Chapter 10

SMEs Access to Finance: Philippines

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September 2011

This chapter should be cited as
Aldaba, R. M. (2011), 'SMEs Access to Finance: Philippines', in Harvie, C., S. Oum, and D. Narjoko (eds.), *Small and Medium Enterprises (SMEs) Access to Finance in Selected East Asian Economies*. ERIA Research Project Report 2010-14, Jakarta: ERIA. pp.291-350.

CHAPTER 10

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This paper examines the access to finance issues confronting Philippine SMEs based on a survey of firms and commercial banks. The firm survey covering the garments, textiles, automotive, electrical and electronics, and food manufacturing industries highlights the difficulties faced by small and medium enterprises (SMEs) in accessing finance. Financing obstacles posed one of the top four most serious problems for the growth of their businesses. The survey indicates the continued dependence of SMEs on internal sources of financing, not only during their start-up phase but also in the ongoing operations of the business.

Close to 41% of the respondents intend to expand the size and scope of their businesses in the next two years. 67% said that internal funds alone are not sufficient to finance the expansion, with the same proportion of firms indicating that they would seek to finance their expansion using a loan. Previous surveys had also showed a substantial proportion of firms that planned to borrow in the future. However, the continuing dependence of firms on internal sources of financing seems to suggest a gap between the plans of firms to borrow and the actual amount of funding made available by banks.

SMEs, particularly the smaller ones, have been unable to access funds due to their limited track record, limited acceptable collateral, and inadequate financial statements and business plans. The bank survey showed the same reasons for turning down financial requests: firms' poor credit history, insufficient collateral, and insufficient sales, income or cash flow, unstable business type, and poor business plans.

To improve micro, small and medium enterprises' (MSMEs') access to finance, the paper suggests the implementation of a Central Credit Information Corporation in order to address informational asymmetries. Changing the mindsets of banks and introducing non-traditional approaches to SME lending would also be important, along with training and capacity building programs for SMEs to improve their financial literacy and management capacity.

1. Introduction

Given their dynamic and productive characteristics, small and medium enterprises (SMEs) are seen as crucial for a country's economic growth, employment creation and innovation. Their lack of access to financing has often been cited as one of the major constraints affecting their performance and competitiveness. Lack of access to financing implies that a substantial number of SMEs cannot obtain financing from banks and other sources in order to start up, innovate, grow and develop their enterprises. In a recent Philippines Institute for Development Studies (PIDS)-Economic Research Institute for ASEAN and East Asia (ERIA) survey of the barriers faced by 101 SMEs from the electronics, automotive, garments, and food sectors, Aldaba *et al.*, (2010) indicated that financing constraints have remained one of the most critical barriers affecting SME growth. The surveyed firms cited the following financing problems: shortage of working capital to finance new business plans, difficulties in obtaining credit from suppliers and financial institutions, insufficient equity, and expensive cost of credit.

As of 2008, the Philippines had a little over 761,000 registered enterprises with 91.6% being micro enterprises. Small enterprises had a share of 7.7% while medium enterprises accounted for a share of only 0.4%. The wholesale and retail trade sector dominated the total with a share of almost 50%, followed by manufacturing and hotels and restaurants, with shares of 14% and 12%, respectively. Total employment of around 5.54 million was registered during the same year with micro enterprises accounting for a share of 30%. SMEs contributed roughly the same with a share of 31.2%. Wholesale and retail trade generated 35% of the total; manufacturing followed with a share of 19%.

Within the manufacturing industry, a total of 112,377 enterprises were registered in 2008. Micro enterprises accounted for about 90% of the total, while SMEs had a share of 9.5%. Total employment was about 1.4 million, with SMEs contributing 28% of the total, while micro enterprises had a share of around 17.8%.

From the seventies to the present, overall SME policies and programs in the Philippines have evolved, with their focus shifting from inward-looking towards a more externally-oriented approach. In the 1990s, government policy on SMEs concentrated on improving market access, export expansion, and increasing competitiveness. In 1991, the Magna Carta for Small Enterprises was passed to consolidate all government programs for the promotion and development of SMEs into a unified framework. The Magna Carta also mandated all lending institutions to set aside 8% of their total loan portfolio to SMEs.

Finance is a critical factor for competitiveness and the ability to exploit and participate in the global economy, as well as taking opportunities arising from regional integration. The paper focuses mainly on the access to finance issues confronting SMEs in the Philippines. A survey of both firms and commercial banks was conducted for an in-depth understanding of the issues. The paper is divided into five sections. After the introduction, section two reviews SME performance and structure. Section three discusses the policies and programs of the government for SMEs, current sources of SME finance, and the finance issues and constraints faced by SMEs. Section four analyzes the survey results and supplements this by incorporating the results of similar SME access to finance surveys conducted by other organizations in the past. The final section presents the policy implications of the paper.

2. SME Performance and Structure

The Philippines has two operational definitions of small and medium enterprises. Based on employment, which is the most commonly used definition in the country, the different size categories are classified as follows:

Micro enterprises	: 1-9 employees
Small enterprises	: 10-99 employees
Medium	: 100-199 employees
Large	: 200 or more employees

In terms of assets, SMEs are defined as follows:

Micro enterprises	: P3 million or less
Small enterprises	: P3-15 million
Medium	: P15-100 million
Large	: P100 million or more

In terms of number of establishments; micro, small, and medium enterprises (MSMEs) dominate the economy and accounted for almost 99.6% of the total number of establishments in 2008. With a share of about 92%, micro enterprises are more predominant than small and medium enterprises, which account for only 8% of the total number of establishments. Geographically, both micro and SMEs are highly concentrated in the National Capital Region (NCR) and the Calabarzon area.

Table 1a. Number of Establishments, by Size and Industry, 2008.

	TOTAL	Micro	Small	Medium	Large
PHILIPPINES	**761,409**	**697,077**	**58,292**	**3,067**	**2,973**
Agriculture, Hunting and Forestry	3,985	2,526	1,197	131	131
Fishing	1,306	897	358	25	26
Mining and Quarrying	340	209	102	10	19
Manufacturing	112,377	100,605	9,763	940	1,069
Electricity, Gas and Water	1,388	479	688	117	104
Construction	2,202	1,184	832	98	88
Wholesale and Retail Trade	379,005	360,798	17,468	448	291
Hotels and Restaurants	93,405	85,764	7,382	198	61
Transport, Storage and Communications	8,647	6,366	2,016	151	114
Financial Intermediation	25,766	20,733	4,794	120	119
Real Estate, Renting and Business Activities	45,060	40,115	4,016	366	563
Education	13,562	7,242	5,802	293	225
Health and Social Work	31,113	29,633	1,261	116	103
Other Community, Social and Personal Service Activities	43,253	40,526	2,613	54	60

Source: National Statistics Office.

Table 1b. Percentage Distribution

Industries	TOTAL	Micro	Small	Medium	Large	SMEs
Agriculture, Hunting and Forestry	0.52	0.36	2.05	4.27	4.41	2.16
Fishing	0.17	0.13	0.61	0.82	0.87	0.62
Mining and Quarrying	0.04	0.03	0.17	0.33	0.64	0.18
Manufacturing	14.76	14.43	16.75	30.65	35.96	17.44
Electricity, Gas and Water	0.18	0.07	1.18	3.81	3.5	1.31
Construction	0.29	0.17	1.43	3.2	2.96	1.52
Wholesale and Retail Trade	49.78	51.76	29.97	14.61	9.79	29.2
Hotels and Restaurants	12.27	12.3	12.66	6.46	2.05	12.35
Transport, Storage and Communications	1.14	0.91	3.46	4.92	3.83	3.53
Financial Intermediation	3.38	2.97	8.22	3.91	4	8.01
Real Estate, Renting and Business Activities	5.92	5.75	6.89	11.93	18.94	7.14
Education	1.78	1.04	9.95	9.55	7.57	9.93
Health and Social Work	4.09	4.25	2.16	3.78	3.46	2.24
Other Community, Social and Personal Service Activities	5.68	5.81	4.48	1.76	2.02	4.35
Total	**100**	**100**	**100**	**100**	**100**	**100**

Source: Based on Table 1a.

In terms of distribution by sector, most establishments are in the wholesale and retail trade sector, notably in the micro category. As Table 1b shows, this sector accounted for almost 50 percent of the total number of establishments, followed by manufacturing with a share of about 15 percent. The hotels and restaurants sector is third with a share of 12 percent.

Among SMEs, wholesale and retail trade also dominates, with a share of around 30 percent, followed by manufacturing with a share of 17 percent of the total number of SMEs. On the other hand, among large enterprises, manufacturing comprised the bulk, at 36 percent of the total number of large enterprises.

In terms of employment, Table 2 shows that SMEs contributed 31 percent of the total number of workers in all establishments. Among SMEs, manufacturing and wholesale and retail trade accounted for about 22 and 23%, respectively. Among large enterprises, manufacturing jobs also comprised the bulk, with a share of 37 percent of the total. Meanwhile, for micro-enterprises, jobs generated by the wholesale and retail trade comprised the bulk with a share of 47 percent while manufacturing jobs contributed only 15 percent of the total.

Table 2a. Employment Distribution by Size and Industry, 2008

Industry Sector	TOTAL	Micro	Small	Medium	Large
PHILIPPINES					
Agriculture, Hunting and Forestry	5,544,590	1,663,382	1,314,065	418,058	2,149,085
Forestry	146,696	9,371	32,256	18,086	86,983
Fishery	27,654	3,404	8,228	3,710	12,312
Mining and Quarrying	20,732	820	2,660	1,340	15,912
Manufacturing	1,429,370	255,021	251,146	128,853	794,350
Electricity, Gas and Water	89,425	2,419	20,000	16,840	50,166
Construction	116,254	4,752	23,822	13,908	73,772
Wholesale and Retail Trade	1,323,518	789,758	341,545	60,412	131,803
Hotels and Restaurants	452,068	222,931	174,327	25,983	28,827
Transport, Storage Communications	192,111	23,802	50,987	20,559	96,763
Financial Intermediation	395,346	77,935	86,061	14,857	216,493
Real Estate, Renting and Business Activities	694,549	99,582	95,463	49,448	450,056
Education	329,681	29,833	147,259	40,310	112,279
Health and Social Work	145,235	49,068	30,342	16,432	49,393
Other Community, Social & Personal Service	181,951	94,686	49,969	7,320	29,976

Source: National Statistics Office.

Table 2b. Percentage Distribution

Industries	TOTAL	Micro	Small	Medium	Large	SMEs
Agriculture, Hunting and Forestry	2.65	0.56	2.45	4.33	4.05	2.91
Fishing	0.5	0.2	0.63	0.89	0.57	0.69
Mining and Quarrying	0.37	0.05	0.2	0.32	0.74	0.23
Manufacturing	25.78	15.33	19.11	30.82	36.96	21.94
Electricity, Gas and Water	1.61	0.15	1.52	4.03	2.33	2.13
Construction	2.1	0.29	1.81	3.33	3.43	2.18
Wholesale and Retail Trade	23.87	47.48	25.99	14.45	6.13	23.21
Hotels and Restaurants	8.15	13.4	13.27	6.22	1.34	11.56
Transport, Storage and Communications	3.46	1.43	3.88	4.92	4.5	4.13
Financial Intermediation	7.13	4.69	6.55	3.55	10.07	5.83
Real Estate, Renting and Business Activities	12.53	5.99	7.26	11.83	20.94	8.37
Education	5.95	1.79	11.21	9.64	5.22	10.83
Health and Social Work	2.62	2.95	2.31	3.93	2.3	2.7
Other Community, Social and Personal Service Activities	3.28	5.69	3.8	1.75	1.39	3.31
Total	100	100	100	100	100	100

Source: Based on Table 2a.

Note that medium enterprises constitute a small share not only of the SME sector but also of the total Philippine industrial structure. As such, the country's industrial structure has often been characterized as "hollow" or missing in the middle. The same is true for manufacturing industry.

Table 3. Distribution of Number of Enterprises and Employees by Size Structure

Year	Micro	%	Small	%	Medium	%	Large	%	Total
1995	1,345,175	31	945,401	22	366,890	8	1,664,076	39	4,321,603
2000	2,165,100	37	1,522,227	26	416,686	7	1,798,173	30	5,902,256
2003	2,214,278	34	1,556,206	24	485,891	8	2,218,419	34	6,474,860
2006	1,667,824	33	1,279,018	26	381,013	8	1,657,028	33	4,984,950
2007	1,661,884	32	1,297,792	25	396,066	8	1,832,051	35	5,187,793
2008	1,663,382	30	1,314,065	24	418,058	8	2,149,085	39	5,544,590
2009	1,731,082	30	1,449,033	25	415,526	7	2,094,298	37	5,689,939

Source: National Statistics Office.

In terms of value added, the MSME sector contributed 35.7% of the total with manufacturing contributing the largest share of 6.87%. Wholesale and retail trade and repair contributed 6.58% followed by financial intermediation with a share of 6%. Within the sector, small enterprises accounted for the largest share of 20.5%. Medium enterprises followed with a share of 10.3% while micro enterprises registered a share of 4.9%. Among small enterprises, wholesale and retail trade and repair contributed the most with a share of 4.07% followed by manufacturing with a share of 3.82% while financial intermediation was next with a share of 3.35%. For medium enterprises, manufacturing accounted for the biggest share of 2.77% followed by electricity, gas and water with a share of 1.92% and financial intermediation with 1.87%. For micro enterprises, wholesale and retail trade and repair represented the largest contribution of 1.73%.

Table 4. Value Added Structure, 2006

Total (in million pesos)	Total 2,108,546	Micro 103,918	Small 431,340	Medium 216,685	Large 1,356,603	MSMEs 751,943
Agriculture; hunting and forestry	0.79	0.01	0.22	0.09	0.47	0.32
Fishing	0.15	0	0.02	0.02	0.1	0.04
Mining and quarrying	1.86	0.92	0.01	0.4	0.53	1.33
Manufacturing	32.91	0.28	3.82	2.77	26.05	6.87
Electricity; gas and water	8.35	0.02	2.92	1.92	3.49	4.86
Construction	1.64	0.02	0.46	0.23	0.92	0.72
Wholesale and retail trade; repair of motor vehicles; motorcycles and personal and household goods	8.24	1.73	4.07	0.78	1.66	6.58
Hotels and restaurants	1.91	0.16	1.1	0.2	0.46	1.46
Transport; storage and communications	14.09	0.11	1.58	0.65	11.76	2.33
Financial intermediation	16.21	0.8	3.35	1.87	10.19	6.02
Real estate, renting and business activities	7.67	0.62	1.56	0.71	4.78	2.88
Education	3.15	0.08	0.84	0.45	1.78	1.37
Health and social work	1.18	0.08	0.18	0.13	0.79	0.4
Other community; social and personal service activities	1.85	0.09	0.34	0.06	1.36	0.49
Total	100	4.9	20.5	10.3	64.3	35.7

Source: National Statistics Office.

Within manufacturing, the large bulk of Philippine enterprises are micro-enterprises, which comprised 90% of the total in 2006, while SMEs and large enterprises accounted for 10% and 1% of the total number of manufacturing enterprises, respectively. Firms in the food and beverages sector dominated, with a share of 47%, followed by wearing apparel (13%) and fabricated metal products excluding machinery and equipment (11%).

Table 5. Manufacturing Establishments by Size and Sector, 2006

Manufacturing Sub-sector	Total	%	Micro	%	SMEs	%	Large	%
Food Products and Beverages	55189	47.03	51882	44.21	3125	2.66	182	0.16
Tobacco Products	26	0.02			15	0.01	11	0.01
Textiles	1497	1.28	1122	0.96	342	0.29	33	0.03
Manufacture of Wearing Apparel	15759	13.43	14379	12.25	1244	1.06	136	0.12
Tanning and Dressing of Leather, Manufacture of Luggage, Handbags and Footwear	1590	1.35	1240	1.06	333	0.28	17	0.01
Wood, Wood Products & Cork, except Furniture; Articles of Bamboo, Cane, Rattan & the like	3440	2.93	3004	2.56	416	0.35	20	0.02
Paper and Paper Products	559	0.48	252	0.21	285	0.24	22	0.02
Publishing, Printing and Reproduction of Recorded Media	3887	3.31	3023	2.58	850	0.72	14	0.01
Coke, Refined Petroleum and Other Fuel Products	18	0.02			15	0.01	3	0
Chemicals and Chemical Products	1133	0.97	485	0.41	601	0.51	47	0.04
Rubber and Plastic Products	1291	1.1	651	0.55	589	0.5	51	0.04
Other Non-Metallic Mineral Products	5179	4.41	4693	4	450	0.38	36	0.03
Basic Metals	1050	0.89	658	0.56	361	0.31	31	0.03
Fabricated Metal Products except Machinery and Equipment	13024	11.1	12304	10.49	682	0.58	38	0.03
Machinery and Equipment Not Elsewhere Classified	3020	2.57	2428	2.07	570	0.49	22	0.02
Office, Accounting and Computing Machinery	73	0.06	9	0.01	43	0.04	21	0.02
Electrical Machinery and Apparatus, nec	290	0.25	67	0.06	183	0.16	40	0.03
Radio, Television and Communication Equipment and Apparatus	263	0.22	24	0.02	119	0.1	120	0.1
Medical Precision and Optical Instruments, Watches and Clocks	122	0.1	42	0.04	55	0.05	25	0.02
Motor Vehicles, Trailers and Semi-Trailers	703	0.6	536	0.46	139	0.12	28	0.02
Other Transport Equipment	425	0.36	330	0.28	82	0.07	13	0.01
Manufacture and Repair of Furniture	7227	6.16	6624	5.64	564	0.48	39	0.03
Recycling	92	0.08	58	0.05	34	0.03	0	0
Manufacturing, Not Elsewhere Classified (nec)	1489	1.27	1263	1.08	207	0.18	19	0.02
Total	117346	100	105074	89.54	11304	9.63	968	0.82

Source: National Statistics Office.

Table 6 indicates that from 1999 to 2006, the total number of SMEs in manufacturing declined from 15,748 to 11,278. The share of SMEs to the total also dropped from 12% in 1999 to only 9.6% in 2006. Table 7 shows that in terms of employment contribution, the number of workers in SMEs also declined between 1999 and 2006 from 516,506 workers to 385,263. The share of SMEs declined from 31% in 1999 to 28% in 2006.

Table 6. Number of Manufacturing Establishments by Size, 1999-2006

Year	Micro	%	SMEs	%	Large	%	TOTAL
1999	113861	87	15748	12	1322	1	130931
2000	108998	86.9	15231	12.1	1238	1	125467
2001	108986	88	13615	11	1194	1	123795
2002	108847	88.5	13148	10.7	982	0.8	122977
2003	107398	88.6	12763	10.5	1024	0.8	121184
2004	103926	88	13081	11.1	1120	0.9	118127
2005	103982	88.6	12392	10.6	1008	0.9	117382
2006	105083	89.5	11278	9.6	985	0.8	117346

Source: National Statistics Office.

Table 7. Manufacturing Employment by Size, 1999-2006

Year	Micro	%	SMEs	%	Large	%	TOTAL
1999	366689	21.9	516506	30.8	791277	47.3	1674472
2000	354025	22.3	505062	31.8	730127	45.9	1589214
2001	353415	23	446600	29.1	734088	47.9	1534103
2002	353255	24.1	437490	29.8	676443	46.1	1467188
2003	360576	24.7	403923	27.6	698173	47.7	1462672
2004	327112	21.3	432869	28.2	775969	50.5	1535950
2005	323510	22.1	408100	27.9	731736	50	1463346
2006	259664	18.9	385263	28.1	727984	53	1372911

Source: National Statistics Office.

In terms of value added, the share of small and medium enterprises (SMEs) increased from 23 percent of the total manufacturing value added in 1994 to 28 percent in 1998 (see Table 8). However, this fell to 21 percent in 2003. Large firms contributed 79 percent of the total, an increase from their 72 percent contribution in 1998.

Table 8. Manufacturing Value-added Contribution by Size, 1994, 1998, 2003 and 2006

Year	1994		1998		2003		2006 *	
Size	SMEs	Large	SMEs	Large	SMEs	Large	SMEs	Large
Total	23	77	28	72	21	79	20	80
Value-added current prices (in billion Php)	324.2		664.2		738.95		688.06	

Source: National Statistics Office

Note: *2006 covers only the formal sector of the economy.

Table 9 presents the contribution of the different manufacturing sub-sectors to total value added in 2003. Among SMEs, the largest contribution was posted by the food processing and manufacturing sub-sector with a share of 21 percent. This is followed by industrial chemicals and other chemicals with a share of 16 percent. Non-electrical and electrical machinery is next with a share of around 10 percent. Transport and garments registered the same share, of about 5 percent each.

Table 9. Manufacturing Value Added Contribution by Sector (in %), 2003

Manufacturing Sector	Micro	SMEs	Large	Total
Total(in million pesos), 2003	24298	155072	583878	763248
2006*	5965	138869	549187	694021
Food Processing	9.96	10.12	7.81	8.35
Food Manufacturing	24.56	10.76	5.45	7.13
Beverages	4.54	5.23	6.29	6.02
Tobacco	0	0.05	2.99	2.3
Textiles	0.4	3.43	1.15	1.59
Wearing Apparel ex Footwear	13.65	4.7	2.82	3.55
Leather and Leather Products	0.03	0.35	0.68	0.59
Leather Footwear	3.05	0.24	0.04	0.17
Wood and Cork Products	3.37	1.95	0.38	0.79
Furniture except Metal	6.01	3.11	0.45	1.17
Paper and Paper Products	0.16	4.05	1.25	1.78
Printing and Publishing	5.29	2.94	0.65	1.26
Industrial Chemicals	0.6	8.99	1.29	2.83
Other Chemicals	1.01	7.21	6.86	6.75
Petroleum Refineries	0	0	18.38	14.06
Petroleum and Coal Products	0.03	0.1	0	0.02
Rubber Products	3.2	1.05	0.66	0.82
Plastic Products	0.63	4.54	1.22	1.87
Pottery, China and Earthenware	0.25	0.35	0.32	0.32
Glass and Glass Products	0.04	0.85	0.64	0.66
Cement	0	0.03	2.32	1.78
Other Nonmetallic Mineral Prods	3.76	1.99	0.42	0.85
Iron and Steel	1.02	4.41	0.88	1.6
Nonferrous Metal Products	0.03	1.01	1.16	1.1
Fabricated Metal Products	11.2	4.36	1.09	2.08
Machinery except Electrical	3.66	2.9	6.82	5.93
Electrical Machinery	0.49	6.9	20.14	16.82
Transport Equipment	1.98	4.81	5.56	5.29
Professional and Scientific Eqpt	0.1	0.53	1.78	1.47
Miscellaneous Manufacture	0.98	3.05	0.5	1.03
Total Share (in %)	100	100	100	100

Source: National Statistics Office.

Note: *2006 covers only the formal sector of the economy.

Table 10 presents labor productivity as measured by value added per worker in the manufacturing industry for the years 1994, 1998 and 2003. On the whole, though an increase in the labor productivity of both SMEs and large enterprises was registered between the years 1994 and 1998, the same fell in 2003. For SMEs, labor productivity dropped from P139,000 to P97,000 while for large enterprises, labor productivity declined from P227,000 to P211,000.

Table 10. Labor Productivity: 1994, 1998, 2003 and 2006

Year	1994		1998		2003		2006*	
Establishment Size	SMEs	Large	SMEs	Large	SMEs	Large	SMEs	Large
Labor Productivity In PhP million at 1985 prices	0.11	0.196	0.139	0.227	0.097	0.211	0.064	0.118

Source: Own calculations using National Statistics Office data.

Note: *2006 figures are not comparable with the rest of the years, the 2006 Annual Survey of Establishments covers only the formal sector of the economy

In general, the labor productivity of SMEs has remained at only about half the labor productivity of large enterprises. Some narrowing of the gap was evident in 2003, but , SMEs still suffer from low productivity. According to the Financial Investment Advisory Service (FIAS), World Bank and IFC (2005), the value added per worker relative to all firms was approximately 46% in the Philippines as compared to 64% in Indonesia, 65% in Malaysia, and 84% in Thailand.

3. Government Policies and Programs for SMEs

3.1. Overall Policy Framework

Since the 1970s, the Philippine government has devoted considerable effort to supporting and promoting SME development through a variety of schemes and agencies, covering numerous programs and policies on financing, market improvement, technology transfer, and entrepreneurship. During the seventies, which were characterized by government protectionist policies, SMEs did not grow substantially due to two major factors: (i) very few SMEs made use of the incentives and services available to them; and (ii) formal lending bodies had very little involvement in SMEs because of the perceived risks and high costs associated with processing and supervising their projects.

With the government's trade liberalization policies in the eighties, SMEs started to face a more competitive business environment. During this period, the government adopted market improvement strategies to increase market access and expand the domestic market for SMEs. To achieve this, the government focused on the creation of subcontracting linkages, provision of financing and guarantees to exporters as well as common market facilities, market intelligence and information access, and identification of local market centers and rural transport facilities.

In the nineties, the government's SME policy focused on market access, export expansion, identification of specialization, entrepreneurship and management, technology and quality systems and domestic linkages. The most important piece of SME legislation, the Magna Carta for Small Enterprises, was passed in January 1991. Representing landmark legislation, the Magna Carta (RA 6977) aimed to consolidate all government programs for the promotion and development of SMEs into a unified institutional framework.

The Magna Carta may be highlighted by the following provisions: (i) creation of the Small and Medium Enterprise Development (SMED) Council to consolidate incentives available for SMEs; (ii) creation of the Small Business Guarantee and Finance Corporation (SBGFC) to address SME financing needs; and (iii) allocation of credit resources to SMEs by mandating all lending institutions to set aside 8% of their total loan portfolio to SMEs (6% for small and 2% for medium enterprises). RA 6977 was amended by RA 8289 in 1997 to further strengthen the promotion and development of, and assistance to, small and medium enterprises.

The Department of Trade and Industry (DTI) is the main government agency responsible for the development and regulation of Philippine SMEs, including micro and large enterprises. There are various DTI-attached agencies set up with 14 offices and 20 line bureaus mandated to support SMEs and SME exporters. The SMED Council formulates SME promotion policies and provides guidance and direction in implementing SME programs. It is a multi-agency group chaired by the DTI Secretary. The Bureau of Micro, Small and Medium Enterprises Development (BMSMED) leads

DTI's SME Core Group and coordinates SME policies, programs and projects. It acts as a "one-stop-shop" to guide SMEs to specialized support agencies. The BMSMED is also the secretariat to the SMED Council tasked to review policies and strategies for SME development.

In 2001, the Small Business Guarantee and Finance Corporation (SBGFC) was merged with the Guarantee Fund for Small and Medium Enterprises (GFSME) through EO 28 and became known as the Small Business Corporation (SBC). It registered a total of P728 million in loan approvals in 2002, exceeding its previous highest approval level of P180 million in 1999. The SBC is considered as the National Government's largest provider of SME financing, with a lending portfolio of over P3 billion. It has more than 3,000 clients and 71 partner financial institutions serving 57 (out of 75) provinces in the country.

In order to provide SMEs with greater access to capital, the Small Business Guarantee and Finance Corporation (now called Small Business Corporation) developed a lending program in 2003, known as SME Unified Lending Opportunities for National Growth (SULONG). The Program is a collaboration among government financial institutions consisting of the Land Bank of the Philippines, the Development Bank of the Philippines, the Small Business Corporation, the Quedan and Rural Credit Corporation, the Philippine Export-Import Credit Agency, and the National Livelihood Support Fund. Interest rates are fixed at 9% per annum for short-term loans, 11.25% per annum for medium-term loans and 12.75% per annum for long-term loans. The program funds export financing and temporary working capital with short-term loans, as well as permanent working capital, equipment or lot purchase or building/warehouse construction with long-term loans. More than PHP 35.3 billion (US640 million) in loans have been released to 368,000 SMEs since 2003.

Under the One Town One Product (OTOP) Program of the government, PHP 1 million (US$ 18,200) will be allocated for lending to an SME in every locality, through identified funding sources. The DTI, in coordination with local government units, identifies a product or service cluster for funding support. SMEs that offer such product or service are eligible to apply for a loan with a maximum effective interest rate of 10% per annum. The OTOP Program offers a comprehensive assistance package through local government units (LGUs), national government agencies and the private sector, covering business counseling, appropriate technologies, skills and entrepreneurial training, marketing, and product design and development.

In 2002, RA 6977 was further amended by RA 9178 or the Barangay[1] Micro Business Enterprises (BMBE) Act. The latter provides support to micro-enterprises and the informal sector through incentives to local government registered barangay micro enterprises, exemption from income tax, reduction in local taxes, exemption from payment of minimum wages, financial support from government financial institutions and technological assistance from government agencies.

With respect to microfinance lending, the government created the People's Credit and Finance Corporation (PCFC) as a government-owned finance company registered with the Securities and Exchange Commission on September 14, 1995. PCFC is the only government agency mandated by law to provide microfinance lending. It provides wholesale funds to retail microfinance institutions consisting mostly of rural banks/cooperative rural banks, cooperatives, and non-government organizations.

Under Republic Act 9510 or the Credit Information System Act (CISA) which was legislated in October 2008, a centralized credit bureau, to be known as the Central Credit Information Corporation (CICC), would be created to provide information for the local banking industry, as well as other financial institutions, to use so as to determine the credit worthiness of their borrowers more efficiently. Those with "clean" records may get charged lower interest rates and be encouraged to borrow, while those with poor records will be penalized with a higher risk premium, and would be unable to borrow. According to the World Bank[2], the establishment of a credit bureau will increase the probability of small firms accessing financing from 28% without a credit bureau to 40%. It will also reduce financing constraints for small firms. By sharing credit information, the efficiency of banks in processing loan applications will increase by 43% while the default rate will drop significantly, to two percent. The PSBank (June 2010) noted that apart from improving the overall availability of credit particularly for MSMEs and providing mechanisms to make credit more cost-effective, the credit

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[1] Barangay or village is the smallest unit of administration in Philippine local government.
[2] As cited in Philippine Star, "Proposed credit info bureau still in limbo after two years" by Ted Torres, 24 March 2010.

information system is expected to reduce excessive dependence on collateral to secure credit facilities. However, while it's implementing rules and regulations were already approved in May 2009, the CICC is still not operational.

It is important to note that despite the government's financing programs and mandatory credit allocation to small and medium enterprises, access to finance has remained a major constraint to SME growth and development, as the volume of funds for SME lending has been inadequate for their needs. The success of government sponsored lending programs has been limited because much of the funds from these lending programs are directed not to real SMEs but more toward livelihood and micro-enterprise projects, many of which fail to grow. The government's Small Business Corporation has very limited coverage in terms of areas reached, and complaints abound on the long time it takes to evaluate proposals. Additionally, Government programs do not provide funds for start-up companies.

Although banks appear to be generally complying with the mandatory lending to SMEs, with a total compliance rate reaching almost 29 percent in 2002; these loan funds, particularly from large banks and financial institutions, hardly benefited small firms. Anecdotal evidence shows that much of this money does not actually go to SMEs but to some large firms that deliberately understate their assets so as to be classified as small or medium enterprises. Foreign banks and large domestic banks comply with the requirement by depositing the required amount with the Bangko Sentral ng Pilipinas (BSP), instead of exerting efforts to look for SME borrowers (Lamberte 2001). Meanwhile, some rural banks cite difficulties in finding medium enterprises in the small towns where they operate. Mostly, banks would rather pay the fine than set aside non-income-generating funds for lending to medium enterprises.

3.2. Sources of Financing for SMEs

The banking system has been structured into commercial, thrift, and rural banks in order to provide loans not only to large borrowers but also to cover the needs of smaller borrowers including SMEs. Thrift banks and rural banks were granted incentives (such as reduced capital requirements, lower reserve requirements and access to rediscount facilities from the central bank) for locating outside Metro Manila and providing banking services in the provinces, particularly to small enterprises. Thrift banks and private development banks were mandated to lead in meeting the long and short-term financing needs of SMEs for investment and working capital. However, private development banks have been unsuccessful, due to their limited resources and their reliance on government financial institutions for a substantial part of their funding requirements. Nangia and Vaillancourt (2007) indicated that despite incentives to disperse them, thrift banks have remained geographically concentrated in Metro Manila. Thrift banks were also constrained even more by their limited resources. Private development banks also often establish minimum lending levels that deter many SMEs. Commercial banks have been the largest sources of financing for SMEs. Note that they need to meet the mandatory credit requirement under RA 6977. In more recent years, they have shown increasing interest in SME lending. Note also that apart from their own resources, commercial, thrift, and rural banks use wholesale credit lines from government financial institutions (GFIs) and donor funds.

Development finance institutions such as the Development Bank of the Philippines have direct lending programs for both small and large enterprises, using credit lines provided by donors and the government. Other GFIs that provide direct lending include the Land Bank of the Philippines, SBGFC, the Philippine Export-Import Credit Agency (PhilEXIM), as well as the Sulong Program by Quedancor. Government agencies like the Department of Science and Technology (DOST) and DTI also provide direct lending. There are also private foundations and business associations which provide funds through rural banks, non government organizations (NGOs) and cooperatives, that targeting micro-enterprises more than SMEs. Other sources of funds include lease financing and loans from non-bank financial intermediaries like leasing and finance companies and some limited investments by venture capital companies targeted at medium enterprises.

Banks along with GFIs like the Development Bank of the Philippines (DBP) and Land Bank of the Philippines (LBP) are the main providers of SME loans. They provide loans of all sizes ranging from P150,000 to P100 million. Though some commercial banks go down to as little as P1 million, in general commercial banks rarely lend below the range P5-10 million because smaller loans are assumed to be unprofitable. On the other hand, only a small number of rural banks lend beyond P150,000 (the limit for micro credit) due to their limited capital and capacity. Lending is thus limited in the

P150,000 to P5 million range. Note, however, that the standard loan conditions apply on all loans (whether P150,000 or P5 million) and none of the exemptions available for micro-loans apply to SME loans. For micro credit, BSP relaxes its regulations on adverse classification and loss provisioning for loans with inadequate collateral and incomplete documentation. Nangia and Vaillancourt (2007) argue that some of the conditions (or lack of them) which have encouraged the growth of micro credit in recent years have not been changed for SME loans, and this has contributed to their insufficient financing levels. Llanto and Lamberte referred to this as the "missing middle" or missing market for financial services arising from the failure of smaller banks to move up to keep up with larger financing needs of enterprises.

As of September 2010, the Bangko Sentral ng Pilipinas (BSP) reported that total banks' allocation of credit resources to MSMEs amounted to P289.1 billion, of which P152.5 billion went to micro and small enterprises and P136.6 billion to medium enterprises. In 2009, total lending amounted to P309.4 billion. Meanwhile, the government's SULONG Program released a total of P15.3 billion in loans as of June 2010. As Table 11b shows, the bulk was accounted for by the Land Bank of the Philippines (56.5% share) together with the Development Bank of the Philippines (31%) during the period 2004 to June 2010. The PCFC reported a total amount of loans released of about P191.5 billion during the period 2004 to October 2010.

Table 11a. Compliance Report: Bank Lending Under RA 6977 (in million Pesos)

Micro, Small And Medium Enterprises Credit (8% & 2%) [2]	2002	2005	2007	2009
Total Loan Portfolio Net of Exclusions	**943,850**	**1,095,531**	**1,339,735**	**1,728,628**
Direct Compliance for MSMEs	233,259	226,170	239,511	305,952
Alternative/Indirect Compliance for MSMEs	38,771	14,689	15,724	3,403
Funds Set Aside for MSMEs [3]	11,069	13,176	8,660	-
Total Compliance for MSMEs	**283,099**	**254,035**	**263,895**	**309,356**
Percentage of Compliance for MSMEs	**29.99**	**23.19**	**19.7**	**17.9**

Source: Supervisory Data Center, Bangko Sentral ng Pilipinas.

[1] The mandatory credit allocation is presently at 8% for Micro and Small Enterprises and 2% for Medium Enterprises pursuant to R.A. No. 9501 of 2008. Prior to R.A. No. 9501, the Magna Carta was based on R.A. No. 6977, as amended by R.A. No. 8289, with a lower mandatory credit allocation of 6% covering only Small Enterprises with same 2% for Medium Enterprises.
[2] Any discrepancy between the computations of the constituent items and the figures shown above may be attributed to the rounding of numbers.
[3] Consists of either Cash on Hand or Due from BSP which are free, unencumbered, not hypothecated, not utilized or earmarked for other purposes. The Due from BSP is a special account deposited with the BSP and does not form part of the bank's legal reserves. Under the new mandatory credit allocation (R.A. No. 9501), Funds Set Aside is no longer considered as a mode of compliance.

Table 11b. SULONG Program Loan Releases (in million Pesos)

GFI	2004	2005	2006	2007	2008	2009	10-Jun	Total
DBP	9872.1	10488.1	11051.1	8514.5	11630.5	7592.1	4108.1	63256.6
LBP	12559.5	17431.3	16214.4	16352.8	20001.4	21883.3	9986.9	114429.6
NLDC	115.2	25.3	59.5	46.7	36.1	32.3	9.1	324.3
PhilEXIM	404	154	201.6	327.8	283.1	275.8	93.9	1740.1
QUEDANCOR	831.4	559.7	1133.5	548.2	184.5	14.5	0	3271.7
SBGFC	3268	2939.2	3443	2689.7	3004.8	1825.2	1057.1	18227
SSS	166	129	303.6	96.6	455.5	186	50.2	1386.9
TOTAL	27216.3	31726.6	32406.6	28576.3	35595.8	31809.3	15305.3	202636.3

Source: DTI-BMSMED.

Equity financing through the Philippine stock market is still in its infancy stage. The Initial Public Offering (IPO) requirements, for instance, are too formidable for SMEs. These include authorized capital of P20-100 million (US$460,000-2.3 million), 25% paid-up, net tangible assets of at least P5 million (US$115,000), and being operational for at least two years with positive operating income.

So far, the largest proportion of SME funding comes from the personal resources of business owners and their family members including internal accruals as well as borrowings from relatives and friends and loans from informal lenders. Bank financing represents a very small proportion of both start-up capital and the current financing needs of SMEs, which reflects the difficulties faced not only by SMEs in obtaining loans from banks and other formal sources, but also the unwillingness of many owners to secure loans from formal and informal lenders.

Given the limited official data on SME financing, survey results from various sources (the Small Enterprise Research and Development Foundation or SERDEF of the University of the Philippines-Institute for Small Scale Industries, the National Confederation of Cooperatives (NATCCO), the World Bank, the Asian Development Bank, and the International Finance Corporation) were compiled to provide information on the funding sources of SMEs. These surveys also focused on SME access to finance and asked basically similar questions. As Table 12 shows, 53% to 73% of the surveyed firms relied on own resources for their initial funding. Only 10 to 19% relied on bank loans while 11 to 28% used informal credit. In terms of their current funding, 52% to 78% of firms still relied on own resources while 15% to 21% used bank loans. For 7 to 29% of the firms, current funding depended on informal credit. Overall, the results showed significant dependence of SMEs on internal sources for financing, and a relatively lower share of borrowings from banks and other financial institutions.

Table 12. Initial and Current Funding Sources for SMEs based on Surveys (% of firms)

Source	Initial Funding (%)		Current Funding (%)			
	SERDEF	NATCCO	SERDEF	WBES	ICPS	PEP
	1992	1998	1992	2000	2004	2006
Own resources	79	53	78	52	60	69
Bank loans	10	19	15	21	11	19
Informal credit	11	28	7	27	29	12
Total	100	100	100	100	100	100

Source: Culled from Nangia and Vaillancourt (2007).

Notes:

- SERDEF (UP-ISSI): A Study on Financial Intermediation for SMEs in 7 Regions of the Philippines (1992); NATCCO: National Confederation of Cooperatives. Lending and Borrowing Patterns for MSMEs (1998); WBES: World Business Environment Survey (2000); ICPS (ADB): Investment Climate & Productivity Study (2004); PEP Philippines (IFC): SME Finance Survey (2006).
- SERDEF: 372 SMEs in manufacturing and services located in 7 regions
- NATCCO: 383 MSMEs (large majority – 79% micro enterprises) from 6 regions
- WBES: World Bank Enterprise Survey
- ICPS: 800 small, medium & large firms in 4 manufacturing industries (food, garments, textiles, & electronics & electrical equipment) located in 4 regions of NCR, Calabarzon, Davao, & Cebu.
- PEP: 187 SMEs from Luzon and Mindanao and engaged in non-agricultural production

3.3. Finance Issues and Challenges

The draft MSME Plan for 2010-2016 indicated that despite the availability of funds for lending, MSMEs find it difficult to access these funds. Based on consultations with various stakeholders, concerns were raised regarding the inability of enterprises, particularly the smaller ones, to access funds due to the stringent and voluminous requirements of financial institutions. Firms find it hard to borrow due to the collateral requirements and the long time it takes to process their loan applications. MSMEs also find the minimum loan requirement and short repayment period too restrictive, and loan restructuring difficult. Firms also pointed out the high interest rates charged by financial institutions to MSMEs, the lack of funds for start-up MSMEs in some regions, the lack of access to venture capital funds, the absence of financial packages for MSMEs in some regions, and the limited access to information on fund sources for MSMEs.

Meanwhile, banks expressed their concerns about the bankability of MSMEs and the high risks involved in MSME lending. Banks believe that MSMEs in some regions lack appropriate financial management capacity. Both the banking sector and the MSMEs noted the inadequacy of government policies to address these concerns.

The previous SME Development Plan (2004-2010) also highlighted the same finance issues. The overemphasis on collateral has been a major impediment to SME development. With collateral coverage as the primary condition of lenders, project feasibility is practically ignored. The lack of credit information and highly centralized examination system have led to long loan processing times, and created project delays and backlogs. Furthermore, most SMEs are not able to comply with borrowing conditions such as the submission of financial statements and business plans. Banks seldom provide assistance on loan applications, and many do not have trained personnel to extend this service.

Note, however, that the experience of the Philippine Planters Development Bank illustrates a successful case of private bank lending geared towards SMEs. Planstersbank has shown that the above challenges can be overcome (Aldaba 2008). In lending to SMEs, Planters went beyond banking by providing non-financial services to help its SME clients strengthen their operations, including assistance in preparing accounting records, business advice, and networking. Planters customized designed and customized its products and services to suit the needs of SMEs. It also simplified its loan documentation and tailor fitted loans to match borrowers' cash flows.

Philippine SME studies have continued to highlight the same major constraints that affect SME development, covering access to finance along with issues on technology, skills, information gaps and difficulties in product quality and marketing (FINEX and ACERD, 2006; Tecson, 2004; Fukumoto, 2004). In these studies, the lack of access to financing is highlighted as the most difficult constraint to SME growth. The FINEX and ACERD study pointed out that the problem seems to lie not in the supply of funds potentially available for SME lending but in the difficulty of access to these funds. In theory, there should be sufficient funds for SME financing, since banks are required by law to allocate 8 percent of their loan portfolios to SMEs. At the same time, government financial institutions have their own SME financing programs. Nevertheless, private banks are reluctant to lend to SMEs because of their general aversion to dealing with a larger number of smaller accounts. Moreover, many banks are still not aware of the need for lending to small businesses. Many SMEs cannot access available funds due to their limited track records, limited acceptable collateral, and inadequate financial statements and business plans. Based on a survey of MSMEs, Tecson (2004) noted that SMEs complained that banks still considered their projects' bankability rather than viability, leading them to rely on collateral lending.

The country's underdeveloped financial markets also represent a formidable barrier, not just to the entry of new enterprises but also to the growth prospects of small and medium sized firms. The absence of a deep liquid peso financial market contributes to the high cost of investment and makes it more difficult for enterprises to expand. Note, however, that financing constraints do not affect all firms equally, with access to financial credit being a particular problem affecting SMEs (Maxwell Stamp PLC, 2001). Based on a survey of SMEs, Hapitan (2005) concluded that SMEs still face difficulties in credit access, particularly from foreign banks. This, the study found, is the result of accessibility problems in terms of branch location and the absence of information on the availability of credit facilities.

Lamberte (2001) argued that since the 1990s, the policy environment for microfinance to develop has improved significantly, and private banks have responded to it positively. However, banks still face some constraints in expanding their services further. These constraints include the inadequacy of infrastructure (electricity and telecommunications) in the country, which increases the cost of providing financial services to MSMEs; limited capital among small banks which sets a ceiling as to how much of their deposits they can mobilize; and competition with government banks and government-owned non-bank financial institutions such as the Small Business Corporation and the People's Credit and Finance Corporation. Moreover, while most rural banks and thrift banks are easily able to allocate 6% of their loan portfolio to small enterprises, they find it hard to comply with the requirement to allocate at least 2% to medium enterprises.

3.4. SME Finance Gap

Access to finance has remained one of the most critical factors affecting the competitiveness of MSMES. Many are unable to qualify for bank loans because they lack the necessary track record and collateral. Moreover, most do not have the financial expertise to manage a healthy cash flow. The lack of credit information has deterred banks from lending to MSMEs. Other factors that have constrained banks from lending to SMEs include a lack of familiarity with the SME business environment, an inability to deal with sub-standard financial record keeping, the absence of business plans, the high cost of collecting information, and limited management capabilities (Nangia and Vaillancourt, 2007). In other words, banks believe that SME lending entails higher risks and larger transactions costs. The cost of lending to SMEs has also been affected by prudential norms and regulations, especially loan recognition and provisioning requirements.

SME financing is to a large extent driven by government policy covering targeted interventions through government financial institutions using private banks as conduits, direct lending by government agencies and corporations, and the mandatory credit requirements of banks. However, despite these programs and policies, the volume of funds for SME lending has remained inadequate for their needs. Nangia and Vaillancourt (2007) estimated the annual volume of unmet demand for SME loans to be about P170 billion (US$3.95 billion). The calculated unmet demand was based on estimates of the current level of SME financing provided by banks, and commonly held benchmarks for the level of funding that should be provided by banks. Using the

International Finance Corporation-Private Enterprise Survey (IFC-PEP) survey data, the authors extrapolated total SME lending demand for capital investments of P157 billion. Based on their survey data, SMEs had around P80 billion in loans outstanding. These figures suggested a lower level of unmet demand for SME lending of about P77 billion (US$1.78 billion). Another estimate of the gap provided by the Philexport suggested around P67 billion (US$.16 billion) while the DTI estimated the SME finance gap at about P180 billion (US$4.2 billion). Using the more updated 2009 total bank lending indicated in Table 11 and applying the IFC-PEP finding that banks provide 21% of the financing needs of SMEs would indicate a finance gap of about P130 billion.

4. Survey Results

4.1. General Characteristics of the Surveyed Firms

A survey of 97 firms was conducted to study the access to finance issues affecting Philippine small and medium enterprises. The firms are located in Central Luzon, one of the three largest regions in the country (together with the National Capital Region and CALABARZON) in terms of employment and value added contribution. 2008 figures showed that in terms of number of enterprises, Central Luzon accounted for 10% of the total, CALABARZON had 15% and NCR 26%. In terms of employment, Central Luzon posted a contribution of around 8%, CALABARZON 16% and NCR 40%. Overall, the three regions accounted for 53% of GDP (NCR with 33%, CALABARZON 12% and Central Luzon 8%).

Due to the limited size of the sample, analyzing the impact of the gap on the performance of SMEs through regression analysis is difficult. For instance, only 32 firms reported that their requests for bank loans, capital leases, equity financing, government financing, and trade credit had been authorized. One firm had withdrawn its application and was considered to have no access to finance. Most of the firm respondents indicated that they had not made any requests for financing. With respect to official statistics, further problems arise due to the lack of reliable data on SME financing, particularly on the volume of loans to SMEs. There are some official aggregates provided by the BSP as well as by other government agencies and regulators but there are no statistics on funding from informal sources.

Table 13 presents a summary of the characteristics of the surveyed firms. The firm respondents are mostly from the garments and textiles industry (60%) followed by food manufacturing (20%), electrical and electronics (12%), and motor vehicle and motorcycle industries (7%). By ownership status, the surveyed firms are mostly 100% domestically owned (77%). 8% are foreign-owned (American, Chinese, Japanese, Korean, and Taiwanese) and 15% are joint venture companies. In terms of age, 30% of the firms are in the age range 6-10 years, 23% are from 11 to 15 years and 20% are from 16 to 25 years. 71% of the surveyed firms have employment from 6 to 49 workers while 11% have 50 to 99 workers.

Table 13. General Characteristics of Surveyed Firms (in %)

	Garments & Textiles	Automotive	Electrical & Electronics	Food & Others	Total
Total Number	**58**	**7**	**12**	**20**	**97**
In %	**60**	**7**	**12**	**21**	**100**
MSME Philippine Definition (number)	**57**	**7**	**12**	**20**	**96**
Micro: 1-9 workers	18	14	17	15	17
Small: 10-99 workers	67	86	75	70	70
Medium: 100-199	7		8	5	6
Large: 200 & above	9			10	7
No response					1
Company Status	**58**	**7**	**12**	**20**	**97**
100% Domestic	86	71	42	75	77
100% Foreign	5	29	17	5	8
Joint Venture	9		42	20	15
Age of Company	**56**	**7**	**12**	**20**	**95**
2-5	17	29	25		16
6-10	30	29	25	35	30
11-15	18	14	33	35	23
16-25	21	29	8	20	20
26-35	11		8	5	8
36-50	4				2
51 - 53				5	1
Company Size	**58**	**7**	**12**	**20**	**97**
1-5 persons	7			5	5
6-49 persons	72	71	58	75	71
50-99 persons	7	29	33	5	11
100-199 persons	5	0	8	5	5
more than 200	9			10	7

Source: Tabulations based on the survey.

The average profit rate remained unchanged at 19% for all industries during the years 2008 and 2009. The profit rates for electrical and electronics together with food manufacturing and others increased during the same years. , For garments and textiles however, the profit rate declined. In 2009, on average, labor as percentage of total cost accounted for 29% for all industries. Raw materials cost registered the largest share at 50%, utilities 12%, and interest payments 5%.

Table 14. Cost Structure for 2009 and 2008

Year 2009	**All**	**Garment & Textiles**	**Automotive**	**Electrical & electronics**	**Food & others**
Total Sales	738,590	723,117	667,337	1,270,013	488,002
Profit (% of sales)	19	20	10	22	17
Labor (% of cost)	29	33	36	18	19
Raw materials	50	45	37	61	61
Utility	12	14	10	6	10
Interest payments	5	5	6	3	5
Other Costs	10	8	13	14	12
Year 2008	**All**	**Garment & Textiles**	**Automotive**	**Electrical & electronics**	**Food & others**
Total Sales	701,799	599,856	982,104	1,326,585	509,162
Profit (% of sales)	19	22	10	15	16
Labor (% of cost)	28	33	27	18	21
Raw materials	51	45	49	58	62
Utility	11	14	8	7	9
Interest payments	5	5	6	2	4
Other Costs	11	9	10	16	10

Source: Tabulations based on the survey.

On average, total sales grew by 9% in 2009, a slowdown from an 11% growth posted in 2008. Automotive sales growth was negative for both years while growth declined from 20% to 4% for electronics and from 10% to 5% for food manufacturing during the same years. For garments and textiles, however, growth increased from 12% in 2008 to 14% in 2009.

Table 15. Sales Patterns

	All	Garments & Textile	Automotive	Electrical & electronics	Food & Others
Total	**97**	**58**	**7**	**12**	**20**
Average annual sales growth rate					
2009	9	14	-12	4	6
2008	11	12	-4	20	10
Domestic Market (100%)	**71**	**43**	**4**	**5**	**19**
Both Domestic & Export Markets	**7**	**2**	**1**	**4**	
Final Assemblers	40	33	80	56	37
First Tier	23	36	0	0	11
Second Tier	5	2	0	22	5
Third Tier and More	13	11	0	11	21
No Response	24	18	20	22	42
Export Market (100% of sales)	**15**	**9**	**2**	**3**	**1**

Source: Tabulations based on the survey.

In terms of market orientation, most of the firms in the sample focused solely on the domestic market (71%) while 15% were export-oriented. In terms of buyers, most of the respondent firms sell to final assemblers (40%) and first tier suppliers (23%). For the automotive and electronics industries, the proportions of firms who supply final assemblers were 80% and 56%, respectively. For food, the share of final assemblers was 37% and 33% for garments and textiles.

In terms of the composition of workforces by level of education and training, on average, 72% of the respondent firms' workers have secondary education, of whom 65% are female. Nine percent have vocational training, of whom 21% are female. 19% have tertiary education with females accounting for 45%. The electrical and electronics industry has the highest proportion of workers with tertiary education (51%) and vocational training (25%).

Table 16. Average Employment and Composition by Education and Level of Training

Industry	Average Employment (number)	Tertiary	% Female	Vocational	% Female	Secondary or less	% Female
Total	60	19	45	9	21	72	65
Garments & Textiles	68	10	40	7	25	83	82
Automotive	39	33	32	8	10	59	16
Electrical & electronics	54	51	59	25	23	24	21
Food & others	50	17	56	5	13	78	66

Source: Tabulations based on the survey.

In terms of business capability, only a relatively small proportion of the surveyed firms have invested to improve their business processes or adopted or introduced new products. In the last three years, 23% of the surveyed firms met an international standard such as ISO. 19% introduced information and communication technologies (ICT) and reorganized business processes accordingly. Only 8% reported that they established new divisions or plants. 16% reported that they had introduced new products to the market in the past three years. 36% of firms that met international standards were in the 50 to 99 workers category. 50% of firms that introduced ICT had 6 to 49 workers and 22% had 50 to 99 workers.

Table 17. Business Capability

	All	Garment & Textiles	Automotive	Electrical & electronics	Food & others
Met International Standards	**22**	**8**	**1**	**8**	**5**
1-5 persons					
6-49 persons	27	13	0	38	40
50-99 persons	36	25	100	50	20
100-199 persons	9	13	0	13	0
more than 200 persons	27	50	0	0	40
Introduced ICT and reorganized business processes	**18**	**7**	**1**	**5**	**5**
1-5 persons					
6-49 persons	50	43	100	40	60
50-99 persons	22	0	0	60	20
100-199 persons	11	29	0	0	0
more than 200 persons	17	29	0	0	20
Established new divisions or new plants	**8**		**1**	**3**	**4**
1-5 persons					
6-49 persons	38		100	0	50
50-99 persons	50		0	100	25
100-199 persons	0		0	0	0
more than 200 persons	13		0	0	25
Bought new machines or facilities with new functions to operation	**21**	**8**	**1**	**5**	**7**
1-5 persons					
6-49 persons	52	75	0	20	57
50-99 persons	24	0	100	60	14
100-199 persons	5	0	0	20	0
more than 200 persons	19	25	0	0	29
Upgraded existing machines, equipment, or facilities	**27**	**12**	**2**	**7**	**6**
1-5 persons					
6-49 persons	59	58	50	57	67
50-99 persons	22	17	50	29	17
100-199 persons	7	8	0	14	0
more than 200 persons	11	17	0	0	17
Introduced new know-how on production methods	**19**	**5**	**1**	**7**	**6**
1-5 persons					
6-49 persons	53	60	0	57	50
50-99 persons	21	0	100	29	17
100-199 persons	11	20	0	14	0
more than 200 persons	16	20	0	0	33
Introduced new products or services	**16**	**3**	**1**	**5**	**7**
1-5 persons	6	33	0	0	0
6-49 persons	56	67	100	40	57
50-99 persons	19	0	0	40	14
100-199 persons	6	0	0	20	0
more than 200 persons	13	0	0	0	29

Source: Tabulations based on the survey.

4.2. Access to Finance

The survey results show that out of the 97 respondent firms, 31% had made financing requests (defined as any request for borrowing, capital leases, government grants and equity financing) in the last 12 months. 10% had made similar requests in the last three years while 14% had made borrowing requests more than three years ago. A relatively large proportion of the firms, 42%, had never sought external financing. The reasons why the firms did not borrow were not evident from the survey. In the NATCCO survey, however, the surveyed firms cited the following reasons: had enough funds of their own and did not acquire further assets, high interest rate, did not want to take the risk associated with borrowing money, collateral problems, insufficient track record, and difficulties in getting a loan.

Table 18a. Recent Request for Financing

Most recent request for external financing	Frequency	%
last 12 months	30	31
last 3 years	9	10
more than 3 years ago	14	14
never made request	41	42
refused/don't know	3	3
Total	97	100

Source: Tabulations based on the survey.

4.2.1. Bank Loans, Lines of Credit or Credit Cards

Table 18b shows that of those who requested financing in the last 12 months, 62% applied for new or additional loans, lines of credit or credit cards. 72% approached only one or two credit supplier(s) to obtain financing while 17% approached three to five credit suppliers. 22% were refused financing by the credit suppliers.

Table 18b. Loans, Lines of Credit/ Credit Cards in the Last 12 Months

In the last 12 months, applied for new or additional loans, lines of credit/credit cards in last 12 months	Frequency	%
Yes	18	62
No	11	38
Total	29	100
Number of credit suppliers approached		
1-2	13	72
3-5	3	17
6-10	2	2
Total	18	78
Refused financing		
Yes	4	22
No	14	78
Total	18	100
Last financial institution or credit supplier approached for new credit		
Bank	14	78
Microfinance Institution	2	11
Government Institution	0	0
Others (friends, hardware store)	2	11
Total	18	100
Reasons for approaching this credit supplier		
Thought this credit supplier would offer the best credit terms and conditions	13	36
This was the regular financial institution for the business	12	33
Thought this credit supplier would offer the lowest interest rate	8	22
Others: marketing assistance	2	6
This was the only credit supplier in our area	1	3
Total	36	100

Source: Tabulations based on the survey.

A great majority (78%) said that banks were the most recent financial institution or credit supplier that their business approached for new or additional credit. Most of the firms chose this credit supplier because this was the regular financial institution of the business and they thought that this would offer the best credit terms and conditions.

Most of the firms used the financing requested for working capital/operating capital (42%), other machinery and equipment (17%) and to grow the business (17%). 85% of the firms said that the full credit amount was authorized as a result of the request. Only 4% said that a partial amount was authorized while 7% withdrew their application. The reasons cited for the withdrawal of their application were the cumbersome borrowing process and their firms’ insufficient sales.

Table 18c. Uses of Requested Financing

	Frequency	%
How the business intend to use financing requested		
Working capital/ operating capital, such as inventory or paying suppliers	24	42
Other Machinery and equipment	10	17
To grow the business	10	17
Land and buildings	4	7
Vehicles/ rolling stock	4	7
Debt consolidations	3	5
Other purpose	2	3
Research and development	1	2
Total	58	100
Credit authorized as a result of this request		
The full amount was authorized	23	85
Partial amount was authorized	1	4
Application was withdrawn	2	7
Don't Know	1	4
Total	27	100
First request for financing was made through		
Application filled in at the branch	17	71
Application over the Internet or email	1	4
Others	4	17
Don't Know	2	8
Total	24	100

Source: Tabulations based on the survey.

Most of the firms' first request for financing from the credit supplier was made by filing an application at the branch (71%) while about 4% filed their application over the Internet. For 60% of the respondents, the total amount of financing requested amounted to about US$20,000 while for 15% of the respondents, the total amount was greater than $100,000. The mean amount of financing requested was about US$150,000, with a minimum of $529 and a maximum of $2 million.

Table 18d. Amount of Financing Requested

Amount of financing requested	Term Loan	%	Operating line	%	Others	%	Total financing requested	%
less than 5,000	1	14	1	10	2	29	4	20
5,001 to 10,000	2	29	2	20	1	14	4	20
10,001 to 20,000	1	14	4	40	3	43	4	20
20,001 to 30,000	1	14					1	5
30,001 to 50,000		0	1	10			3	15
50,001 to 100,000	1	14			1	14	1	5
above 100,000	1	14	2	20			3	15
Total	7	100	10	100	7	100	20	100

Source: Tabulations based on the survey.

For 96% of the firms who requested financing, the full amount was authorized as a result of the request. For 56% of the firms who responded, the interest rate ranged from 6 to 15%. For most of the firms (76%), the interest rate was fixed. Mean interest rate was about 16.5%. The results also showed that micro firms in the electrical, electronics and parts and machinery group paid the highest average interest rates (at 36%) while micro enterprises in the garments and textiles sector paid on average 31.7%. Small enterprises in parts, components and motor vehicles paid 31.2%. Overall, micro enterprises paid the highest average interest rate, at 32.8%. For small enterprises the average interest rate was 12.1% while large enterprises paid only 8.8%.

Table 18e. Type of Recent Financing Request

Financing request	Number	Mean	Std. Dev.	Min	Max
Term Loan	7	31289	35908.48	4228	105708
Operating Line	10	267718	664861.8	592	2114165
Other Instruments	7	20009	29441.38	529	84567
Total Financing Requested	20	149911	473975.4	529	2114165

Source: Tabulations based on the survey.

Table 18f. Recent Request for Financing

	Frequency	%
Credit authorized due to this request		
The full amount was authorized	22	96
Partial Amount was authorized	1	4
Request was turned down	0	
Application under review	0	
Application withdrawn	0	
Total	23	100

Interest rate on the loan		
2-5	3	11
6-15	10	56
16-25	3	17
26-45	2	11
above 50	1	6
Total	18	100
Interest Rate		
Fixed Rate	19	76
Variable Rate	4	16
Don't Know	2	8
Total	25	100
Percentage of Fees		
less or equal 10%	16	89
10-15%	1	6
>15%	1	6
Total	18	100
Financing guaranteed by a government program		
No	23	88
Yes	*2*	*8*
Don't Know	1	4
Total	26	100
Collateral Required		
No	12	46
Yes	13	50
Don't Know	1	4
Total	26	100
Co-signee Required		
Yes	9	35
No	17	65
Total	26	100
Documents Requested		
Formal application for financing	18	22
Business financial statements	17	20
Other documentation	12	14
Appraisal of assets	11	13
Personal financial statement	10	12
Cash flow projection	8	10
Business plan	7	8
Total	83	100
Satisfaction Rating		
Very Dissatisfied	3	13
Dissatisfied	1	4
Neither satisfied nor dissatisfied	2	9
Satisfied	11	48
Very Satisfied	6	26
Total	23	100

Source: Tabulations based on the survey.

Table 18g. Interest Rate Paid by Size of Establishment and Sector

	Micro	Small	Medium	Large	Total
Garment & Textiles	31.7	11.0			17.9
Parts, Components, and Motor Vehicles(incl. motorbikes)		31.2			31.2
Electrical, electronic, parts and machinery	36.0				36.0
Food & Other Manufacturing		9.9		8.8	9.8
Total	32.8	12.1		8.8	16.5

Source: Tabulations based on the survey.

On average, the fees associated with obtaining the loan amounted to 3.5% of the total loan. 88% said that the financing was not guaranteed by a government program. 50% indicated that the credit supplier required the business to provide collateral to obtain the new financing. 46% said no collateral was required. For 65% of the firms, no co-signatures from individuals other than business owners were required as a condition of obtaining the loan. As part of the application process, the following documents were required: formal application for financing (22%), business financial statements (20%), appraisal of assets (13%), personal financial statement (12%), cash flow projection (10%), business plan (8%) and others (14%). Other documents required included bank account, barangay clearance and pictures, community tax certificate, Department of Trade and Industry and Bureau of Internal Revenue registration/certificate, insurance policy, vehicle registration, income tax return, schedule of sales, electricity bill, business permits, and post-dated checks. Overall, 48% were satisfied with the services offered by the financial institution that provided term lending. 26% were very satisfied, but, 13% were very dissatisfied and 4% dissatisfied.

4.2.2. Capital Lease Financing

19% of the respondent firms had made a request for new or additional capital lease financing in the last 12 months. 5% had made a request in the last three years while another 5% had made a request more than three years ago. Note that 51% had never made a request for capital lease financing.

Through this lease, 20% acquired other machinery and equipment. The majority used the lease for other types of assets such as raw materials and working capital. The lease was authorized for all those who had made a request for lease financing in the last

12 months as well as for those who had requested in the last three years. On average, the total value of the lease authorized amounted to US$176,300.

Table 19. Requests for Leases

	Frequency	Percent
When did the business make its most recent request for new or additional capital lease financing?		
Last 12 Months	8	19
Last 3 Years	2	5
More than 3 years ago	2	5
Never made a request for capital lease financing	22	51
Refused/Don't know	9	21
Total	43	100
What type of asset did the business try to acquire through this lease?		
Business or office space	1	10
Vehicles	1	10
Computer hardware and software	1	10
Other Machinery and Equipment	2	20
Others	5	50
Total	10	100
Was the lease authorized as a result of this request		
Yes	10	100

Source: Tabulations based on the survey.

4.2.3. Equity Financing

Only about 8% of the firms had sought equity financing in the last 12 months while 6% had done so in the last three years. 81% of the respondents had not sought equity financing. Requests for equity financing were from friends and relatives (20%), private investors from outside the firm unrelated to the firm and its owners (20%), government institutions (20%), and others such as banks (40%). For 80% of those who made equity financing requests, an investment was provided as a result of the request. On average, the total value of the investment provided amounted to US$778,200.

Table 20. Requests for Equity Financing

	Frequency	Percent
When did the business make its most recent request for equity financing?		
Last 12 Months	3	8
Last 3 Years	2	6
More than 3 years ago		0
The business has never make a request for equity financing	29	81
Refused/Don't know	2	6
Total	36	100
From whom did this establishment request equity financing?		
A friend or relative of the business owners	1	20
An employee of the business	0	0
A private investor from outside the firm unrelated to the firm and its owners (i.e. angels)	1	20
A crown corporation or government institution	1	20
Others: banks	2	40
Total	5	100
Was an investment provided as a result of your most recent request?		
Yes	4	80
Don't Know	1	20
Total	5	100

Source: Tabulations based on the survey.

4.2.4. Supplier and Government Financing

Only 5% of the firms had made a request for a grant, subsidy, no-interest loan or repayment contribution from the government in the last 12 months while around 3% had made similar requests in the last three years. The bulk, 82% of the firms, had never made a request for government-aided financing. Of the two firms who responded, one said its request for government financing was approved but the other was disapproved. The total amount of financing authorized was about US$634,000.

Table 21. Requests for Supplier and Government Financing

	Frequency	Percent
When did the business make its most recent request for a grant, subsidy, no-interest loan or non-repayment contribution from government?		
Last 12 Months	2	5
Last 3 Years	1	3
More than 3 years ago	2	5
Never	31	82
Refused/Don't Know	2	5
Total	38	100
Was the request approved?		
Yes	1	50
No	1	50
Total	2	100
When did the business make its most recent request for trade credit from a supplier?		
The last 12 months	13	35
Last 3 Years	2	5
More than 3 years ago	1	3
Never	18	49
Refused/Don’t know	3	8
Total	37	100
Was request approved?		
Yes	10	71
No	2	14
Refused	1	7
Don't know	1	7
Total	14	100

Source: Tabulations based on the survey.

35% of the firms that responded indicated that they had made a request for supplier trade credit in the last 12 months while 5% had made a similar request in the last three years. 49% of the respondents had never made a request for trade credit. 71% indicated that the request was approved, 14% were disapproved. The mean total amount of trade credit authorized was about US$13,500.

4.3. Characteristics of Firms That Have Access to Finance

4.3.1. General Firm Characteristics

A total of 33 firms made a financing request for any of the following: bank borrowing, capital leases, trade credit, government grants, and equity financing. Of these firms, 32 (33%) were able to get either full or partial authorization of the amount requested. Only one firm (1%) was unable to get either partial or full approval of its financing requests, and this was due to its withdrawal of its application. The remaining 64 firms (66%) had never made a request for external financing, or refused to provide firm financing information.

Table 22. Firms with Finance Access and Type of Financing Used

Firms	Freq.	Percent
With finance access	32	32.99
No access	1	1.03
Did not request financing	64	65.98
Total	97	100.00

Type of Financing Accessed by Firms	Freq.	Percent
Bank Loan	16	39.02
Capital Lease	10	24.39
Equity Financing	4	9.76
Government Grant	1	2.44
Supplier Credit	10	24.39
Total	41	100.00

Source: Tabulations based on the survey.

In terms of type of finance institutions, Table 22 indicates that banks (39%) are the most common source of financing, followed by institutions providing capital leases (24%) and supplier/trade credit (24%). Equity financing had a share of 10% while government programs had the lowest share, of about 2%.

In terms of industry type, the firms that were able to access finance were mostly from the garments and textiles industry (53%) followed by food and other manufacturing (31%). By size of employment, these firms were largely small (75%) and micro (19%) enterprises. Almost 91% of the firms were 100% domestic-owned, 6% were joint ventures while 3% were foreign-owned. The mean age of the companies was about 16.2 years. For firms that did not make any request, the mean company age was 13.4 years. In terms of distribution by industry, size of employment and ownership there was not much difference between firms with access and firms that had never requested financing.

Table 23. General Characteristics of Firms with Access to Finance

Industry Type	Number of Firms	With Access	No Access	Did Not Request
Garment & Textiles	58	53	0	64
Parts, Components, and Motor Vehicles (incl. motorbikes)	7	9	0	6
Electrical, electronic, parts and machinery	12	6	100	14
Others (e.g. food manufacturing)	20	31	0	16
Total	97	100	100	100
By Employment Size				
Micro	16	19	0	16
Small	67	75	100	67
Medium	6	0	0	10
Large	7	6	0	8
Total	96	100	100	100
Firm Ownership				
100% Domestic	75	91	0	72
Joint	14	6	100	17
100% Foreign	8	3	0	11
Total	97	100	100	100

Market Orientation	All Firms	With Access	No Access	Did Not Request
Domestic Market (100%)	76	94	0	69
Both Domestic & Export Markets	8	3	0	10
Export Market (100% of sales)	16	3	100	21
Indicators				
Firm Age	14	16	10	13
Profit (% of sales)	19	24	2	17
Sales growth rate				
2009	9	3	8	12
2008	11	11		11
Labor productivity (US$)				
2008	3462	3046	2939	3696
2009		3722	3106	4114
Stage				
startup	9	100	9	10
fast growth	3	0	2	2
slow growth	31	0	45	40
maturity	16	0	5	8
decline	41	0	23	29
Do not know	0	0	13	8
No Response	0	0	3	2
Total	100	100	100	100

Source: Tabulations based on the survey.

In terms of stage of development, the bulk of the firms with access to finance were in industries in the slow growth and declining stages of their life-cycle. Only 12% were in the start-up and fast growth stages while 16% were in the maturity stage. The firms that did not request financing also had the same distribution by stage of growth with firms in slow growth and declining stages accounting for the majority. In terms of labor productivity, the firms registered US$3,722 in 2009. Firms that did not request finance had a slightly higher labor productivity of around US$4,114 during the same year. In terms of profitability rate as measured by profit as % of sales, firms with finance access had a higher profit rate of 24% than firms that never made any finance request, which recorded a rate of 17% in 2009. In terms of annual growth rate of sales, firms with access registered growth of 11% in 2008 but dropped to 3% in 2009, while firms that never made a finance request enjoyed 12% growth in 2009 and 11% in 2008.

4.3.2. Owner's Characteristics

Table 24 describes the characteristics of the major owners of firms that were able to access finance, including the company's R&D expenditures and patent ownership. The mean age of owners was 46.8 years. 50% of the owners were female and mean length of experience was 15.9 years. 75% of the owners know other foreign languages. With respect to the net worth of the owners, 42% had net worth of from US$25,000 to 100,000 while 19% had net worth within the $100,000-500,000 range. 88% of the firms in the group also indicated that majority ownership of the business was held by members of the same family. Only 26% said that the majority owners of the business had invested in another unrelated business. 27% said that the majority owners acted as operators in these other unrelated businesses. In terms of R&D investment, only 13% invested in research and development although 28% owned a patent. R&D as percentage of sales was around 1.1%.

Table 24. Characteristics of Owners with Finance Access

	With Access	No Access	Did Not Request		With Access	No Access	Did Not Request
Gender				**Majority of business held by members of family**			
Female	52	0	54	No	13	100	26
Male	48	100	46	Yes	88	0	74
Length of Experience				**Majority owners made investments in another unrelated business**			
1-5 years	6	0	14	No	74	100	89
6-10 years	28	0	20	Yes	26	0	11
11-20 years	41	0	28				
21-30 years	16	0	14	**Majority owners act as operators in these businesses**			
31-40 years	0	0	3	No	73	100	90
41-50 years	3	0	2	Yes	27	0	10
refused	3	0	2				
don't know	3	100	17	**Investment in R&D**			
Languages spoken				No	88	100	91
Only Native Language	25	0	36	Yes	13	0	9
Knows Other Foreign Language	75	100	64				
Net-worth				**Own Patent?**			
Less than $25000	32	0	61	No	72	100	88
$25000 – 100000	42	0	20	Yes	28	0	13
$100000 – 500000	19	100	18	Age of Major Owner	47		54
Between $500000 & 1000000	3	0	2	Length of Experience	16		15
Over $1million	3	0	0	R&D as % of Sales	1.1	0	1.8

Source: Tabulations based on the survey.

For those firms that never requested financing, the mean age of owners was 53.5 years with mean length of experience of about 15.3 years. 54% of the firms had female owners. 64% knew other foreign language. The bulk of the firms (61%) had net worth less than US$25,000 while 20% had net worth of from US$25,000 to 100,000, and 18% from US$1,000,000 to 500,000. 88% of the firms in the group also indicated that majority ownership of the business was held by members of the same family. 11% said that the majority owners of the business had invested in another unrelated business. 10% said that the majority owners acted as operators in these other unrelated businesses. In terms of R&D investment, only 9.4% invested in research and development and 12.5% owned a patent. R&D as a percentage of sales was around 1.8%.

Compared with firms that never requested financing, the owners of firms with access to finance were younger (mean age 47 years, and 54 years for the other group). In terms of length of experience of the owner, there was not much difference. Firms with finance access had a higher proportion of owners who knew other foreign languages; with net worth valued from US$25,000 to 500,000; and had patent ownership.

4.3.3. Business Expansion Plans

For firms with access to finance, close to 72% intended to expand the size and scope of their businesses in the next two years while 25% did not have intentions of expanding. 73% said that the company's current ability to fund their expansion plans through internal funds alone was not sufficient. 22% said the owners had sufficient internal funds. 13% indicated that the owners would fund the expansion by sharing equity in the business while 91% indicated that they intended to make a loan request. 8% said they would fund the expansion through other means, such as borrowing from relatives and friends.

Table 25. Firms' Expansion Plans

	With Access	No Access	Did Not Request	Total
Do you intend to expand in the next 2 years?				
Not expand	25	0	55	44.33
Expand	72	0	25	40.21
Don't know	3	100	20	15.46
Total	100	100	100	100
Is company's current financing sufficient?				
Not sufficient funds	74		56	67
Sufficient internal funds	22		31	26
Don't know	4		13	8
Total	100		100	100
How would owners finance the expansion plans?				
by sharing equity in the business				
No	87		63	77
Yes	13		38	23
Total	100		100	100
by making a loan request				
No	9		69	33
Yes	91		31	67
Total	100		100	100
Others				
No	52		44	49
Yes	9		19	13
No Response	39		38	38
Total	100		100	100

Source: Tabulations based on the survey.

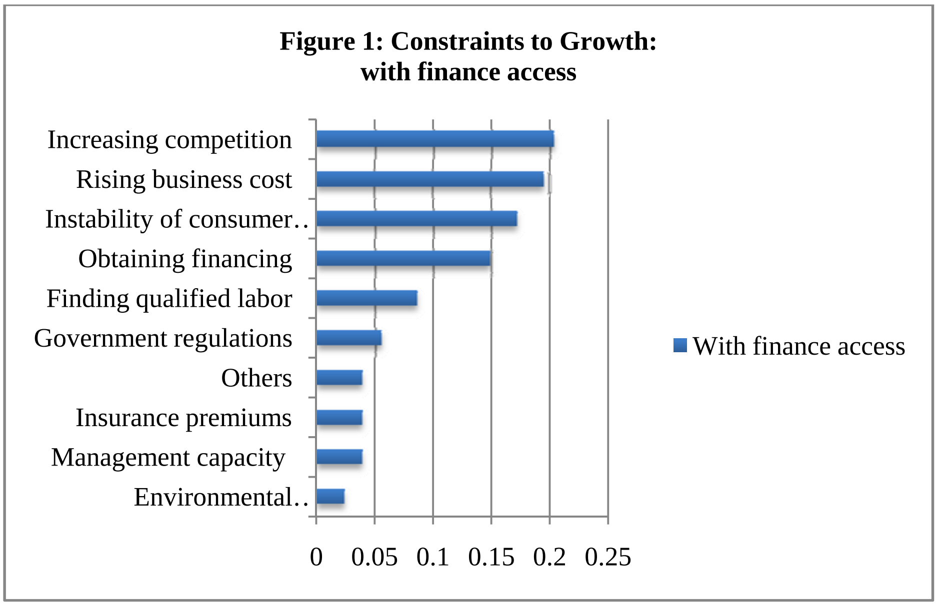
For firms that never made any request for financing, only 25% had plans for expanding their businesses in the next two years. 56% said they did not have sufficient funds to finance the expansion plan while 31% said that they had sufficient internal funds. 37.5% indicated that they would finance their expansion by sharing equity in the business, 31.3% by making a loan request and 19% through other means.

Results from other surveys also showed a substantial proportion of firms planning to borrow in the future. The proportions ranged from 52% under the PEP to 96% for the NATCCO survey. Note, however, that despite a large majority of firms that expressed plans to borrow from banks in the future, the continuing dependence of firms on internal sources of financing may seem to suggest a gap between the plans of firms to borrow and the actual amount of funding made available by banks.

4.3.4. Major Business Constraints

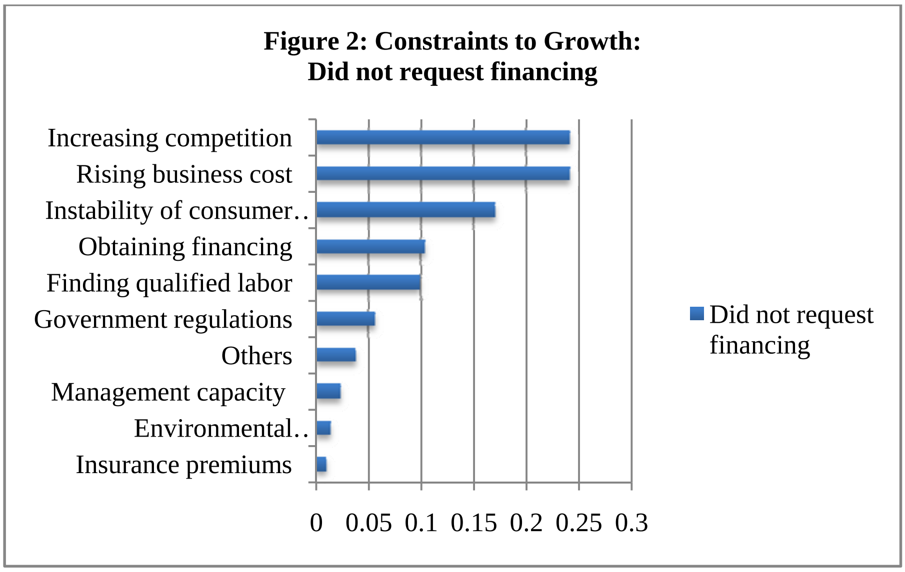
For firms with access to finance, the major obstacles to the growth of their business were increasing competition (20%), rising business costs (20%), instability of consumer demand (17%), obtaining finance (15%), and finding qualified labor (9%). For those firms that had never made any financing request, the same factors were identified: increasing competition (24%), rising business costs (24%), instability of consumer demand (17%), obtaining finance (10%), and finding qualified labor (10%).

Figure 1. Constraints to Growth: with Finance Access



Source: Tabulations based on the survey.

Figure 2. Constraints to Growth: Did not Request Financing

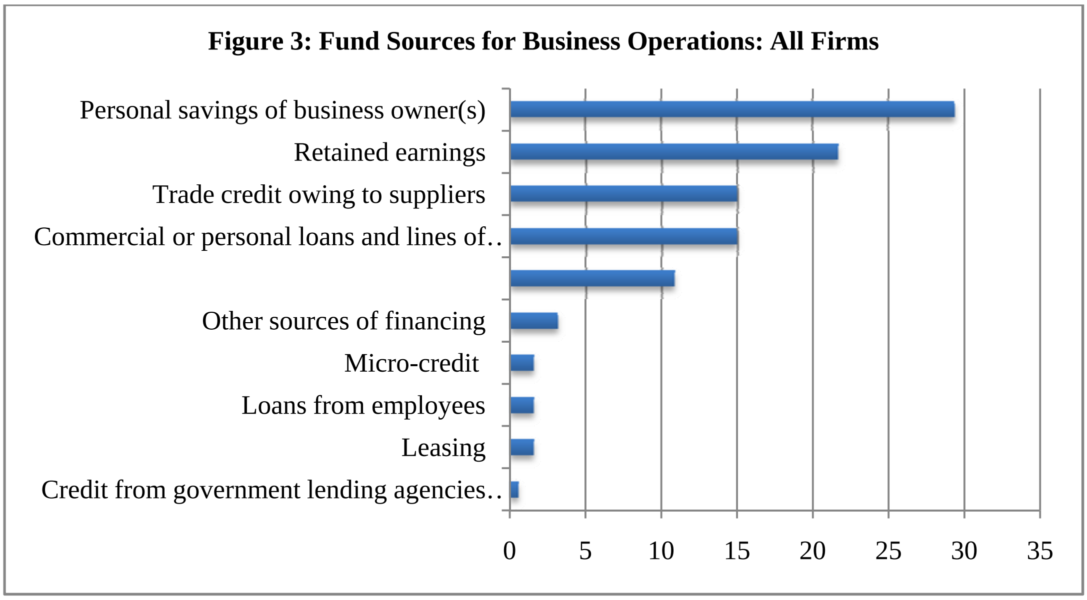


Source: Tabulations based on the survey.

4.3.5. Sources of Funds

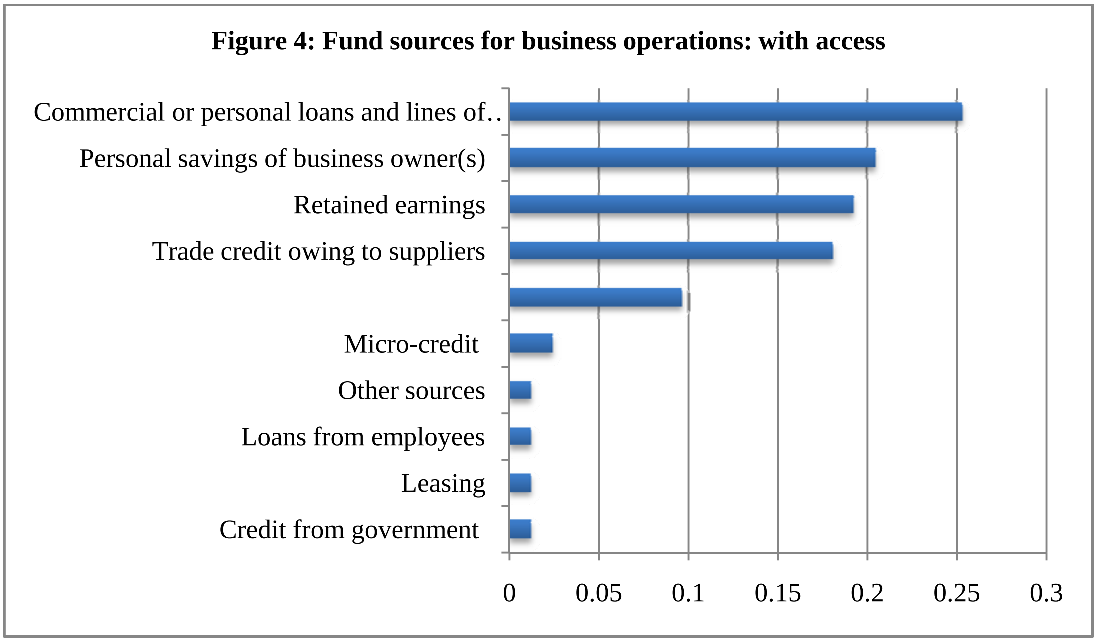
For firms with access to finance, commercial or personal loans and lines of credit from financial institutions, including credit cards (25%), were their major sources of finance used to keep their businesses operating. These sources was closely followed by personal savings of business owners (20%), retained earnings (19%), trade credit owing to suppliers (18%), and loans from individuals unrelated to the firm or its owners (10%).

Figure 3. Fund Sources for Business Operations: All Firms



Source: Tabulations based on the survey.

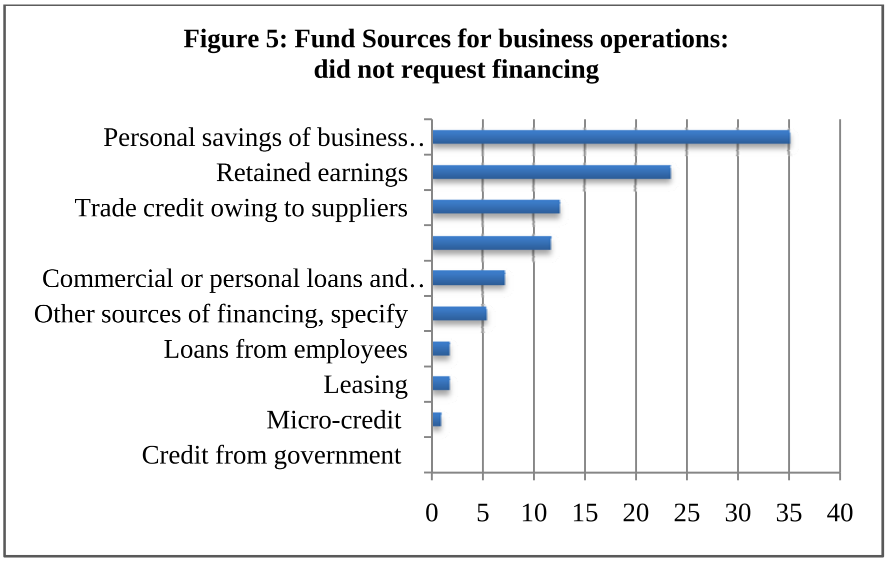
Figure 4. Fund sources for Business Operations: with Access



Source: Tabulations based on the survey.

As start-up funds for their business, the major sources used were personal savings of owners (32%), commercial or personal loans and lines of credit from financial institutions including credit cards (19%), loans from friends or relatives of the business owners (16%), and trade credit (11%).

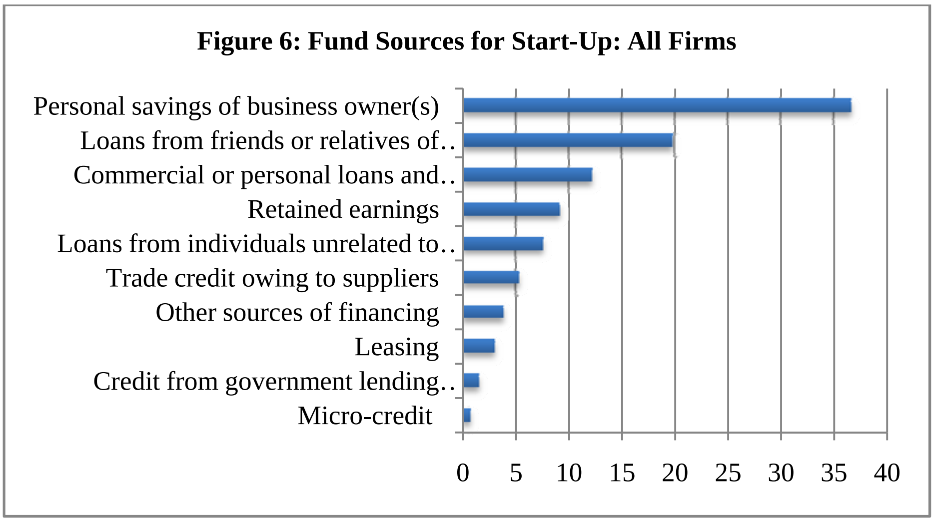
Figure 5. Fund Sources for Business Operations: Did not Request Financing



Source: Tabulations based on the survey.

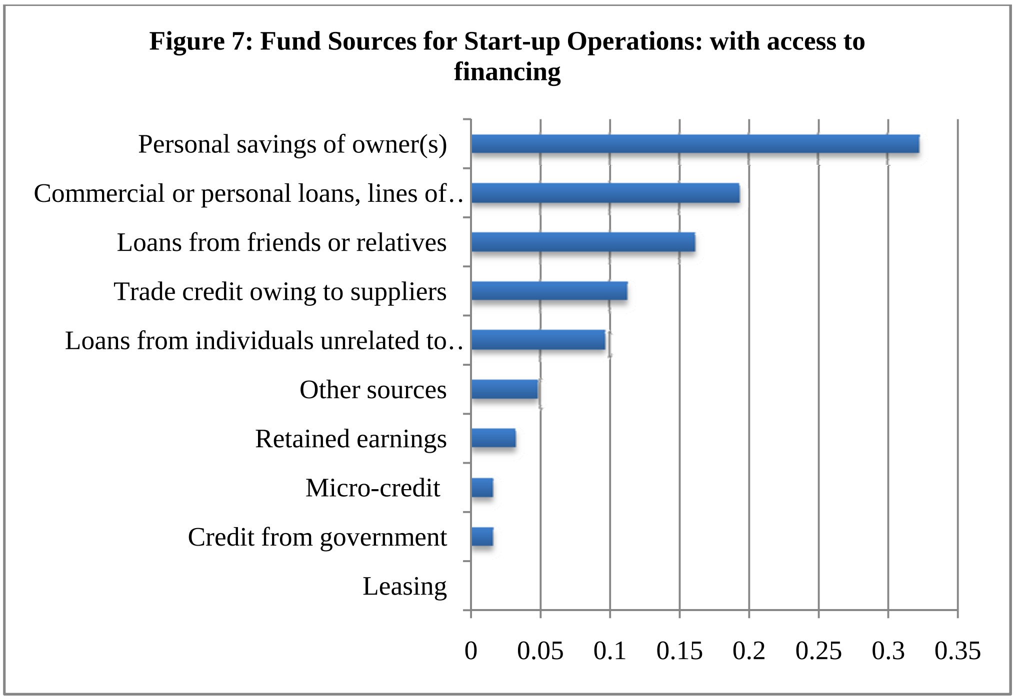
For those firms that had never made any financing request, personal savings (35%) were the major source of financing followed by retained earnings (23%), trade credit (13%), and loans from individuals unrelated to the firm (12%).

Figure 6. Fund Sources for Start-Up: All Firms



Source: Tabulations based on the survey.

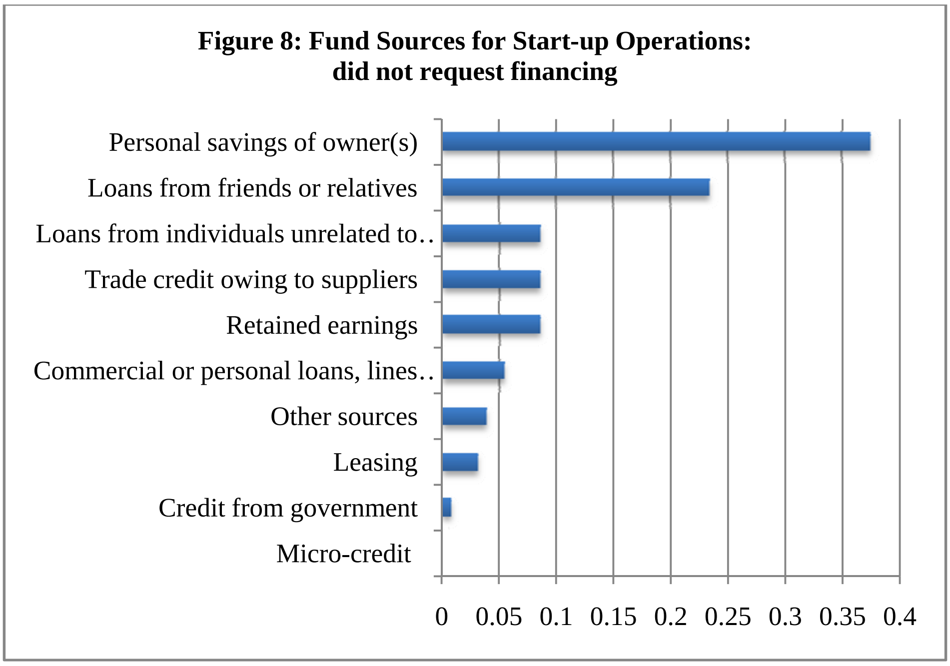
Figure 7. Fund Sources for Start-up Operations: with Access to Financing



Source: Tabulations based on the survey.

For their start-up funds, the top sources were personal savings (38%), loans from friends and relatives (23%), commercial personal loans (16%), loans from individuals unrelated to the firm (9%), trade credit (9%), and retained earnings (9%).

Figure 8. Fund Sources for Start-up Operations: Did not Request Financing



Source: Tabulations based on the survey.

4.4. Bank Survey

Three banks responded to the SME access to finance survey. Tables 26A to 26E summarize the survey results. The total assets of the three banks range from $4.6 million to $198.5 million. Bank 1 has 6,000 business clients in the group with 6-49 employment while Bank 3 has 81 clients with 50 to 99 employees. In terms of outstanding loans, Bank 1 reported a total of US$17 million, consisting mostly of term loans followed by umbrella credit. Bank 3 reported a total of US 51, 557 livelihood and salary loans.

In terms of distribution of outstanding credit by industry, Bank 1 reported a total of $2.3 million outstanding credit from the automotive industry and $690,000 from the electronics and electrical industry. Bank 3's $51, 557 outstanding credit is all from the garments and textiles industry.

Table 26a. Total Assets and Business Clients of Respondent Banks

Bank Code	Total Assets (in US$)	Business Clients by Employment Size	
		6 to 49 workers	50 to 99 workers
Bank 1	27,586,207	6,000	
Bank 2	4,597,701		
Bank 3	198,533,979		81

Source: Tabulations based on the survey.

Table 26b. Loan Outstanding by Type and Size (in US$)

Bank Code	Term	Mortgage	Lines of Credit	Umbrella Credit	Others	Total
Bank 1	9,195,402	2,298,851	1,149,425	4,597,701		17,241,379
Bank3					51,557*	51,557

Source: Tabulations based on the survey.
Note: * livelihood/salary loan.

Table 26c. Credit Outstanding to Business Clients (in US$)

Bank Code	Authorized amount	Outstanding loan	No. of clients
Garments & Textile			
Bank 1		114,943	4
Bank 3	51,557	51,557	81
Automotive			
Bank 1		2,298,851	10
Electronics & electrical			
Bank 1		689,655	6

Source: Tabulations based on the survey.

Only Bank 2 reported that it provides factoring financing. The total amount authorized is $114,900 with total outstanding amount of $45,977.

Table 26d. Factoring Financing to Business Clients (in US$)

Bank Code	Total Amount Authorized	Total Amount Outstanding	No. of Clients
Bank 2	114,943	45,977	1

Source: Tabulations based on the survey.

Both Banks 1 and 2 have leases totaling $114,900 and $45,977 respectively. Bank 1 provides leases to the garments, automotive and electronics industries while Bank 2 reported only other industries.

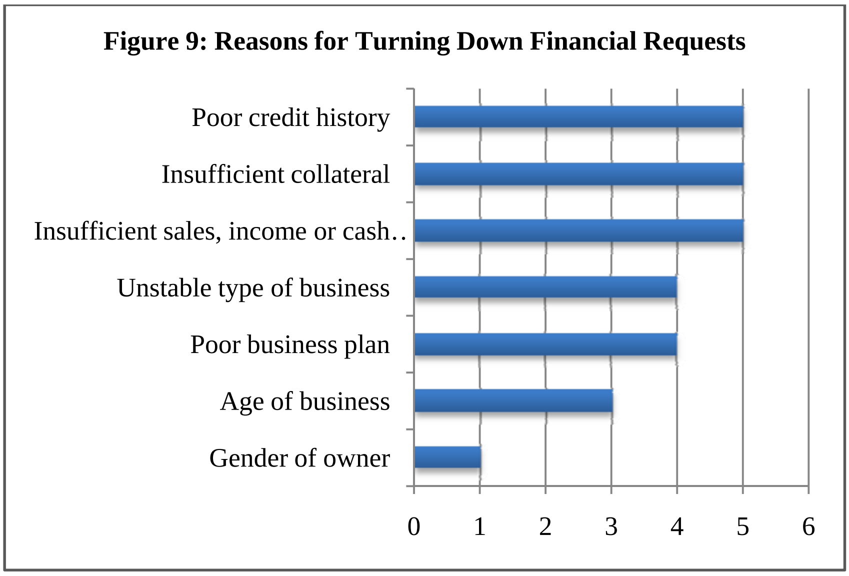
Table 26e. Lease Outstanding to Business Clients

Bank Code	Total amount leases	Total amount outstanding	No. of clients
Garments & Textile			
Bank 1	114,943		2
Automotive			
Bank 1	459,770		4
Electronics & electrical			
Bank 1	689,655		6
Food & Others			
Bank 2	114,943	45,977	1

Source: Tabulations based on the survey.

Figure 8 contains a ranking of the reasons for turning down financial requests. The top reasons cited were poor credit history, insufficient collateral, and insufficient sales income or cash flow. These were followed by unstable business type, poor business plan and age of business. The gender of the owner is not considered as important. These results are consistent with the results of previous surveys of SMEs and financial institutions. According to the SERDEF survey (as cited in Nangia and Vaillancourt), the main reasons for rejecting applications were: adverse credit/repayment record, insufficient or unacceptable collateral, and non-viability. The results of the SERDEF survey also showed that 90% of all applications were approved and that banks provided borrowers with technical and marketing assistance along with training and information. Banks are heavily biased towards lending to existing enterprises with good track records and viable projects. Their primary criteria were collateral and good credit standing, as well as management quality and location.

Figure 9. Reasons for Turning-down Financial Requests



Source: Tabulations based on the survey.

5. Conclusions and Some Broad Policy Implications

5.1. Access to Finance Issues: Findings from SME Literature in the Philippines

Access to finance has remained one of most critical factors affecting the competitiveness of MSMES. Studies focusing on the growth constraints faced by SMEs in the Philippines have continued to highlight the difficulties of MSMEs in accessing finance. Based on the PEP survey, Nangia and Vaillancourt (2006) indicated that funds obtained from the banking sector accounted for only 11 to 21% of capital raised by SMEs. This is lower than the 30% international benchmark seen in other developing countries like India and Thailand. Furthermore, banks are generally reluctant to make large loans, particularly those ranging from P150,000 to P5 million (US$3,450-115,000) which is the normal range of funding required by SMEs.

Studies have shown that despite the availability of funds for lending, SMEs, particularly the smaller ones, have been unable to access funds due to their limited track record, limited acceptable collateral, and inadequate financial statements and business plans. In these studies, the lack of access to financing is highlighted as the most difficult constraint on SME growth. The problem seems to lie not in the supply of funds potentially available for SME lending, but in the difficulty of access to these funds. In theory, there should be sufficient funds for SME financing since banks are required by law to allocate 8 percent of their loan portfolios to SME financing. At the same time, government financial institutions have their own SME financing programs. Private banks, however, are reluctant to lend to SMEs because of their general aversion to dealing with a larger number of smaller accounts. Moreover, many banks are still not aware of the need for lending to small businesses. Many SMEs cannot access available funds due to their limited track records, limited acceptable collateral, and inadequate financial statements and business plans.

Banks have continuously pointed out that the lack of credit information has deterred them from lending to SMEs. Without the necessary credit information, it is difficult to determine the creditworthiness of borrower firms. Banks are also concerned about the bankability of MSMEs and the high risks involved in MSME lending, given that many MSMEs have limited management and financial capability. Financial institutions have therefore continued to impose collateral requirements and other stringent conditions such as minimum loan requirements. Other issues include slow loan processing, short repayment periods, difficulties in loan restructuring, high interest rates, and lack of start-up funds for SMEs.

There are various estimates of the financial gap, ranging from Philexport's P67 billion (US$1.6 billion) to the Department of Trade and Industry's P180 billion (US$4.2 billion). Extrapolating from the PEP survey results (SMEs' average investment requirements and loan appetite less average declared availment of loans), Nangia and Vaillancourt estimated a finance gap amounting to P76 billion (US$1.8 billion) and using more official existing SME lending and assuming 30% of total current SME funding as benchmark, they arrived at P170 billion (US$3.9 billion) gap. Applying the same procedure and using the PEP finding that banks provide 21% of the financing needs of SMEs, an estimated gap of around P130 billion was obtained.

5.2. Access to Finance Survey

The present survey, which was carried out among 97 firms in Central Luzon covering garments, textiles, automotive, electrical and electronics, and food manufacturing and other industries. It illustrates the experiences of MSMEs in seeking bank credit financing, capital leases, equity financing, and Government and trade supplier credit. Overall, the results reflect the difficulties faced by SMEs in accessing finance. Both for firms with access to finance as well as those that had not made any finance request, financing obstacles (12%) were one of the top four serious problems for the growth of their businesses, along with increasing competition, rising business costs, and instability of consumer demand.

The current survey shows the continued dependence of SMEs on internal sources of financing, not only during the start-up phase but also to finance the current operations of the business. To keep their business operations running, firms have continued to rely on the personal savings of business owners (29%), retained earnings (22%), and loans from individuals (11%). Finance sources for start-up operations consisted mainly of the personal savings of owners (37%), loans from friends or relatives of business owners (20%), retained earnings (9%), and loans from unrelated individuals (8%). Commercial or personal loans and lines of credit from financial institutions including credit cards accounted for 12% of the total.

Close to 41% of the respondents intended to expand the size and scope of their businesses in the next two years while 44% did not have intentions to expand. 67% said that the company's internal funds alone were not sufficient to fund their expansion plans. 23% said the owners would fund the expansion by sharing equity in the business, 67% by making a loan request, and 21% through other means, such as borrowing from relatives and friends. Previous surveys also showed a substantial proportion of firms planning to borrow in the future. The proportions ranged from 52% under the PEP to 96% for the NATCCO survey. Note, however, that despite a large majority of firms that expressed to the intention of borrowing from banks in the future, the continuing dependence of firms on internal sources of financing may seem to suggest a gap between the plans of firms to borrow and the actual amount of funding made available by banks.

The bank survey showed that the top reasons for turning down financial requests were the firms' poor credit histories, insufficient collateral, insufficient sales, income or cash flow, unstable business type, and poor business plans. In terms of bank requirements, 50% of the respondent firms indicated the need for collateral to obtain the new financing. Voluminous documents were also required as part of the application process, including business financial statements, appraisal of assets, personal financial statements, cash flow projections, business plans and other documents such as government clearances, registration certificates, proofs of billings (credit card, electricity, etc) and post-dated checks, among others. A majority of those who borrowed were either satisfied or very satisfied with the banking services that provided their loans.

Looking at the characteristics of firms that were able to access financing, it is evident from the survey results that these firms are mostly those with high sales growth, high profitability rates and whose owners tend to have higher net worth. Among those firms that borrowed from banks, the survey results showed that micro and small enterprises paid higher interest rates are than large enterprises.

5.3. Policy Recommendations

To improve MSMEs access to finance, the paper suggests the following:

1) Credit rating information and asymmetric information.

It is important to address the high risk profile of firms arising from the absence of track records, informational asymmetries, shortage of assets and collateral and insufficient management skills. To address these issues, the implementation of the Central Credit Information Corporation must be expedited. The central credit system is expected to improve the overall availability of credit, particularly for MSMEs, to provide mechanisms to make credit more cost-effective, and to reduce the excessive dependence on collateral to secure credit facilities.

2) Changing the mindsets of banks and developing a non-traditional approach to SME lending.

It is also important to change the traditional mindsets of banks, and to encourage the adoption of a non-traditional approach to SME lending. Traditionally, lending to SMEs has been seen as entailing higher risks and higher costs, and the tendency is to seek to over-guarantee the loan. The case of Plantersbank has proven that SME lending can be profitable and rewarding. In more recent years, RCBC (the fourth largest universal bank in terms of capital base in the country) intensified its SME lending program by bringing in a new team of banking professionals, reviewing and instituting radical changes in traditional banking practices and processes and introducing new tools and technology that changed the way SME loans are screened, evaluated, approved and administered. As a result, its SME lending grew by 63% or over P9 billion (US$193.3 million) in 2008 compared to P6 billion in 2006. RCBC also established a web portal (www.getaloan.com.ph), a free online self-assessment services that firms can visit to immediately find out whether their business will be eligible for a business loan with the bank. Questions asked include basic information on the business, financial performance, credit experience, location, purpose of the loan, required loan amount, etc. Each answer is awarded specific points and those that pass and are interested in getting a loan are invited to proceed with the bank's application process.

There is also an initiative in the country by the International Finance Corporation to create an SME banking model that departs from the traditional lending approach. It focuses not only on SME banking but also stresses the importance of banks offering and cross-selling multiple products, focusing on strong marketing and adopting segmentation and a product development capacity. It also emphasizes the importance of a strong management information system to support credit scoring and credit relations management. The program is currently being tested with a microfinance institution, CARD Bank.

Through its cooperation program with the Philippine Government, the Small and Medium Enterprise Development for Sustainable Employment Program (SMEDSEP), the German Government has also introduced new lending technology on the provision of credit by rural banks and thrift banks to SMEs. This technology is expected to encourage more banks to intensify lending to SMEs on the basis of business viability, which makes collateral requirements only a secondary consideration in providing loans. SMEDSEP has also partnered with the University of the Philippines through the Institute of Small Scale Industries (UP-ISSI) to institutionalize SME finance training for rural banks and thrift banks in the Philippines. Under this partnership, SMEDSEP will pass on to UP-ISSI the technologies on the provision of credit to SMEs by rural banks and thrift banks.

3) Training and capability building programs for SMEs, evaluation of government lending programs, and improvement of official SME statistics.

Training and capacity building programs for SMEs to improve their financial literacy and management capacity are also necessary. Equally important is the need for the government to review the impact of its SME lending activities along with its other SME programs on training and marketing, and identify whether these are the correct interventions and responses to the current financing issues faced by MSMEs. In the context of the government's role in SME financing through SBC, PCFC, and the Sulong Program; the survey results showed that only 5% of the firms made a request for a grant, subsidy, no-interest loan or repayment contribution from the government in the last 12 months. Around 3% had made similar requests in the last three years while the bulk, 79% of the firms, had never made a request for government-aided financing. Finally, there is also a need to improve data collection and statistics on SMEs, particularly on financing indicators for more precise information and empirically-based policy-making.

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