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**“Credit Supplementation Institutions:
Going Beyond Guarantee for SMEs”**

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EXECUTIVE SUMMARY

In ASEAN, small and medium-sized enterprises (SMEs) account for more than 90% of all enterprises, employ 50-99% of the domestic workforce and contribute around 32-77% of total domestic output in their respective countries. In the Philippines, the number of SMEs grew by 66% from 492,510 in 1995 to 816,759 in 2011. Similarly, the numbers of those employed by these firms have grown by 45.7% from 2.7 million in 1995 to 3.9 million in 2011 (*Mendoza and Melchor November 2014*)

Micro Small and Medium Enterprises (msmes) have a very important role in developing the Philippine economy. They help reduce poverty by creating jobs for the country's growing labor force. They stimulate economic development in rural far-flung areas. They serve as partners to large enterprises as suppliers and providers of support services. They serve as breeding ground for new entrepreneurs and large corporations. A strong and vibrant MSME sector is thus an indication of a thriving and growing economy. Despite policies that aim to provide an enabling environment for MSME development, the sector still faces various constraints that prevent it from realizing its full growth and potential.

Overall, SMEs face numerous constraints to further growth and productivity, including credit constraints, cumbersome registration procedures and strict regulatory environments, and other challenges related to an economic playing field that is not level between large and small firms. SMEs, especially start-ups, have lower probabilities of survival than larger firms, leading to high rates of market entry and exit across nearly all economic sectors.

To go beyond survival and actually compete, SMEs will need to undergo successful business transformation in various dimensions of their operations—spanning enhanced entrepreneurial skill, innovation in process and product development, more successful collaboration across SMEs and with larger firms, and improved crisis resilience among other factors.



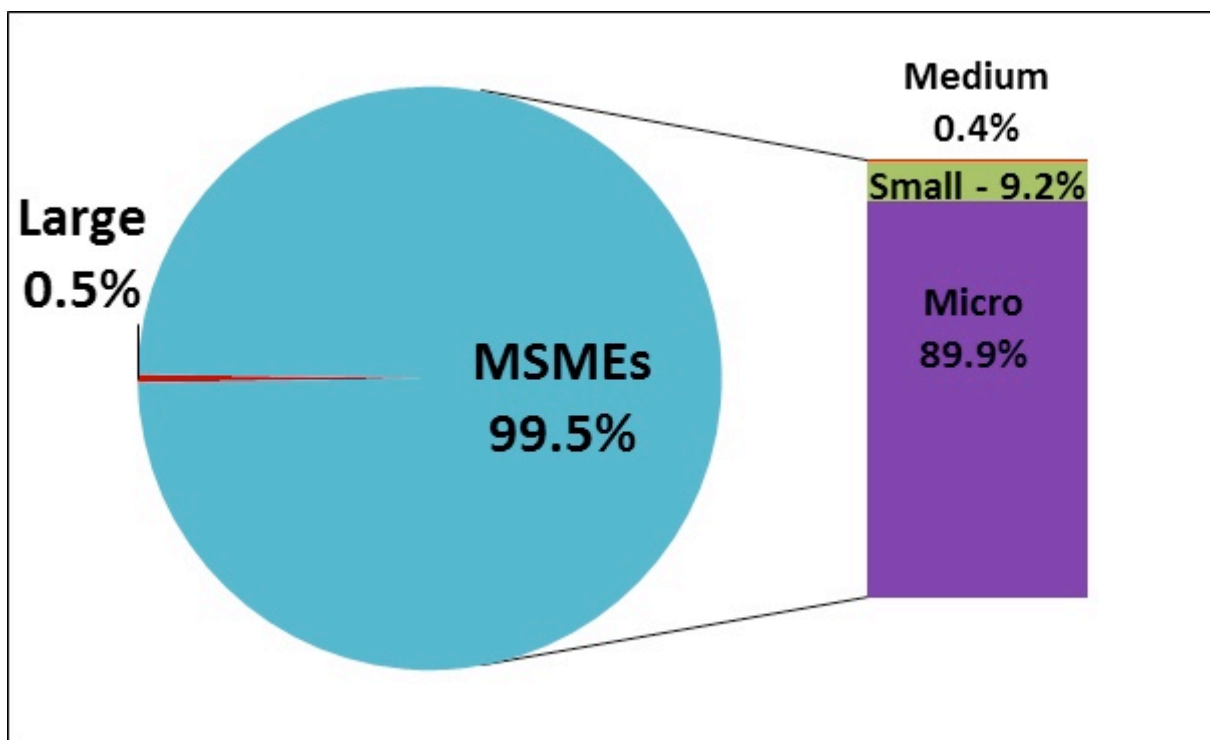
INTRODUCTION/BACKGROUND

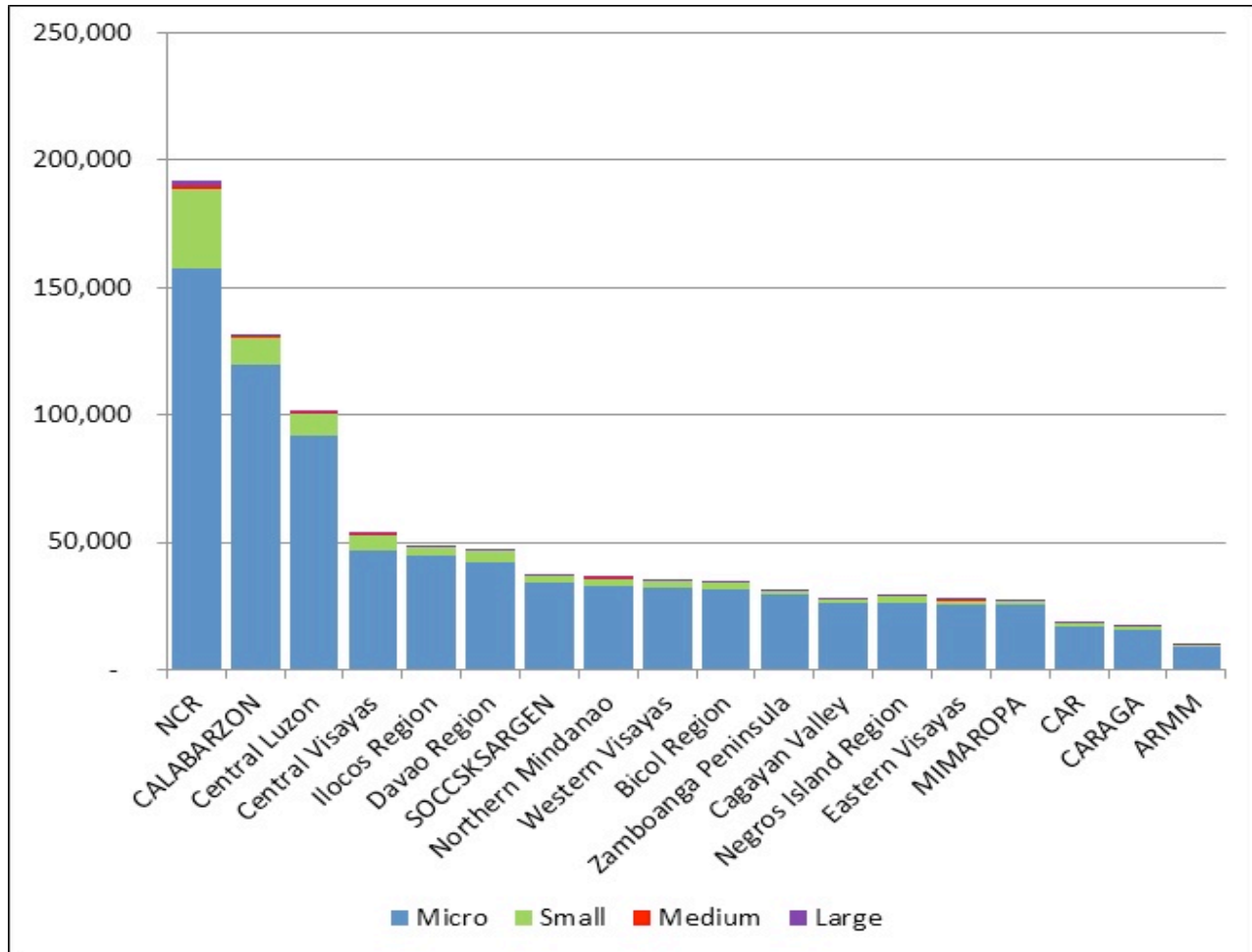
Micro, small and medium enterprises (MSMEs) are the foundation of a competitive and equitable economy. They are the most important job creators. In the US, for example, small firms accounted for 64 percent (11.8 million) of new jobs created between 1998 and 2011. Within this group, young and high-growth businesses have had a huge impact on the economy, accounting for roughly half of new jobs created, expanding and creating opportunities in new locations and stimulating further employment growth in related industries. The growth of the MSMEs particularly in the countryside is thus a key to democratizing and decentralizing economic development, especially in markets where business has traditionally been concentrated in few urban centers.

MSMEs in the Philippines are defined by law, Republic Act No. 9501, as amended. The Magna Carta for SMEs defines micro, small and medium enterprises according to asset size. Micro enterprises are those with asset size of less than P3.0Million; small enterprises are those with asset size of more than P3.0Million up to P15.0Million; medium enterprises are those with asset size of P15.0Million up to P100Million. An enterprise with more than P100Million is considered a large enterprise.

Number of Establishments

Based on 2015 statistical data provided by the Philippine Statistics Authority (PSA), there are 900,914 establishments in the Philippines. Of these, 99.5% (896,839) are micro, small, and medium enterprises (MSMEs) and the remaining 0.5% (4,075) are large enterprises.





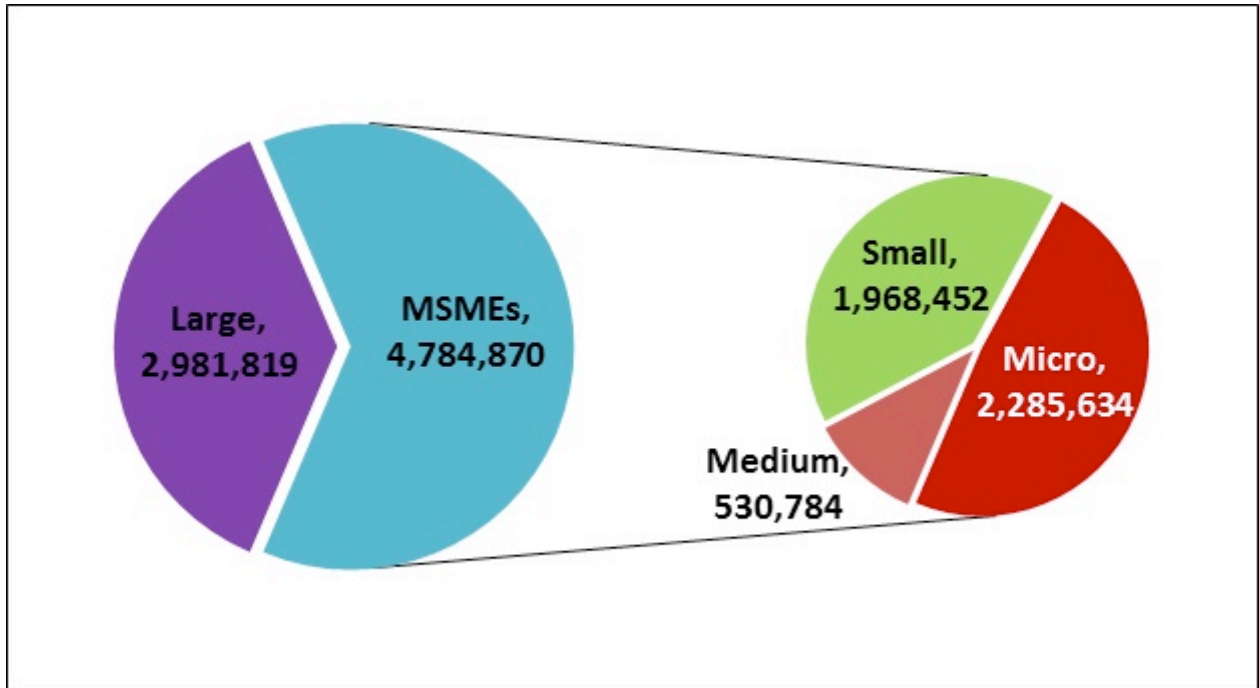
Employment

MSMEs generated a total of 4,784,870 jobs in 2015 versus 2,981,819 for the large enterprises. This indicates that MSMEs contributed almost 61.6% of the total jobs generated by all types of business establishments that year. Of these, 29.4% or 2,285,634 jobs were generated by micro enterprises; 25.3% or 1,968,452 by small enterprises; and 6.8% or 530,784 by medium enterprises.

By industry sector, MSMEs in the wholesale and retail trade; repair of motor vehicles and motorcycles generated the most number of jobs with 1,707,103 in 2014 followed by MSMEs in manufacturing, 764,184; accommodation and food service activities, 666,254; education, 273,838; and financial and insurance activities, 230,137.

Majority of the jobs are generated by MSMEs in the National Capital Region (NCR) with 1,471,465 jobs; followed by MSMEs in Region 4-A (CALABARZON), 676,201; Region 3 (Central Luzon), 484,084; Region 7 (Central Visayas), 324,780; and Region 11 (Davao), 234,716.

Distribution of Enterprises by Total Employment





SMALL BUSINESS CORPORATION

Small Business Corporation (SB Corp) is a government corporate agency created under the “Magna Carta for Small Enterprises” (Republic Act No. 9501, as amended) which is mandated to implement comprehensive policies and programs to assist MSMEs in all areas, including but not limited to finance and information services, training, and marketing.

For twenty six (26) years, the SB Corp has consistently extended credits and loan guarantees to MSMEs under its enterprise development financing mandate. SB Corp is at the forefront of the government’s effort to encourage MSMEs growth through various enterprise-financing activities. Tasked with the development of various alternative modes of financing services for MSMEs, the corporation is focused on developing an appropriate mix of financing products and capacity building services from the generic credit and credit enhancement facilities to more evolved financial intermediation products utilizing new credit technologies.

Together with the Department of Trade and Industry, its parent agency, SB Corp. works with various partner financial institutions such as banks and lending companies in providing financial services and assessing the different MSME applicants who want to avail of such services.

SB Corp. also works with other government financial institutions (GFIs) that provide similar financial services to other sectors of the economy. The company is the lead convener of the government’s ASENSO (Access of Small Entrepreneurs to Sound Lending Opportunities) program—the collective efforts of GFIs to lend to MSMEs.

Since 2004, the program has released a cumulative of P436.17 billion to various MSMEs, with SB Corp. share in the cumulative loans totaling P26.793 billion.

The Crucial Role of MSMEs

MSMEs are scattered in various sectors of the economy such as wholesale and retail, motor vehicle industries, food and accommodation services, manufacturing, information and communication, financial and insurance activities, among others. In 2015, it employed more than 4.7 million Filipinos in various jobs in their sector, as opposed to the 2.9 million Filipinos employed in large enterprises, according to the DTI.

But when it comes to value being added to the economy, MSMEs are largely low value. In the latest available data from the DTI, MSMEs contribute only 35.7 percent of value to the economy, despite having more enterprises and workers being employed. This value is lower as against our Southeast Asian neighbours where MSMEs contribute a larger portion in their respective economies.

What's hindering greater MSME contribution to the growth of our economy? Several non-financial factors are at play such as difficulty in securing government permits, access to electricity and infrastructure, natural calamities that threaten MSME production, among others. But more importantly, it is the lack of access to capital that prevents MSMEs from producing more and adding greater value to the economy. It needs the government's assistance to acquire much-needed capital to start and grow their business.

“MSMEs are vital in dispersing new industries to the countryside and stimulating gainful employment. A country like the Philippines where labor is abundant has much to gain from entrepreneurial activities. MSMEs are more likely to be labor intensive. Thus, they generate jobs in the locality where they are situated. In this sense, they bring about a more balanced economic growth and equity in income distribution (*Bartholomew Brillo Reynes, Former President and CEO of Small Business Corporation by EPI FABONAN III for SB Corp.*)

BEYOND GUARANTEE

In the SB Corp's proposed Philippine Industry Road Map for SME Finance (*Messrs. Charles G. Belgica and Ric M. Perez*), advocates and professionals on SME development have identified certain gaps and bottlenecks in SME finance that hinder financing access. Some are cultural in nature others are systemic to our local banking system and still some are borne out of an irrational distribution of resources for development. Among which are asymmetry on information (low on financial literacy), availability of information pertaining to credit histories/MSME track record, competency of people who run the financial institutions/lack of understanding of the SME market and its financing needs, collateral oriented lending, lack of capital, poor quality of projects, transaction costs, institutional barriers and negative attitude towards investors.

MSMEs are, collectively, the largest employers in many low-income countries, yet their viability can be threatened by a lack of access to financing. Their growth is often stifled. Access to financial services can therefore boost job creation, raise income, reduce vulnerability and increase investments in human capital.

Even as government changed hands in the past 26 years, SB Corp. remains steadfast in its commitment to support the financial needs of MSMEs. This commitment has become even stronger and broader under the administration of President Rodrigo Duterte (PRRD).

Consistent with the directive of PRRD, SB Corp has responded to the needs of the MSME sector by fulfilling its mandate of access to finance directly and indirectly through the following flagship programs:

1. Lending Program called Pondo sa Pagbabago at Pag-asenso (P3).

The program aims to rival the five-six lending scheme that scrupulous lenders use to prey on MSMEs by giving them an alternative source of funding. P3 is a funding program that will provide microenterprises an alternative source of financing that is easy to access and available at a reasonable cost. The program is designed as a better alternative source of financing for enterprises that are forced to borrow from informal lenders at very high rates. The program has been piloted in three areas in the country. From its initial pilot areas, the program was rolled-out nationwide on May 31, 2017. Since then a total of P246.4 million has been released as direct lending to MSMEs and as microfinance through conduit financial institutions. Initial direct borrowers to the program were 180 micro borrowers (mostly market vendors) and 50 accredited cooperatives. Loan amounts range from P5,000 to P100,000, at a maximum interest rate of 2.5% per month, with no collateral requirement. Minimum requirements for loan application include business permit, certificate of good standing (to be given by the market administration) and valid ID; processing takes one day provided documents are complete. Currently the SB Corp is ironing out the operating mechanics with members of the Microfinance Council of the Philippines Inc. (MCPI) and of the National Confederation of Cooperatives Inc. (NATCCO).

2. Enterprise Rehabilitation Financing (ERF)

Throughout the recorded history of the Philippines, disasters in various parts of the country have been reported. Unmistakenly, floods and storms have been the most frequently occurring hazards. The program was created taking into consideration the high level of exposure to hazards due to its geography.



The company continues to extend a helping hand to MSMEs in their effort to rehabilitate their business affected or damaged by various calamities in the country, particularly in areas still recovering from Super Typhoon Yolanda in CALABARZON, MIMAROPA and the Visayas Region.

Since SB Corp. spearheaded its program in these areas in December 2013, a total of P629.80 million has been released to MSMEs that availed of the financing program. A notable beneficiary of the program is Bantayan Island, Cebu's egg industry, which was rehabilitated within two years from the calamity through loans totaling P110.79 million. Another exemplar of success is the rehabilitation of the tourism industry in Cebu and Eastern Samar through loan releases totaling P16.8 million that benefited 11 hotels/resorts.

3. ACTIVE PROGRAMS

Direct Lending Program

Leading the charge is the company's lending activities. As of June 2017, the company's total portfolio balance for its lending programs is at P3.0 billion, with retail lending posting the highest portfolio balance at P1.3 billion followed microfinance at P1.06 billion, Enterprise Rehabilitation Financing at P0.446 billion and MSME wholesale lending P0.234 billion. During the first semester of 2017, the total loan releases for direct lending was reported at P846 million—an increase of 68 percent in loan as against P503.74 million total releases in December 2016.

Direct lending is a facility designed to suit the specific financing needs of micro, small and medium enterprises (fixed asset financing, working capital, etc.). SB Corp provides additional liquidity when the business needs it most as credit champion for MSMEs.



Wholesale Lending

SBC offers its mSME Wholesale Lending Program to provide funding to financial institutions nationwide for lending to mSMEs. It improves the ability of these institutions in mSME lending. The Program provides funding access even to small conduits in the countryside which have positioned as MSME lenders.

It provides funding at terms properly matched with the requirements of MSMEs. The Program impacts on the vision to have vibrant MSMEs through ensuring liquidity in the financial system for MSME credit by granting banks better cost efficiency and opening up more credit opportunities for MSMEs.

MSME wholesale lending through partner banks posted releases totaling P243.56 million, a modest 13-percent increase from the December 2016 figure of 214.77 million. This performance was the result of MSME wholesale lending being affected by a more relaxed approach to wholesale and a policy shift to consider lending to MSMEs with higher loan sizes compared to aiming for a bigger number of borrowers.

MSME borrowers that availed of retail lending increased from 531 to 885 during the first semester of 2017, a 67-percent increase from the same period last year. Likewise, MSMEs that availed of wholesale lending posted a cumulative total of 182 during the first semester of 2017, a decrease of three percent from the same period last year.



Risk-Based Lending (RBL) Advocacy

This is an advocacy with the end of changing the mindset of lenders from collateral based lending to risk based lending. This will require a perspective that probability of default is only due to borrower quality and not on collateral quality. The advocacy is owned and pursued by SB Corp since 2008 and have been making the players in SME Finance aware of the basics of RBL through the conduct of Broad-Based Seminars on RBL. The advocacy is also the battlecry of SB Corp.in its capacity building programs.

1. Capacity Building Program for financial institutions (FIs)

RBL Consultancy on SME Lending is a capacity building agenda of SB Corp. for FIs. It is a 37-day consultancy engagement with a FI wherein SB Corp through its local consultant handholds the FI in the adoption and practice of RBL. The FI is expected to implement a SME Development Action Plan with the objective of setting up and building up its SME portfolio. The consultancy will also result to a change in mindset toward RBL. These banks will form the core group of RBL practitioners and from them shall radiate the use of RBL technology in other FIs.

2. MSME Capacity Building Program

This program capacitates MSMEs in the more aspects of managing and running their business to improve their financial literacy and management capacity. SB Corp has been implementing capacity building projects benefitting its clients since 2006. It has developed several training modules on business planning and on basic records keeping. The program is a three (3) day training on business planning. In 2010 the program was improved in order to create more significant impact to participating SMEs. The Enterprise Enhancement Program (EEPro) was launched in 2011. EEPro is designed to guide SMEs in completing their business plan and make it as their guide in business operation. Program is implemented by way of classroom-based training and on-site coaching and consultancy.

4. OTHERS

- a) SB Corp. actively participates in the crafting of a framework to develop the legal and institutional infrastructure as well as practices governing the use of secured transaction and movable asset finance systems and form an important part of the lending infrastructure that will enable more credit to flow to MSMEs. Most MSMEs do not own real estate that is typically accepted by lenders in many developing economies as collaterals for loans, thus, giving rise to the most commonly cause of MSME's lack of access to finance. In more advance markets, MSMEs can obtain loans by using movable assets (such as inventory, accounts receivable, crops, and equipment among others) as collaterals. This, however, requires functioning laws and collateral registries governing secured transactions, which are very inadequate and not trusted by lenders in many developing countries to protect their rights to collateral.

- b) Effective Credit Information System - As the Small Business Corp moves forward in its goal to be the leader in small enterprise development financing and small credit delivery systems nationwide, it takes a step further to accelerate and improve access to credit for its clients by becoming the first Government-Owned and-Controlled Corporation to submit its borrowers' data to the Credit Information Corporation (CIC). SBC is the first GOCC that was able to submit the five-year historical data of its borrowers to the CIC, even before the deadline set for data submission. The CIC is a government-owned and-controlled corporation whose primary mandate is to establish a comprehensive and centralized credit information system for the collection and dissemination of fair and accurate credit information. Data collected by the CIC can be used by MSMEs to represent themselves to lending institutions as proof of creditworthiness. A good credit report is expected to allow borrowers to obtain loans at better rates or longer terms.



OPPORTUNITIES FOR IMPROVEMENT

The corporation should work on the Strengthening of the Credit Guarantee Program. The guarantee program is designed to encourage banks to lend to MSMEs with collateral deficiencies. Majority of MSMEs have difficulty on accessing credit because they lack collateral to back-up loans, limited or no credit track record and often, lack of expertise to produce accurate financial statements. Typical in banking practices, they equate borrower credit worthiness with loan value of collateral. This imbalance credit decision eventually results in a partial or negative response to the credit demand which is being addressed by the program.

While the guarantee program has been with the industry way before the SB Corp was established, there are areas for improvement identified. First, the risk mitigation features of the system often impede the timeliness and effectiveness of the system. Prescription period within which to call the guarantee often hampers the effectiveness of the guarantee facility. Second is the too many documentary requirements for the guarantee to take effect on enrolment and calls need to be streamlined for greater efficiency. Finally, the credit guarantee system is a surety-a corporate guarantee, which is a huge departure from its original nature which is a sovereign guarantee. The shift from the sovereign guarantee to surety or corporate guarantee has lessened its attractiveness to the lenders and sees this as a weakness of the guarantee system.

Just recently, PRRD has called on the SB Corp. to design specific programs for calamity stricken MSMEs. The credit risk guarantee fund (CRGF) is a credit guarantee program that will help the MSMEs affected by typhoon Yolanda access credit from financial institutions for the recovery and rehabilitation of their business. The loan portfolio was backed up by a P200Million credit risk support fund from the government. The CRGF shall adopt a portfolio guarantee scheme with thirty (30) percent default rate threshold on the enrolled MSME loan portfolio. In case of call on guarantee, a maximum guarantee of 80% shall be extended provided that the 30% default rate cap is not breached.



SB Corp. has been providing MSMEs with a wide range of financial services, including direct and indirect lending, loan guarantee, financial leasing, secondary mortgage, venture capital operations and debt instruments for compliance with mandatory allocation provisions since 1991. These successes would not be possible if not for the trust and cooperation given by SB Corp.'s partner financial institutions (PFIs). PFIs are critical partners in the accomplishment of SB Corp.'s vision of mainstreaming MSME finance in the country. SB Corp. agrees to support and cooperate with PFIs where the partnership results to increased access to credit for MSMEs (*B. Reynes former SB Corp President and CEO*).

Last October, Malacañang issued Executive Order No. 5, calling for the adoption of “Ambisyon Natin 2040,” a twenty-five year, long-term development plan that aims to triple real per capita income, totally eradicate poverty and transform the country into a middle-class society. Beginning with the Aquino administration, and now, with the Duterte administration, the power of MSMEs to transform the economy is finally beginning to be recognized.

What's driving the Philippine economy? Is it big businesses that dominate agriculture, manufacturing, real estate, mining, transportation, communications and other key industries? Is it the government, which formulates plans for the economy and enacts economic policy?

While government and big business both have an important role to play in the economy's growth and development, micro, small and medium enterprises are, undoubtedly, also crucial in driving the economy. After all, they comprise 99.5 percent of all enterprises in the Philippines (DTI 2015).