devaluation of the peso against the U.S. dollar. While the company’s exposure had been calculated carefully, it still ran into difficulty with borrowers not repaying their debts. Nevertheless, during this period, the company, managed to deliver dividends as well as other incentives that were promised to shareholders.

Over the next three years (2011-2014), the company gradually became cash-strapped. Management decided to downsize, but maintain its loan portfolio, even if it meant litigation for debt that remained in collections.

Prior to his time with GHMI, Vergara worked in the banking sector for 15 years while earning his MBA and Doctor of Management degrees. He studied microfinance management, while managing his CDOC-based consulting company, which specialized in banking and insurance products as well as investments and benchmarking.

The Dilemma

In light of the bad news, Vergara thought about where to begin. He reached for his mobile phone and called Paler.

"Manny, next week I am going to make a report about the company's performance before shareholders. I don't think I will have the courage to give them the reports you submitted to me," he said.

"I am thinking about that too, Sir," came Paler's reply. "However, if we can explain it to them the right way, perhaps they would understand."

"But how do you suppose we explain it to them, Manny?" Vergara interrupted.

"I suggest you prepare notes on the financial statements that will serve as your talking points and submit them first thing tomorrow morning," Paler obliged with optimism.

There was a large portfolio of non-performing loans, but with many of them were land titles that served as collateral. Vergara was thinking about whether it would be wise to dispose of the properties and use the proceeds to replenish the company's cash on hand.

He asked Paler to start researching this, only to find out that many of the properties were located in areas where buyers lacked interest. Those who were interested in the properties wanted them for a lower price. The next move Vergara made was to ask Paler to evaluate the company's loan policies to explain the large number of past due accounts.

He found that many of the company's Class A borrowers were finding difficulty paying their loans, so their loan amounts had been reduced. To him, this was unthinkable considering that when the company first started all it had was success stories. One of his favorite cases was a fish vendor who borrowed PHP 1,000 (22 USD) each week, and paid each of the loans back in seven days. After three months of this, her loanable amount was increased to PHP 5,000 (114.71 USD), which she was able to pay off before the amount was due. With the right motivation and sense of determination, the vendor was able to put up a fish stall on a piece of land she rented. By then, the vendor's loan amount increased to PHP 10,000 (223.64 USD). She maintained the same record of repaying her loans before the maturity date, and was ultimately able to keep the fish stall and open a grocery store. It is interesting to note that despite her success, she continued to borrow money. She increased her loan amount to PHP 50,000 (1,116.82 USD), which she usually paid off in less than a month.

While Vergara was reflecting on this and other success stories, he remembered what Paler had shared with him just days ago. He related to him the story of one microfinance company in the area, which had been in business since 2002, but was struggling under the same conditions as GHMI.

Vergara thought long and hard. Pain gripped his heart; he would never consider shutting down the company as an option because it had been able to give more than 500 people a chance to improve their lives. Still, he knew he needed to turnaround the company to keep shareholders happy.

In Search of a Breakthrough

With barely a week to finalize his report, Vergara was pressed for time. He was not sure what else he could do to find out what went wrong with the company's financials or what to do about it. The only thing he was sure of was shareholders would decide after the meeting whether to continue to invest in the company, or shift their support to other ventures. Their decisions would depend on his report. Vergara would have to come up with a set of solutions and pick the best one. For him, the biggest challenge was maximizing the use of capital as well as technological and human resources to increase the company's profits and competitiveness. Several questions raced through his mind: Which financial goals would make the company profitable again? How could sales and marketing staff help the company achieve these goals? How could the company reduce costs? Which investments would be profitable? Which internal control measures should the company use? And, overall, how could management save the company?