

JAPAN INTERNATIONAL COOPERATION AGENCY (JICA)

Department of Trade and Industry (DTI)  
the Republic of the Philippines

Final Report  
for  
Support Program for SME Development Plan in  
the Republic of the Philippines  
(Summary)

March 2004

UNICO INTERNATIONAL CORPORATION

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## Abbreviation

ACAPP	: Association of Consolidated Automotive Parts Producer, Inc.
ACTETSME	: APEC Center for Technology Exchange and Training for Small and Medium Enterprises
ADB	: Asia Development Bank
AFFI	: Association of Filipino Franchisers Inc.
AFIC	: ASEAN Furniture Industries Council
AFTA	: ASEAN Free Trade Area
AICO	: ASEAN Industrial Cooperation
APEC	: Asia-Pacific Economic Cooperation
AHAM	: Association of Home Appliances Manufacturers
ASEAN	: Association of South East Asian Nations
ASPBI	: Annual Survey of Philippine Business and Industry
BAP	: Bankers Association of the Philippines
BBC	: Brand-to-Brand Complementation Scheme
BDT	: Bureau of Domestic Trade, DTI
BEMB	: Bonded Export Marketing Board, DTI
BETP	: Bureau of Export Trade Promotion, DTI
BIS	: Bureau of Import Services, DTI
BITR	: Bureau of International Trade Relations, DTI
BMBEs	: Barangay Micro Business Enterprises
BOI	: Board of Investments, DTI
BPS	: Bureau of Products Standards, DTI
BSMED	: Bureau of Small and Medium Enterprises Development, DTI
BSMI	: Bureau of Small and Medium Industries
BSP	: Bangko Sentral ng Philipinas
BTRCP	: Bureau of Trade Regulation & Consumer Protection, DTI
CAD	: Computer Aided Design
CALABARZON	: Cavite, Laguna, Batangas, Rizal, Kezon
CAMPI	: Chamber of Automotive manufacturers of the Philippines, Inc.
CARP	: Comprehensive Agrarian Reform Program
CDP	: Car Development Plan
CEPMA	: Consumer Electronics Products Manufacturers Association
CEPT	: Common Effective Preferential Tariff
CFIF	: Cebu Furniture Industries Foundation, Inc.
CFIP	: Chamber of Furniture Industries of the Philippines

CIC	: Center for International Competitiveness, DTI
CIDA	: Canadian International Development Agency
CKD	: Complete Knocked Down
CITC	: Cottage Industry Technology Center, DTI
CITEM	: Center for International Trade Expositions & Missions, DTI
CMDF	: Construction Manpower Development Foundation
COMDDAP	: Computer Manufacturers, Distributors and Dealers Association of the Philippines
CVDP	: Commercial Vehicle Development Plan
DBP	: Development Bank of Philippines
DOE	: Department of Energy
DOF	: Department of Finance
DOLE	: Department of Labor and Employment
DOST	: Department of Science and Technology
DTI	: Department of Trade and Industry
EBITDA	: Earnings Before Interest, Taxes, Depreciation and Amortization
EDC	: Export Development Council
EIAPI	: Electronics Industries Association of the Philippines, Inc.
EMG	: Economic Mobilization Group
EPZ	: Export Processing Zone
FAME	: Fashion Accessories Manufacturers and Exporters. Inc.
FDA	: Food & Drug Administration
FDC	: Food Development Center
FMS	: Financial Management Services
FPRDC	: Forest Product Research & Development Center
GAS	: General Administrative Services, DTI
GDP	: Gross Domestic Product
GFI	: Government Finance Institutions
GFSME	: Guarantee Fund for Small and Medium Enterprises
GNP	: Gross National Product
GPJI	: Guild of Philippine Jewelers, Inc.
GSIS	: Government Social Insurance System
GTEB	: Garments & Textile Export Board
GTZ	: Gesellschaft für Technische Zusammenarbeit GmbH
HACCP	: Hazard Analysis and Critical Control Point
HRDS	: Human Resource Development Services
IAC-IPR	: Inter-Agency Committee on Intellectual Property Rights

IAP	:	Individual Action Plan
ICCA	:	International Coffee and Certifying Agency
ICT	:	Information and Communication Technology
IDE	:	Institute of Development Economics
IMF	:	International Monetary Fund
INFOMAP	:	Integrated Food Manufacturers Association of the Philippines, for Productivity
INTERSMEX	:	Internet Services for SMEs
IT	:	Information technology
ITG	:	International Trade Group
JASDAQ	:	Japan Association of Securities Dealers Automated Quotations
JBIC	:	Japan Bank for International Cooperation
JETRO	:	Japan External Trade Organization
JICA	:	Japan International Cooperation Agency
KfW	:	Kreditanstalt für Wiederaufbau
LBP	:	Land Bank of the Philippines
LGU	:	Local Government Unit
MDF	:	Medium-density Fiber board
MDPPA	:	Motorcycle Development Program Participants Association, Inc.
MEP	:	Market Encounter Program
MIAP	:	Metal Working Industries Association of the Philippines
MIRDC	:	Metals Industry Research and Development Center
MIS	:	Management Information Services
MISSI	:	Monthly Integrated Survey of Selected Industry
MJAI	:	Meycauayan Jewelry Association, Inc.
MNC	:	Multinational Company
MOI	:	Ministry of Industry
MSP	:	Monthly Survey of Production
MTPDP	:	Middle Term Philippine Development Plan
MVPMAP	:	Motor Vehicle Parts & Manufacturers Association of the Philippines
NASDAQ	:	National Association of Securities Dealers Automated Quotation
NBR	:	Establishment of a National Business Registry
NCAC	:	National Consumer Affairs Council
NCC	:	National Computer Center
NCIDA	:	National Cottage Industry Development Authority
NCR	:	National Capital Region
NDC	:	National Development Company

NEDA	:	National Economic Development Agency
NGO	:	Non-Government Organizations
NIMTC	:	National Industrial Manpower Training Council
NLSF	:	National Livelihood Support Fund
NPCC	:	National Price Coordinating Council
NSCB	:	National Statistics Coordination Board
NSO	:	National Statistic Office
ODA	:	Official Development Assistance
OJT	:	On-the-Job Training
OLA	:	Office of Legal Affairs
OOP	:	Office of Operational Planning
OPR	:	Office of Policy Research
OSC	:	Office of Special Concerns
PAFI	:	Philippine Automotive Federation, Inc.
PBSP	:	Philippine Business for Social Progress
PEARL	:	Private Enterprise Accelerated Resource Linkage
PCB	:	Printed Circuit Board
PCCI	:	Philippine Chamber of Commerce & Industry
PCFM	:	Philippine Chamber of Food Manufacturers
PCNFI	:	Philippine CEFE Network Foundation, Inc.
PDCD	:	Program Development & Coordination Division
PDDCP	:	Product Development & Design Center of the Philippines, DTI
PDMA	:	Philippine Die and Mold Association
PEEAIF	:	Philippine Electrical, Electronics & Allied Industries Federation
PEZA	:	Philippine Economic Zone Authority
PFA	:	Philippine Franchise Association
PHILEXPORT	:	Philippine Exporters Confederation, Inc.
PHILFOODEX	:	Philippine Food Processors and Exporters Organization
PHILTINS	:	Philippine Trade Information and Network Systems
PIC	:	Philippine Investment Corporation
PIMSSG	:	Policy, Information & Management Support Services
PITC	:	Philippine International Trading Corporation
PMAI	:	Philippine Metal Casting Association, Inc.
PPRD	:	Policy Planning & Research Division
PPSE	:	Promoting Participation in Sustainable Enterprises
PQIP	:	Productivity and Quality Improvement Program

PRA	:	Philippine Retailers Association
PRDCP	:	Packaging Research and Design Center of the Philippines, DOST
PRIA	:	Philippine Rubber Industries Association
PTTC	:	Philippine Trade Training Center, DTI
QSPBI	:	Quarterly Survey of Philippine Business and Industry
QUENDANCOR	:	Quedan & Rural Credit Guarantee Corporation
ROG	:	Regional Operation Group
SBC(SBGFC)	:	Small Business Guarantee and Finance Corporation
SBIC	:	Small Business Investment Company
SEC	:	Securities and Exchange Commission
SEDCOP	:	Socia-Economic Development through Cooperative in the Philippines
SEIPI	:	Semiconductor and Electronics Industries in the Philippines, Inc.
SERDEF	:	Small Enterprises Research and Development Foundation
SME	:	Small and Medium Enterprises
SMEDC	:	Small and Medium Enterprises Development Council
SMEPC	:	SME Promotion Center
SRTC	:	Statistical Research and Training Center
SSS	:	Social Security System
SULONG	:	SME Unified Lending Opportunities for National Growth
TESDA	:	Technical Education and Skills Development Authority
TIDC	:	Trade & Investment Development Council
TLRC	:	Technology & Livelihood Research Center
UL	:	Underwriters Laboratories, Inc.
UP-ISSI	:	University of the Philippines Institute for Small Scale Industries
USAID	:	U.S. Agency for International Development
WB	:	World Bank
WTO	:	World Trade Organization

Table 1: Outline of Development Challenges and Recommended Strategies

Present status and issues	Background/ factors affecting the issues	Development challenges and strategies	Progress of activities under the current development plan	Projects/ programs provided by foreign donors	Expected benefits
SMEs in local-resource based industries incl. furniture, export general merchandise, and processed food industries					
Strong competitive pressure in both domestic and export markets. The small shares of Philippine products in the major export markets.	Severe competition especially with Chinese products, produced in big scale at lower costs.	<u>Enhancement of international competitiveness</u> - Creative product development and marketing capability	- Trade fairs, local & International (In operation. Highly appreciated.) - Permanent display corners (Planned but not implemented)		- Increased export - Improved awareness on needs for creative product development based on market analysis Increase in the level of Philippine designers
	Philippine needs to maintain their unique position by offering niche products, because of difference in production scale.		- Support for market survey abroad (In operation) - Design workshop (Practiced in the past. Discontinued due to termination of support of foreign donors) Buyer-supplier matching (Planned, but no in progress)		
	Advanced management techniques are not commonly used, since most of the businesses in the sectors have been started with side-work of house wives.	- Improved business management and production management capability	- Improvement of product design and packaging (In practice as a program under PRDCP, but limited budget and resources) - Compendium of government training programs (Completed) - HACCP awareness campaign (In operation through National Caravan, etc.) - Industry association training program (Planned, but not implemented)		- Increase in value added of the products - Improve in cost competitiveness
SMEs in the supporting industries of leading industries incl. electronics and automotive industries					
Lack of linkages between the local SMEs and the leading industries in the Philippines. The leading industries rely their parts and service supply to import or foreign affiliated enterprises located in the Philippines.	Big gap between the requirements of the leading industries and the understanding of local SMEs on business management, production management and	<u>Promotion of industrial linkages</u> - Practical support for development of parts and service supply of local SMEs to the leading industries	- Buyer-supplier matching (Planned, but not in progress)		- Expanded supply of parts and services to the leading industries Increased linkage with the industries other than the leading industries Increased parts export

Present status and issues	Background/ factors affecting the issues	Development challenges and strategies	Progress of activities under the current development plan	Projects/ programs provided by foreign donors	Expected benefits
	Lack of SMEs having the adequate technique of business management, production management, and technologies, which form the basis to promote the linkages with the leading	- Expansion of basis of the supporting industries		- JETRO "Supporting industry development" (In practice. Dispatch of experts) - GTZ "Dual Education and Training" (In operation. Nurturing of technicians)	- Increased linkages with local industries other than the leading industries
<b>SMEs based on the limited local demand</b>					
Difficulty of SMEs, particularly of small and micro enterprises, in stable operation, growth, and starting-up new businesses	Lack of business opportunity. Insufficient supporting system for SMEs in assisting them to solve their problems in their business start-up and expansion.	<u>Identification and creation of business opportunities</u> - Assistance for diversified managerial problems together with creation, identification and provision of business opportunities	- Product commercialization campaigns of DOST-developed technologies (In operation) - Product clinics/ consultation (In operation)	- GTZ "Private Sector Development Program" (Under planning) - CIDA "Private Enterprise Accelerated Resource Linkages" (To be terminated. New program is under planning.) - CIDA "Promoting Participation in Sustainable Enterprises" (In operation)	- Increased import substitution - Increased employment
<b>Applicable to SMEs in all sectors</b>					
In spite of the high demand for short-term finance, a third of SMEs depends their fund supply from the informal sources, having the problem of high interest rate.	Limited SMEs are benefited from SME finance of the formal sector, due to heavy collateral requirement, complicated loan application procedure, and high interest rate, etc.	<u>Improved accessibility of SMEs to financing</u> - Reduction of risk of SME financing	- SULONG Program (In operation. Loan performance has increased, but delay in appraisal is increasingly pointed out) - Unified accreditation for rural and thrift banks (In operation)	- JBIC "ISSEP-II" (In operation. Two-step loan for SMEs)	- SME finance not dependent heavily on collateral - Modernization of SME management, and capacity building of SMEs to be able to provide reliable credit information
SMEs benefited by the finance from the formal sources, are dissatisfied with unfriendly application procedure, and high interest rate, etc.		- Program implementation which meets the policy needs of SME financing	- Credit bureau development (Under planning) - Equity venture fund establishment (Under preparation)		- Active implementation of SME financing program by SBC



Present status and issues	Background/ factors affecting the issues	Development challenges and strategies	Progress of activities under the current development plan	Projects/ programs provided by foreign donors	Expected benefits
<b>Establishment of an Implementation System for SME Development Plans at the Central Government Level</b>					
<p>Policy and measures, and system for SME development have been established already, but the problem has been how to made it work effectively.</p>	<p>The current system assumes that the SME development policy planning, implementation promotion, and administration and monitoring are assumed to be made by specific agency or organization responsible for the specific areas.</p> <p>The coordination among these agencies or organizations are made by SME Core Group in the case of inside of DTI, and SMED Council in the case of inter-Ministry.</p>	<p><u>Establishment of a system for planning, promotion, and administration and monitoring of the SME Development Plan</u></p> <ul style="list-style-type: none"> <li>- Establishment of the SMED Authority as the central organization responsible for SME development</li> </ul>	<ul style="list-style-type: none"> <li>- Reorganization of the SME Core Group as a permanent organization within DTI to take responsibility for SME development (Under consideration)</li> </ul>	<ul style="list-style-type: none"> <li>- JICA "Dispatch of SME advisor to DTI" (In operation)</li> </ul>	<ul style="list-style-type: none"> <li>- Establishment of SMED Authority, or reorganization to establish a central organization responsible for SME development</li> </ul>
	<p>Fund required in implementing the development policy and plan is not ensured yet.</p>	<ul style="list-style-type: none"> <li>- Securing of funds required for implementation of the SME Development Plan</li> </ul>			<ul style="list-style-type: none"> <li>- Funds available for implementation of SME Development Plan</li> <li>- Effective use of programs provided by foreign donors</li> </ul>





Development Goal	Strategic target	Major consideration in developing the programs	Development measures	Implementation schedule							Key factors to implement the development measures successfully	
				2004	2005	2006	2007	2008	2009	2010		
<b>SMEs based on the limited local demand</b>												
Identification and creation of business opportunities	Assistance for diversified managerial problems together with creation, identification and provision of business opportunities	Revitalization of the current SME Center system with: 1) Assignment of counselors/ advisors of professional capability 2) Creation of business opportunities through promotion of regional industrial linkages, and regional development projects	3	Business seeds identification and development								
			4	Buyer-Supplier Database	.....							
			12	Entrepreneurship development of creative SMEs		....	....	....	....	....	....	
			*	Reverse trade fairs in regions	---	---	---	---	---	---	---	
			16	SME support network		.....						- Foreign support in fund for implementation, and experiences in nurturing sufficient number of counselors in a short-term, and establishing the own training system
			17	SME Counselors and SME Advisors	.....							
27	Promotion of regional development seeds identification by LGUs and local CCIs			.....								
<b>Applicable to SMEs in all sectors</b>												
Improved accessibility of SMEs to financing	Reduction of risk of SME financing	Recommendation on supplementary measures assuming the high appreciation of the current SULONG Program	17	SME Counselors and SME Advisors	.....							
			18	SME loan without collateral			.....					
			19	Personal guarantee system	.....							
			20	SBC deposit fund system	.....							
			21	Streamlining of examination system for SBC-guaranteed loan application	.....							
	Program implementation which meets the policy needs of SME financing	Counter measures against the limitation of the current financing system regarding SME finance	24	SBC as policy execution body in the field of SME financing			.....					

Development Goal	Strategic target	Major consideration in developing the programs	Development measures	Implementation schedule							Key factors to implement the development measures successfully
				2004	2005	2006	2007	2008	2009	2010	
Establishment of an implementation system for SME Development Plans at the Central Government Level											
Establishment of the system to formulate, promote implementation of, and administrate and monitor the SME Development Plan	Establishment of Central Government Organization responsible for SME development, and securing of the fund required for implementation of the SME Development Plan	22	SMED Authority		.....						
		23	SME Development Fund		.....						
		25	SME statistics		.....						
		26	SME support information		.....						

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## I. Introduction



# **Chapter 1 Background, Objective and Scope of the Study**

## **1.1 Objective of the Study**

The primary objective of this study is to assist the Philippine government in its formulation of the “(Long-Term) SME Development Plan” and, in the process of the study, to transfer knowledge and skills in the field of SME development policy formulation and program development to the staff of the responsible government agencies, support organizations and SMEs, thereby to help them attain capabilities required for the effective promotion of SME development.

Notably, the major focus of the study is to provide necessary support and assistance for the Philippine counterpart that is to formulate at its own initiative the SME development plan.

## **1.2 Background of the Study**

In the Philippine economy, small and medium-sized enterprises (SMEs) have a significant presence. The previous administrations viewed SME promotion as being important from the socioeconomic policy standpoint, and implemented a variety of policies and programs on that basis.

While the efforts have been producing measurable results, the government realizes that

- The development policies and programs have been often planned without sufficient basic data and analyses on the actual needs of SMEs
- Most programs have produced less of a result than expected, due to budgetary and manpower constraints as well as poor coordination among related agencies
- A system and dedicated institution to implement SME promotion programs has not been established

The present administration of the Philippine government decided to formulate a long-term SME development plan (plan period, up to 2010) to meet that demand.

The general framework of the SME Development Plan is summarized as follows.

<i>Framework of the SME Development Plan</i>	
(1) Positioning in the policy context	The plan will serve as the long-term strategy for the national SME development.
(2) Planning period	2004 - 2010 (defined as the long-term development plan)
(3) Planning policy	Based on the policy set in the National SME Development Plan published in November 2002, a new SME Development Plan will be formulated on the basis of the results of the study.

### **1.3 Scope of the Study**

#### **1.3.1 Scope of the Study**

- (1) Collection and Analysis of Baseline Information
- (2) Provision of knowledge and experience valuable to formulation of the SME Development Plan, including related facilities
- (3) Identification of priority issues for SME development in the Philippines
- (4) Recommendation of specific measures and policies to be implemented in the SME Development Plan and action plans
- (5) Support for formulation of the SME Development Plan
- (6) Seminars and workshops

#### **1.3.2 The Study Area**

The study intends to formulate a nationwide SME Development Plan. Due to time constraints, however, the following four regions were selected.

- (1) Manila Metropolitan Area and CARABARZON Region
- (2) Central Luzon
- (3) Cebu
- (4) Davao

These five regions account for 51.4% of the national population (in 2000) and 65% of business establishments in the country. Thus, studying the regions is expected to give representative data and information on SMEs in the country as a whole.

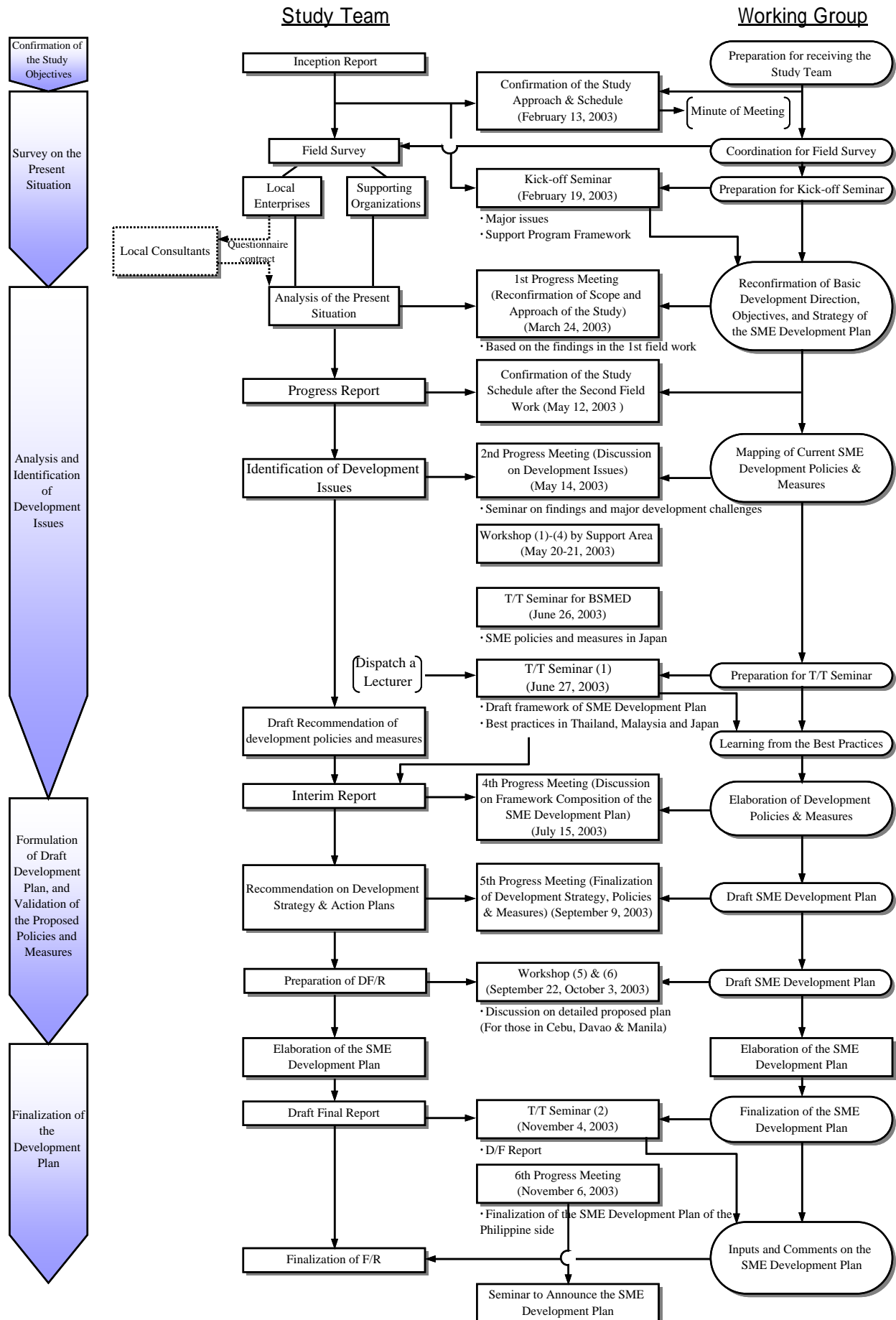
## Chapter 2 Outline of Study

The study started in late January 2003, and submission of a final report was in March 2004.

Phase	Study period
<b>I. Fast-finding study and analysis</b> <ul style="list-style-type: none"> <li>• Study and analysis of the current state of SMEs, policies and programs, etc.</li> <li>• Identification and summary of key issues</li> <li>• Kick-off seminar</li> </ul>	Late January – mid-May 2003 <ul style="list-style-type: none"> <li>• Preparatory work in Japan</li> <li>• First filed survey</li> <li>• First home work</li> </ul>
<b>II. Support for formulation of promotion measures and short-term action plans</b> <ul style="list-style-type: none"> <li>• Technology transfer seminars and workshops</li> <li>• Supplemental surveys for current state</li> <li>• Identification of key issues</li> <li>• Proposition of specific measures and plans, together with necessary support</li> </ul>	Mid-May – Late September 2003 <ul style="list-style-type: none"> <li>• Second field survey</li> <li>• Second home work</li> <li>• Third field survey</li> </ul>
<b>III. Publication and verification of promotion measures and plans</b> <ul style="list-style-type: none"> <li>• Technology transfer seminars and workshops</li> <li>• Refinement, publication and reviewing of specific measures and plans</li> <li>• Preparation of a draft final report</li> <li>• Completion of the SME Development Plan</li> <li>• Completion of the final report</li> </ul>	Early October – Mid. March 2004 <ul style="list-style-type: none"> <li>• Third home work</li> <li>• Fourth field survey</li> <li>• Fifth field survey</li> <li>• Fourth home work</li> </ul>

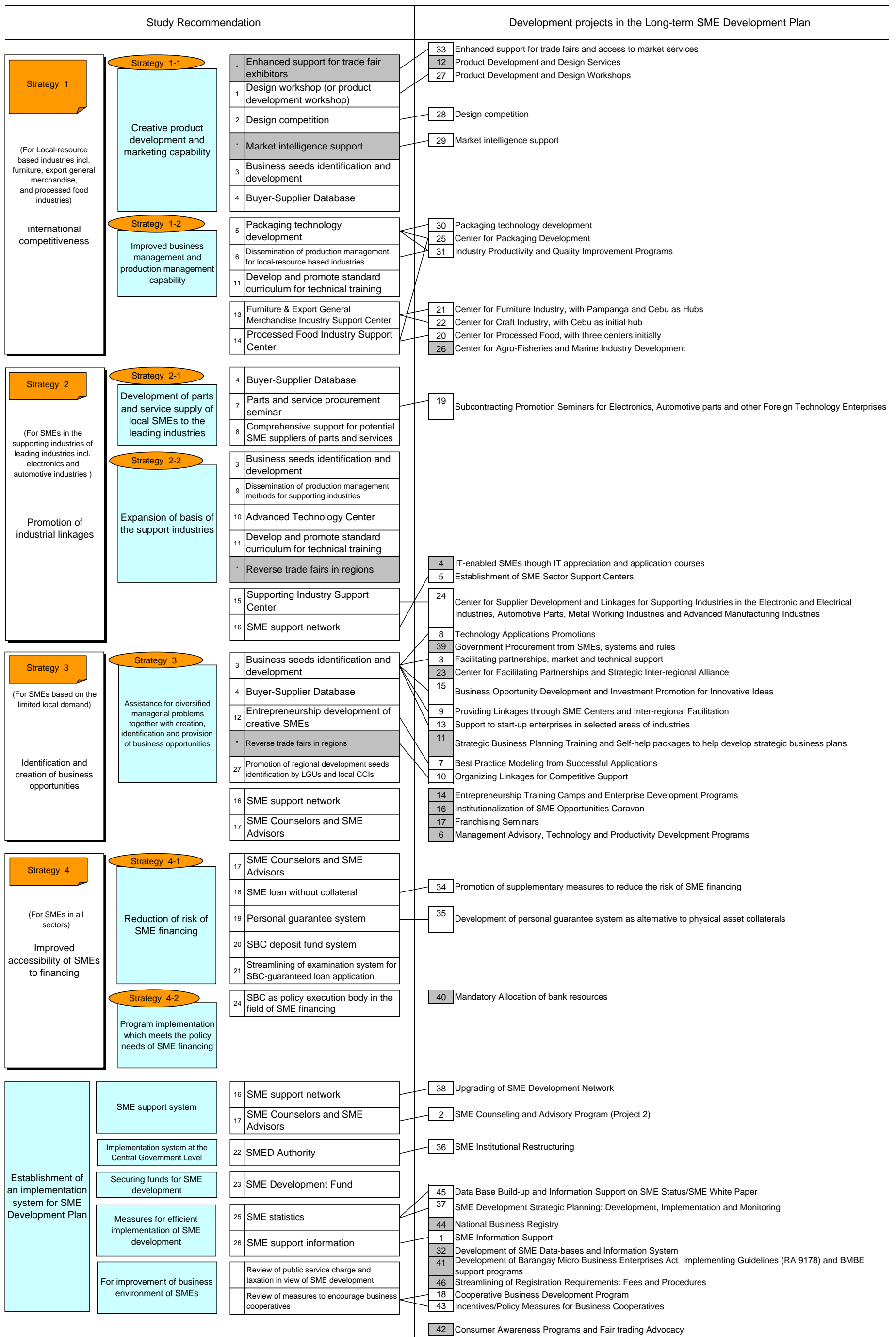
The outline of the process of study and support program is shown in Figure I-1.


Figure I-1 Study Process and Coordination Procedure for Supporting SME Development Plan Formulation



Notes: DF/R=Draft Final Report, F/R=Final Report, T/T=Technical Transfer

**Study Recommendation and Development Projects in the Long-term SME Development Plan**



Notes: Figures refer to the project reference numbers.  
 Projects with  show the projects already under implementation.

## II Current State and Development Issues of SMEs

# Chapter 1 Economic Environment in the Philippines and Economic Development Plans

## 1.1 Overview of Philippine Economy in the 1990s

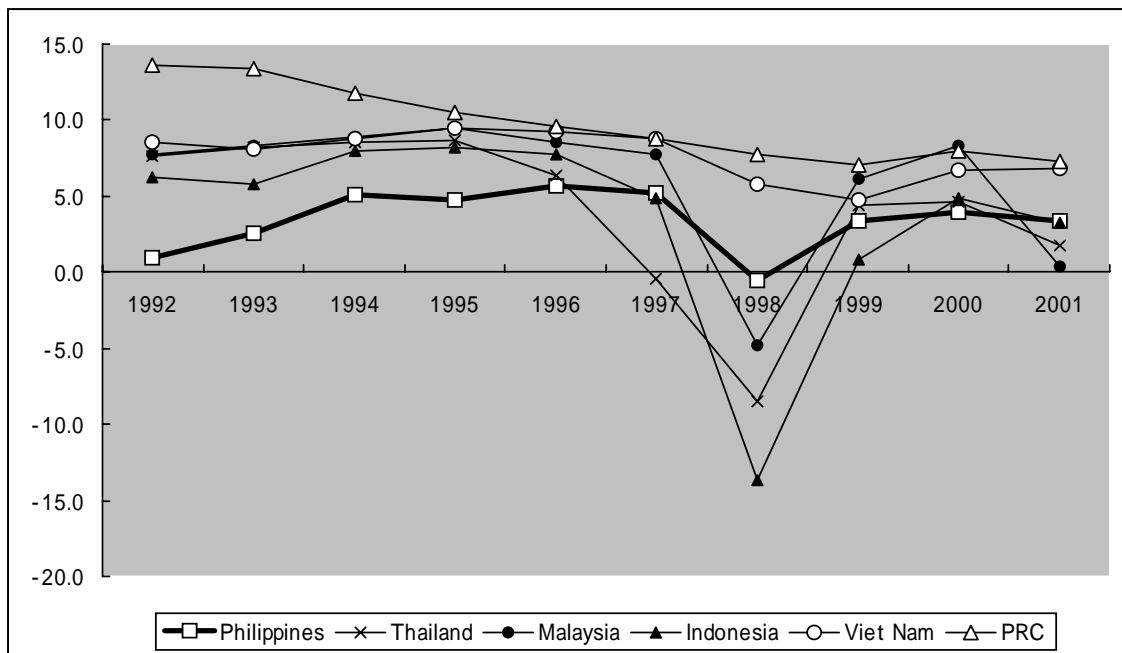


Figure II-1-1 Recent GDP Growth Rates in Selected East Asian Countries

During the 1990s, the Philippine economy grew steadily in terms of real GDP, except for a setback in 1998 due to the Asian currency crisis. Compared to other ASEAN countries, however, the economic growth rate was not particularly high (Fig. II-1-1). The country was unable to keep pace with the strong growth enjoyed in East Asia due to various internal problems in 1990s.

Meanwhile, the country is still afflicted with a high unemployment rate of nearly 10%, higher than in its ASEAN neighbors.

This is because of the weak employment absorption capacity compared with Thailand and Malaysia.

## 1.2 Liberalization of International Trade and Its Effect on the Philippine Economy

The AFTA member countries have agreed, as part of the CFPT (Common Effective Preferential Tariff) scheme, to lower tariff rates toward the 0% to 5% range by 2008. Within the framework of APEC, the Philippines had been scheduled, as part of its Individual Action

Plan (IAP), to lower the tariff rate for raw materials and intermediate goods to 3% and that for manufactured goods to 10% in January 2003. Furthermore, it is to adopt the target rate of 5% or less for end-products, starting in 2004.

They pose a great threat and challenge to industries and companies that lack international competitiveness. In the Philippines, traditional industries (textiles, garment products, woodworking products, furniture, general merchandise, and processed food) are already facing strong competitive pressure in the U.S. and European markets from China and other newly industrialized countries. As a result, the advance of the trade liberalization process brings with it intensified competition inside and outside of the country.

### 1.3 Characteristics of Industrial Structure in the Philippines and Development Challenges

#### (1) Slow advance of industrial development

The country successfully started to industrialize after the Second World War, much earlier than other Asian countries. The manufacturing sector accounted for 25.6% of GDP by 1975, far above the level of around 10% in Thailand and Malaysia. 25 years later, the GDP share has not changed much (24.9% in 2001), while that of manufacturing industries in Thailand and Malaysia have come to exceed 30%. Coupled with a decline in the share of the agriculture, forestry and fishery sector, Thailand and Malaysia have been steadily transforming themselves into industrialized economies (Table II-1-1).

Table II-1-1 Comparison of Key Economic Indices in Selected Asian Countries

	Year	GDP per capita (nominal)	Real GDP share (%)		Gross exports (US\$ million)	Balance of merchandise trade (US\$ million)	Unemployment rate (%)
			Agriculture/ forestry/fishery	Manufacturing			
Philippines	2000	953	20.0	24.8	38,078	6,691	10.1
	2001	892	20.1	24.6	32,150	2,600	9.8
Thailand	2000	1,926	8.8	33.6	67,889	5,466	3.6
	2001	1,800	8.6	33.5	63,190	2,525	3.9
Malaysia	2000	3,853	8.4	33.4	98,429	20,854	3.1
	2001	3,678	8.6	31.5	87,754	18,204	3.3
Indonesia	2000	748	17.0	26.2	62,124	28,609	6.1
	2001	n.a.	16.4	26.1	56,035	25,248	n.a.
Viet Nam	2000	400	24.3	18.7	14,308	-892	6.5
	2001	n.a.	n.a.	n.a.	15,100	-900	n.a.
PRC	2000	855	15.9	44.3	249,212	24,115	3.1
	2001	908	15.2	44.4	266,200	22,600	3.6

Source: Edited from "Yearbook of Asian Affairs, IDE-JETRO

As shown in Table II-1-2 the manufacturing sector grew slower than the overall average for all the years but 2000.



Table II-1-2 Change in GDP in the Manufacturing Sector

Unit: Million P (upper rows); % (lower rows)

	1996	1997	1998	1999	2000	2001	Distribution ratio in 2001
	(Compare to previous year)	(Compare to previous year)	(Compare to previous year)	(Compare to previous year)	(Compare to previous year)	(Compare to previous year)	Six year average
Manufacturing	214,613	223,672	221,151	224,667	237,223	244,082	24.7%
	(5.6)	(4.2)	(-1.1)	(1.6)	(5.6)	(2.9)	(3.13)
Total GDP	849,121	893,151	887,905	917,382	953,578	989,258	100.0%
	(5.8)	(5.2)	(-0.6)	(3.3)	(3.9)	(3.7)	(3.55)

Source: NSCB, NEDA

(2) Skewed investment pattern in the manufacturing sector

Strong economic growth of ASEAN countries, especially Thailand, Malaysia and Indonesia, in the 1990s was primarily driven by direct investment mainly from Japan and other East Asian countries, accompanied by export promotion as a result of industrial development. The investment spree in the region, which continued from the late 1980s to the early 1990s (and is referred to as the “second investment boom in ASEAN”), did not fully benefit the Philippines, as it lagged way behind the three countries in terms of foreign investment (Table II-1-3).

Table II-1-3 Foreign Direct Investment in Four ASEAN Countries

(Unit:US\$ million,%)

	Philippines		Thailand		Malaysia		Indonesia	
	Amount	Growth rate	Amount	Growth rate	Amount	Growth rate	Amount	Growth rate
1989	804	75.1	7,966	29.3	3,188	71.1	4,719	6.4
1990	961	19.5	8,029	0.8	6,517	104.4	8,750	85.4
1991	838	-12.8	4,987	-37.9	6,201	-4.8	8,778	0.3
1992	285	-66.0	10,022	100.9	6,796	9.6	10,313	17.5
1993	569	99.6	4,295	-57.1	2,995	55.9	8,144	21.0
1994	2,470	334.1	5,881	36.9	4,385	46.4	23,494	221.9

Note: Investment amounts include investment in other than manufacturing.

Source: "Yearbook of Asian Affairs, 1995" IDE

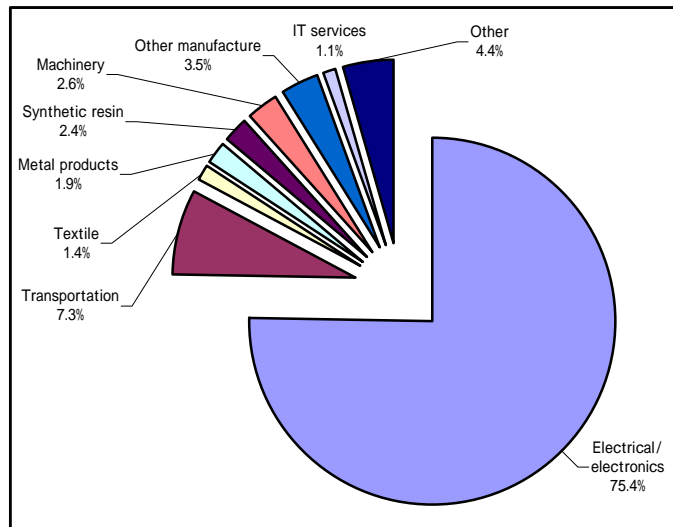


Figure II-1-2 Investment in Special Economic Zones

Source: NSCB

(3) Lack of industrial diversity

In the manufacturing sector in the Philippines, three industries - food processing, textile/garment, and electrical/electronic and peripheral equipment - account for a combined total of 45.3% in terms of the number of establishments, 49.1% in the number of employees, and 37.6% in the value added.

(4) Dependence on export industries operating in the form of contract processing

The country's major export items, roughly divided, are traditional items consisting of primary goods, such as coconut products, sugar, wood, and fruit, and non-traditional ones dominated by industrial products, including electronics products, apparel, and automotive parts. The non-traditional group has been steadily growing since the 1970s and exceeded 70% of total export in 1985. Since then, investment by and expansion of large foreign manufacturers which chose the Philippines as a product base for supply to export markets, led to growth of the share of non-traditional items. The share passed the 90% mark of total export in 1998. Meanwhile, traditional items remained more or less unchanged in terms of export value. Thus, the country's exports have been primarily driven by growth of non-traditional items. Among non-traditional export items, electronics equipment and parts hold a dominant share. As electronics production in the country takes place largely in the form of contract processing and assembly, the country's industrial structure generally lacks both backward and forward linkages.

Table II-1-4 Top Ten Export Items

(Unit: US\$ million)

	1995	1996	1997	1998	1999
Electrical/electronics equipment and parts	7,413	9,988	13,028	17,138	21,166
Machinery and transportation equipment	741	1,294	2,685	3,316	4,951
Garments	2,570	2,423	2,349	2,356	2,267
Coconut oil	826	571	673	706	342
Chemicals	343	353	383	340	294
Processed foods and beverages	292	334	346	306	256
Furniture and fixtures	276	293	322	323	353
Textiles	208	253	299	242	219
Petroleum products	171	273	257	129	216
Copper metal	341	297	232	178	236
Total exports (including other items)	17,447	20,543	25,228	29,496	35,032

Source: BSP

(5) Immaturity of the local supplier base

One of major characteristics of automotive industries and electrical/electronics and IT equipment industries in the Philippines is the small number of job shops (subcontractors) specialized in contract processing such as metalworking, plastics shaping, and rubber processing. However, assembly manufacturers of electrical and communication equipment, electronics parts, and transportation equipment have broad requirements for materials and parts that can be supplied by local industries, and they are willing to increase local procurement in the future – provided that there is adequate supply capability. Unfortunately, local SMEs today are not capable of meeting the needs of these potential buyers (Figure II-1-3).

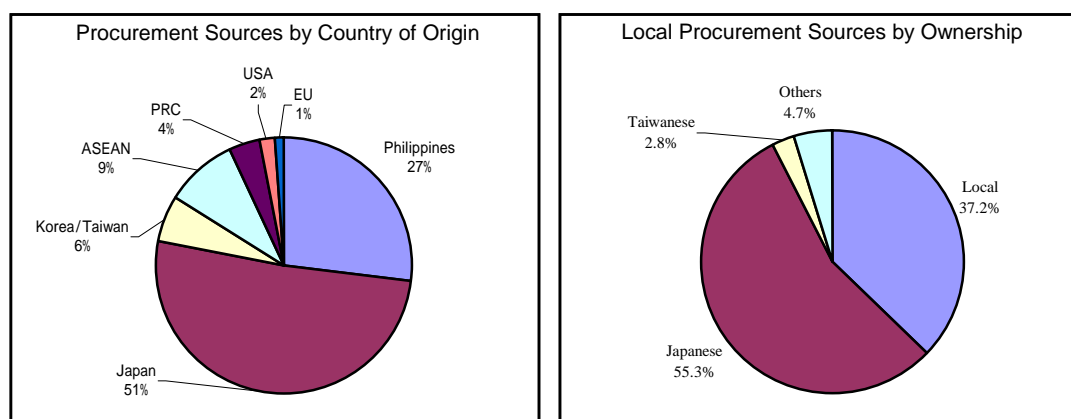


Figure II-1-3 Summary of A JETRO Survey of Japanese Manufacturers Operating in the Philippines (2001)

Source: JETRO Manila

#### **1.4 National Development Plan and SME Development**

The “Medium-Term Philippine Development Plan 2001-2004” (MTPDP) specifies growth targets for each economic sector, and assumes that relatively high growth rates are achieved in and after 2002.

SME promotion is one of the priority areas emphasized in MTPDP. The Plan aims to upgrade SMEs including microenterprises step by step with progress toward the ultimate goal of helping them attain the competitiveness required to survive in the global economy.

For the SME sector, DTI announced a general outline of the National SME Development Plan in November 2002 to increase the percentage share of SMEs (not including microenterprises) from 8.7% to 12% in the next three years, and to raise the share of SMEs in total value added from 32% to 40%.

## Chapter 2 Overview of SMEs in the Philippines

### 2.1 Definition of SMEs

At present, SMEs in the Philippines are classified into three types according to the following definition based on the value of assets (excluding land) and the number of employees. Note that this definition replaced an old definition in January 2003, under Resolution No. 1 of the Small and Medium Enterprises Development Council (SMEDC).

#### Definition of SMEs in the Philippines

<u>Category</u>	<u>Total asset value</u>	<u>No. of employees</u>
Microenterprises	P3,000,00 or less	1-9
Small enterprises	P3,000,001-15,000,000	10-99
Medium enterprises	P15,000,001-100,000,000	100-199

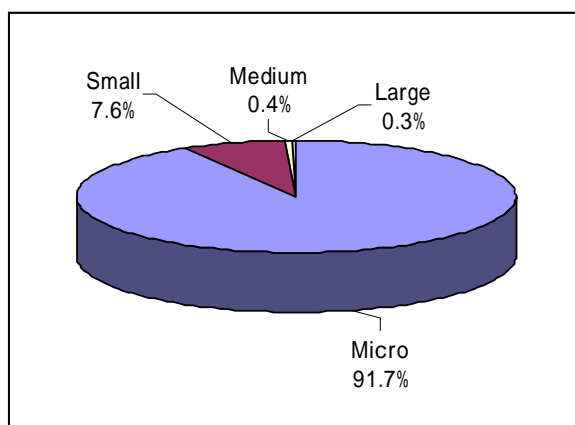
Bangko Sentral ng Pilipinas (BSP) announced the adoption of the above definition.

### 2.2 SMEs in Statistical Data

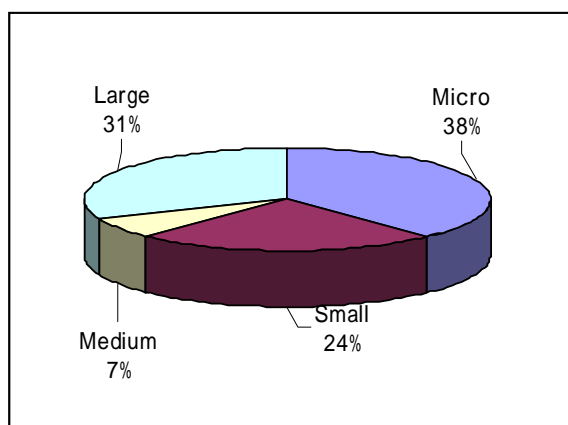
#### 2.2.1 Numbers of Establishments and Employees

##### Percent distribution of establishments by size

According to the 2001 statistics of business establishments published by NSO<sup>1</sup>, there are 811,589 establishments in the country. Thus, SMEs hold a combined share of 99.6% in the number of establishments and 69.1% in terms of employment, as of 2001 (Fig. II-2-1 and II-2-2).



Source: NSO  
Figure II-2-1 Share of Establishments by Size



Source: NSO  
Figure II-2-2 Total Employee by Size of Establishments

<sup>1</sup> NSO, "Establishments in the Philippines in 2001."

### **Change in percent distribution**

It is also noteworthy that, during the three-year period between 1999 and 2001, the total number of business establishments as well as employment has gradually declined.

### **Percent distribution of establishments by industry**

Classification by size of enterprise indicates that, for the manufacturing sector, microenterprises account for 88.0% of the total number of establishments, small enterprises 10.2%, medium enterprises 0.8%, and large enterprises 1.0%, whereas the wholesaling and retailing sector is dominated by microenterprises (95.6%).

### **2.2.2 Geographic Distribution of SMEs**

Analysis of the geographic distribution of enterprises throughout the country indicates a high concentration in the National Capital Region (NCR), which accounts for 24.4% of all establishments and 40.1% of all employees. Also, 65% of SMEs are located in the five regions (NCR, Region 3, 4, 7 and 11). Similarly, the regions account for 72.1% of total employees.

### **2.2.3 Sales and Value Added by SMEs**

Compared to the absolute number of establishments and employment, SMEs hold a relatively small share of value added and sales, around 30%. In comparison to the situation in other countries of the region, this suggests that they possess considerable development potential.

## **2.3 Results of the SME Questionnaire Survey**

As part of the present study, a survey using a specially designed question sheet was conducted to collect data and information relating to the current state of SMEs. The following summarizes the survey results from 175 SMEs.

### **(1) General**

The survey results indicate that major problems that were considered to impede development of SMEs are in the areas of marketing and finance.

Companies in the food processing and furniture industries are most concerned about marketing, followed by those in the metal products industry. Financial problems are also most frequently cited by these industries. On the other hand, problems cited by SMEs in the gifts/housewares, fine jewelry, and wood products industries are more or less evenly spread over marketing, finance, customer's requirements, and insufficient production capacity.

The differences in response between the two industry groups seems to be partially explained by the fact that SMEs in the food processing and furniture industries use subcontractors and have high demand for working capital, while those in the latter group –

notably the gifts and housewares industry – have less financial demand because exporters function also as financiers (smaller manufacturers in particular supply products to exporters).

On the other hand, SMEs in the electronics industry are not much concerned about marketing and finance, but they feel difficulty in meeting customers' requirements.

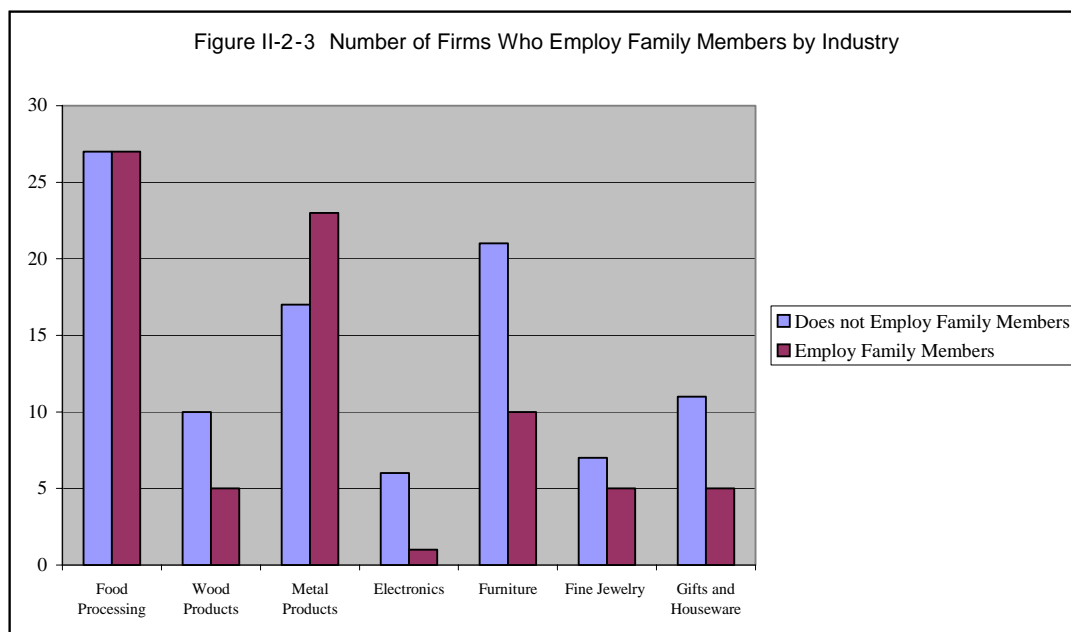
A high percentage of companies having concern about customers' requirements was found in the food processing, furniture, metal products, electronics, and gifts/housewares subsectors, suggesting that the problem is shared by industries that make final products including parts and components.

Insufficient production capacity was frequently cited by companies in the food processing, furniture, metal products, fine jewelry, and gift/housewares sectors. It appears that those in the food processing, furniture and metal products industries cannot increase production capacity due to limited working capital (for raw materials and subcontractors) and the inability to make equipment investment on a desired scale imposes a capacity restraint. Thus the core problem seems to be closely related to finance.

Similar responses were made about the problems relating to business startups. In all the industries surveyed, financial difficulty was most frequently cited by respondents, followed by problems relating to marketing.

## (2) Management

SMEs are often started as personal or family operations and many SMEs continue to be family owned and managed after they have established themselves in the market in which they operate. In the Philippines, this tendency is most widely observed in the metal products and food processing industries. In the former, the number of SMEs employing the owner's family members exceeds those that do not. In the latter, the number is more or less the same for both groups.



Source: JICA Study Team

On the other hand, most companies in the electronics industry do not employ family members, making a sharp contrast to counterparts in other industries surveyed. Finally, SMEs in the furniture, woodcraft, fashion jewelries and gifts/housewares industries tend to have originated as family enterprises, as the number of enterprises employing family members is only one half those not employing. This is because they cannot continue to rely on family management alone when they reach a certain size, and particularly because they have to use subcontractors.

However, this does not necessarily mean that SMEs not employing family members have successfully transformed themselves to modern management. Rather, the opposite is true as revealed from the results of the interview survey that were conducted with the question sheet survey. This will be discussed in more detail later.

The survey asked respondents as to whether they prepared financial reports, which are indicative of modern management. 85% of the surveyed enterprises responded yes. However, the caution is needed because the surveyed enterprises are registered with DTI or SEC (or both) and do not necessarily represent SMEs as a whole.

Yet there is a notable difference in response among the industries surveyed. While all enterprises in the electronics industry make financial reports, other industries show varying percentages of enterprises not preparing them or preparing them occasionally. Although direct comparison is difficult due to a difference in sample size among the industries, the percentage share of enterprises not preparing financial reports is higher in the gifts/houseware, fine jewelry and food processing subsectors, ranging between 17% and 29%.



### (3) Finance

Difficulty in obtaining financing was cited by enterprises in all the industries as the most serious problem. While smaller enterprises try to rely on their internal funds as far as possible, the larger the firm, the greater use made of financing from outside sources.

146 out of 175 enterprises financed their operations using outside sources, and of total, 41% used commercial banks and 34% informal sources. Those using informal sources are mostly observed in the fine jewelry, metal products and food processing industries as well as in Region 4, which primarily serve the domestic market.

On the other hand, all enterprises in the electronics industry borrow funds from commercial banks, reflecting their reliance on export business.

When asked about financial sources they would expect to use in the future, 43% of respondents cited commercial banks and 25% government financial institutions. Those citing commercial banks are expecting the increase in credit line through their repeated use of the bank and a prompt response to the loan application, whereas those citing government banks favored availability of better loan conditions in terms of interest rate and repayment period. On the other hand, government loan programs were cited because of technical support provided by DOST, in addition to favorable loan terms.

Most enterprises, except those in the electronics industry, want to use outside financing to obtain working capital. In the electronics industry, one half of the respondents wants to obtain investment funds and the other half working funds.

The highest percentage of the surveyed enterprises needs funds in amounts between P1 million and P10 million, and P3 million was most frequently cited.

The major obstacle to obtaining commercial loans is inability to offer sufficient collateral, as cited by 40% of respondents, followed by complicated loan application procedures and long time required (27%) and reluctance of commercial banks to issue SME loans (17%).

### (4) Human resources development

The most important problem in the area of labor management is the lack of discipline and morale (45%), followed by difficulty in skills training (35%). In particular, the latter was more cited than the former among those in the furniture and fine jewelry industries.

## Chapter 3 Current State and Development Issues of SMEs in the Selected Industries

### Profile of the Selected Industries

	Production (2001) <sup>*1)</sup>		Number of establishments <sup>*2)</sup>	Number of employees <sup>*2)</sup>	Export (2002) <sup>*3)</sup>	
	Value added (Billion Pesos)	(% of total manufacturing)			Value (Million US\$)	(% of total export)
Food Processing Industry	3,900	47%	approx. 200,000	more than 400,000	1,393 <sup>*4)</sup>	4.0%
Furniture Industry	48	1.5%	approx. 15,000 <sup>*5)</sup>	more than 780,000 <sup>*5)</sup>	316	0.9%
Export General Merchandise Industry	Not available	--	more than 3,200 <sup>*6)</sup>	more than 400,000 <sup>*6)</sup>	608	2.0%
Electronic/electrical Parts Industry	960	11.5%	approx. 800	more than 340,000	24,221	69.0%
Automotive Parts Industry	88	1%	194 <sup>*7)</sup>	40,000 <sup>*7)</sup>	1,167 <sup>*7)</sup>	3.3%

Sources: \*1) NSCB, \*2) Information obtained from industrial associations, \*3) BETP,

Notes: \*4) Includes processed food, fresh foods, and processed marine products.

US\$588 for processed food alone.

\*5) Including sub-contractors

\*6) Holiday decorations and baskets only.

\*7) Automotive parts only.

### 3.1 Food Processing Industry

#### 3.1.1 SMEs in the Food Industry

The major characteristic of the domestic market for processed foods in the Philippines is the dominant position of brand products supplied by foreign companies and large domestic conglomerates. In fact, branded products account for as much as 95% of processed foods distributed and sold through supermarkets and other retailers <sup>1</sup>.

Meanwhile, SMEs play an important role in several national markets including supermarkets, e.g., as suppliers of concentrated juices, seasonings, sauces, and spices, together with organics. SMEs also hold a high share in supply of raw materials to fast food chains and large food processing manufacturers. Nevertheless, they are mainly middle-sized enterprises, and small enterprises and microenterprises are generally unable to enter the national markets due to the lack of ability to supply large quantities of products steadily.

<sup>1</sup> Information provided by a supermarket

SME products exported to foreign markets are the same as or similar to those supplied to domestic markets. Concentrated juices, seasonings, sauces, and spices are exported for consumption by Filipinos living overseas, together with specially seasoned snacks and nuts for local consumption.

Recently, SMEs have been active in produce development and have commercialized various products that use materials available in the country, especially fruits and vegetables that are processed, canned or bottled.

### **3.1.2 Major Issues Facing Promotion of SMEs in the Food Processing Industry**

(1) Evolution from supplying the small local market to the regional/national market

To promote processed foods that meet local demand - notably cakes, snacks and seasonings that are currently sold at local groceries or confectioners - to a regional or national market, much improvement should be made, particularly in the following areas.

1) Increase in product shelf life to improve marketability

This can be accomplished by taking proper measures to prevent contamination by bacteria, without affecting product quality, and by improving packages.

2) Improvement of packaging

Products that are consumed in local markets are mostly not packaged or are put in a simple package. If they are to be sold in a regional or national market, they should be packaged in a proper box or container with a proper label in order to create a clear product image. In fact, shelf life of many products can be prolonged by improving their packaging.

3) Proper bookkeeping and management

Selling products to a regional or national market requires basic management knowledge on standard rules and methods for commercial transaction, including proper bookkeeping practice and business planning.

4) Compliance with technical standards and legal restrictions covering the food industry

Food suppliers serving a large market are required to comply with a set of technical standards and legal restrictions, including hygienic control, allowable food additives, and indication and marking of food content and quality, and to establish and maintain internal rules and standards to ensure compliance.

- (2) Securing of international competitiveness in domestic and export markets, and strengthening of supply capacity for prospective products

As for SMEs that already sell their products to a regional or national market, efforts should be made to help them strengthen competitiveness in their markets and expand sales further.

- 1) Improvement of accessibility to market information, and product development and upgrading capabilities as well as sales promotion capabilities

SMEs are not able to obtain information on consumer attitudes and reactions to their own products, but this is of basic importance and needs to be improved. Further, SMEs must be made capable of obtaining information on the needs and wants of buyers.

- 2) Strengthening of international competitiveness

In the ethnic food market where many SMEs operate, competition with PRC and Thai suppliers is becoming intensified in not only the export market, but the domestic market as well. Now, products from the PRC and Thailand destined for the Philippines are made on the basis of elaborate study of the Philippine market, including cooking methods and taste preferences there. To compete with these products, local products should be further improved so as to increase their consumer appeal, including use of packages and other features.

In fact, processed foods made in the Philippines are losing price competitiveness due to high cost. This is another challenge to the industry.

- 3) Expansion of supply capacity

It appears that many products have a high prospect for market success but cannot be made in sufficient quantity to meet demand due to the shortage of supply capacity. In particular, small food processing companies purchase raw materials for production after they have received an order. Any difference in payment terms will create a cash shortage for SMEs. Some can borrow the amount equivalent to a purchase order from banks by presenting a LC in the case of export business and a purchase order in the case of sales to a large corporation, but this only serves to cover immediate fund requirements and the loan is not available for capacity expansion. As a result, even if a small enterprise successfully promotes its product and has prospects for sales, it cannot take advantage of the situation due to the shortage of investment capital. Delays in equipment modernization is another factor to restrict expansion of supply capacity.

- 4) Quality management and compliance with technical standards

Processed foods supplied by SMEs are often criticized by buyers for the lack of uniform quality. The industry is expected to make continuous efforts to develop, produce and distribute products that are safe to consumers by meeting technical standards in terms of safety, hygiene and indication of nutrients, additives, etc. contained.

In particular, export foods are required to satisfy strict hygienic standards, control on food additives, and proper indication and marking of nutrient content, as well as other requirements enforced in importing countries.

5) Stabilization of raw material sourcing

One of the major issues facing the food processing industry is need to ensure stable supply of raw materials of uniform quality and in sufficient quantities. In fact, some SMEs cannot expand production capacity largely due to the difficulty in materials procurement, preventing them from taking advantage of healthy demand.

Another problem relating to the procurement of raw materials is the high risk of damage and loss in the transportation and storage process, which is estimated to range between 20% and 40% of the total material cost.

6) Improvement of accessibility to financial services

The SMEs have to borrow working capital through loans from friends and relatives at high interest rates, unless they can use a letter of credit (in the case of exports) or a purchase order (from a large corporation) as collateral for commercial loans.

SMEs generally lack access to financial services in a variety of aspects, including the lack of collateral to take out commercial loans, high interest rates, strict requirements for documentation, and a relatively long period of time to obtain loans. Because of this, they have to borrow from informal sources and pay a high interest rate.

SMEs that make sizable exports can establish a credit line at commercial banks, but the credit line is fairly limited, so that there often is a shortage of funds when sales increase rapidly.

In the Philippines, export sales and distribution of SME products are handled by consolidators. In the food industry, consolidators serve as a financier for manufacturers, but the credit line they obtain at commercial banks is usually limited, which in some cases in effect constitutes a restriction on export expansion.

7) Compliance with technical standards and business rules

As discussed above, hygienic control is the most important element of food production, and is particularly important for companies that aim for export markets. They have to meet strict hygienic standards as a first requirement for entering those markets.

Another important issue, which is becoming a major concern for food experts, is the compliance with food-related regulations in different countries, including regulations regarding food additives, ingredients subject to restriction, and residual chemicals.

In addition, environmental management including water quality and waste disposal will increasingly become an important management issue for food companies.

## **3.2 Furniture Industry**

### **3.2.1 SMEs in the Furniture and Fixtures Industry**

Most enterprises in the furniture industry are SMEs. According to DBP's Furniture Industry Profile, large enterprises account for only 10% of the total, small enterprises and micro-enterprises 65%, and medium-sized enterprises 25%. It should be noted, however, that subcontractors play a vital role in the country's furniture production. In particular, those in Cebu account for as much as 80% of total production<sup>2</sup>.

SMEs in the industry are multi-tiered. In the first tier, there are SMEs that maintain business relations with major buyers on a continuous basis, have good product design and development capabilities, and are capable of obtaining technical and other information by themselves. They only expect government support in the area of improving the business environment, such as the sponsoring of international trade fairs.

In the second tier, there are small enterprises that do not have regular customers and require government support in a number of areas, such as assistance relating to participation in trade fairs, financial support, and access to technical information.

Finally, subcontractors are responsible for supply of parts or a specific production process of a furniture assembly manufacturer. Also, they serve as a buffer or swing producers for demand fluctuation.

Furniture production mainly takes place in Cebu, Pampanga, and NCR, with Mindanao where production has increased in recent years.

### **3.2.2 Major Issues Relating to Development of SMEs in the Furniture Industry**

#### **(1) Strategic direction**

The furniture industry is facing increasing competitive pressure from companies in China, which have been modernizing production lines and have volume production capabilities with price competitiveness. In contrast, many manufacturers in the Philippines still rely on manual work, and face difficulty in obtaining locally produced wood materials. For the Philippine manufacturers, selection of volume production as strategy, following the lead of the companies in China, is not feasible on account of the lack of infrastructure (as well as high transportation cost for export products), high labor costs, poor productivity, and difficulty in purchasing suitable wood materials at reasonable prices. Instead, the industry is pursuing niche markets such as furniture using new materials, making hand-made, high-grade furniture, and concentrating on design-intensive products.

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<sup>2</sup> According to CFIF

The key successful factor in this strategy is product development capability, especially in the areas of materials and design.

(2) Major issues to be addressed in SME promotion

1) Comprehensive and focused support for marketing and product development by using trade fairs as recurring, major opportunities

International trade fairs have been playing the most important role in marketing of furniture products in the Philippines. In fact, many manufacturers, of all sizes, emphasize marketing activities and actively participate in trade fairs.

The industry also emphasizes the sending of trade missions for a variety of purposes including normal promotion, collection of market information, contributing to product development activities, and benchmarking. Information obtained from such missions is shared within the industry.

2) Strengthening of design and development capabilities, including raw materials

The furniture industry in the Philippine is increasingly required to develop and offer new products in order to win over competitors from neighboring countries. To offer a new product acceptable to the market, marketing and information gathering activities are of critical importance. Based on market information, a new product is developed by applying design and development skills, including skills and know-how related to raw materials.

In the area of materials development, there must be an adequate organization and system to enable acquisition and use of knowledge about available raw materials for the purpose of using them for furniture and provide consultation, testing and guidance services for manufacturers.

3) Learning of production management techniques

The largest problem in the area of production management is related to proper control of subcontractors in terms of quality and lead-time. They are generally unreliable in terms of on-time delivery. Also, their quality control is very poor, resulting in a defective rate of 10% to 20% and delays in delivery.

At the same time, furniture manufacturers can be improve their situation by learning proper control techniques. As they have their own assembly and finishing (coating) lines and focus on flexible production (large variety, small lots) rather than mass production, they can improve productivity and competitiveness by mastering the latest process management techniques, including flexible production and by purchase control. In particular, computer-based management techniques should be introduced where feasible.

4) Effective training for skilled workers

Small furniture manufacturers can rarely afford to provide in-house training for their own workers, and instead send them to outside training courses. However, many companies feel that these courses provide general training only and additional training is required internally. Also, most training facilities use old equipment and fail to provide a practical training environment.

5) Improvement of accessibility to financial services

Financial access is the most serious problem for SMEs in the furniture industry. While large and medium-sized enterprises can use commercial banks, including those providing export finance, small enterprises and microenterprises point out that commercial banks and government financial institutions are not accessible to them because of: (1) high interest rates; (2) cumbersome and time-consuming procedures in an unfriendly atmosphere; and (3) strict collateral requirements.

Also, exporters serve as a financier for subcontractors by making advance payments or down payments, so that financial access to exporters is equally important to ensure smooth production by the small enterprises which rely on them.

### **3.3 Export General Merchandise Industry**

#### **3.3.1 SMEs in the Export General Merchandise Industry**

Of the commodity goods and general merchandise sold in the country, 70% are locally made products and 30% are imports (according to supermarkets and other industry sources). Among locally made products, those made by large enterprises account for 60% while SME products account for 40%.

However, export general merchandise is mostly manufactured by SMEs and microenterprises. The supply chain for export-destined general merchandise is controlled by manufacturers and exporters that are also SMEs. They generally use subcontractors to make parts or semi-finished products and assemble and finish them at their own facilities, followed by coating and packaging for shipment. Subcontractors are usually microenterprises, family-operated enterprises or self-employed workers, and manufacturers and exporters often provide design and materials. They also serve as an intermediary by making advance payments to subcontractors.

#### **3.3.2 Major Issues Relating to SME Promotion in the Export General Merchandise Industry**

(1) Strategic direction

While the world market for export general merchandise has been expanding steadily, exports from the Philippines have been on a constant decline, while imports have increased.



This largely reflects the fact that the PRC, the largest exporter of export general merchandise, mainly supplies mass-consumed products (including plastics and metal products), whereas the Philippine products are mainly handicrafts. On the other hand, competition with products exported by other Asian countries, including Thailand, Indonesia and Vietnam, is governed by various factors such as price and quality. As yet, detailed analysis of market-related problems has not been carried out.

As for design, general merchandise designers in the Philippines are highly valued by buyers. Designs of Philippine products are sometimes copied by exporters in other countries, while the PRC companies hire Philippine designers and craftsmen at higher wages than paid by companies in the Philippines.

As for raw materials, some point out that what is used in the Philippines is not much different from that available in India or Thailand. Furthermore, raw materials available in the Philippines are often exported to the PRC where they are processed for exports.

Thus, the export general merchandise industry in the Philippines is still very small in terms of world market share. While one can say that it has large growth potential in export markets, it is facing intensifying competition with various countries and may continue to lose share unless it establishes its own differentiating factor.

## (2) Major issues to be addressed in SME promotion

### 1) Lack of market analysis

As in the case of furniture, marketing of export general merchandise also concentrates on participation in trade fairs, which serve as the best opportunity for SMEs to promote their products to buyers.

Compared to the furniture industry, there are more small enterprises and micro-enterprises in the export merchandise sector. They cannot collect market information by themselves and their marketing activity is limited to exhibition of their products at trade fairs. Despite the recent decline in exports, the industry lacks the ability to collect and analyze relevant information in an organized manner.

### 2) Multi-faceted marketing and product development efforts targeting trade fairs

Undoubtedly, trade fairs provide the most important marketing opportunity for the export general merchandise industry. However, many companies do not seem to take full advantage of the potential of these fairs. Further efforts should be made to attract the attention of buyers by presenting a product that has been developed on the basis of careful analysis and evaluation of market trends.

In this connection, technical support organizations that assist SMEs in product development should provide multi-faceted support for participation in trade fairs by collecting and disseminating market information, and by mobilizing support of designers

and buyers in and outside the country. It is especially important to obtain information on raw materials, technologies and merchandising, which is hard to get in the Philippines.

3) Improvement of design skills through training of designers

Household articles and interior decorations are basically designed by modifying and adapting traditional goods to modern life. It is therefore important to redesign traditional handicrafts to make them suitable and acceptable for everyday use. This requires high levels of creativity (conception and design), while appealing to consumer taste in each export market. As export general merchandise does not require sophisticated production techniques, design capability, including the ability to express an idea effectively, constitutes a competitive edge for the industry.

Market information can also be learned from designers working in foreign markets. This is particularly effective in understanding a market in which Philippine designers find it difficult to understand consumer taste. By inviting to the Philippines foreign designers who are familiar with their own markets, in-depth information can be collected for the benefit of effective marketing.

4) Systematic R&D efforts on commercialization of natural materials

Export general merchandise made in the Philippines has as an important feature the use of locally available materials, which should be carefully commercialized on the basis of their characteristics. Commercialization of materials should be started from the viewpoint of product development. In the Philippines, there are various research institutes specialized in specific types of materials, and commercial development of materials tends to start with basic research. For effective and efficient development, however, production design should come first, and based on functional and design requirements, development efforts should focus on selection of a material suitable for the application and commercialization of technology required to ensure its effective use.

5) Establishment of permanent access by potential buyers

There is no formal response system for handling inquiries and questions by buyers outside of trade fairs. Now is the right time to provide a permanent exhibition space and build an Internet-based system to disseminate and receive information on a continuous basis.

6) Production management techniques optimized to the export general merchandise industry

Export general merchandise in the Philippines is mainly handmade and has a competitive advantage from its flexible production (capable of making a wide variety of products each in a small lot). Such an advantage, however, can be translated into a lack of uniform quality and an unreliable delivery schedule.

To make the Philippine products competitive, especially against Chinese products, the industry should make efforts to reduce cost by means of rationalization, including productivity improvement and cost control.

#### 7) Poor management skills

Many general merchandise companies in the Philippines lack business experience and expertise because they have been started by individuals whose primary interest lies in making handicrafts. As a result, they do not have proper management know-how in the areas of pricing, cost control and subcontract management.

Recently, more and more U.S. buyers require vendor compliance, i.e., manufacturers are required to certify their compliance with various standards, including working conditions, environmental standards, and the manufacture of electrical products according to international technical standards such as UL and CE. Philippine companies are no exception to this and have to start efforts to satisfy vendor compliance requirements, otherwise they will run a risk of losing the U.S. business and market. In this connection, establishment of a support organization, which extends support services on behalf of overall development of the general merchandise sector, is urgently needed.

#### 8) Improvement of accessibility to financial service

Production of export general merchandise is highly dependent upon microenterprises and independent contractors, and exporters and assembly manufacturers constitute the first tier and generate cash flow to subcontractors.

Medium-sized enterprises with stable business (exporters) can obtain short-term loans from commercial banks on the basis of a credit line established for each company. However, the credit line is generally set at a relatively low level and is not sufficient to provide operating funds required for business expansion.

### **3.4 Electronic and Electrical Parts Industry**

#### **3.4.1 SMEs in the Electronics Industry**

Semiconductor production is entirely in the hands of European and American multinationals, which make no purchases from local SMEs.

Manufacturers of computer peripheral equipment (e.g., HDDs, FDDs, printers, CD-R/W drives, and DVDs) purchase most parts and components from affiliate plants in other countries, which form the global production bases, or other sources through their global procurement centers or companies. Compared to semiconductor production, they purchase much more parts from local suppliers (as much as 20% for a Japanese manufacturer), which are mostly foreign-affiliated companies operating in the country.

SMEs that are classified in the electronics industry or its support industries are mostly foreign-affiliated companies and are located within two hours from Manila. The remaining, small part of the industry, are represented by local SMEs, which are exceptionally advanced manufacturers or metalworking or plastics molding shops that have major customers in other industries.

### **3.4.2 Major Issues Relating to Promotion of SMEs in the Electronics and Supporting Industries**

#### (1) Strategic direction

Foreign electronics manufacturers (assemblers) operating in the Philippines do not have to discriminate local procurement from global sourcing. They are willing to purchase from any source so long as their specifications are complied with, and lead-time and cost requirements. In reality, however, for various reasons it is not feasible for local SMEs to supply key parts to foreign manufacturers..

The strategic focus of SME promotion in the electronics industry should be placed on provision of diverse business opportunities, rather than mere expansion of the parts supply business.

As for parts supply, efforts should be made to focus on SMEs having high growth potential by providing intensive support in the form of a pilot project, from which experience and benefits can be expanded to other suppliers.

#### (2) Pursuit of diverse business opportunities

##### 1) Development of an effective communication channel between electronics manufacturers and local SMEs

Clearly, the major problem that hinders market development in the industry is the lack of information, i.e., local SMEs do not have information on potential customers, who in turn do not have information on local suppliers.

The reverse trade fair, meaning a trade fair sponsored by buyers rather than sellers, is expected to provide an opportunity for electronics manufacturers to expand local procurement.

Meanwhile, the reverse trade fair has a clear disadvantage in that it requires large costs compared to the limited effects that normally can be expected. It is therefore necessary to develop other matchmaking methods, such as seminars and an IT-based approach.

## 2) Improvement of production management and quality control

To promote a workable linkage between electronics manufacturers and local SMEs, production management capabilities are indispensable for delivery of a product that meets quality requirements within a specified schedule, in addition to production technology itself.

## 3) Encouragement of technology transfer to suppliers

It is not feasible to promote supply contracts for key parts between local SMEs and electronics manufacturers given consideration of the economics of production (not technical skills).

Instead, the linkage between the two parties should be promoted for parts and dies/molds that do not require cost competitiveness based on economies of scale and that are already supplied by local SMEs, such as bulky parts.

To win supply contracts from electronics manufacturers on a continuous basis, however, local suppliers must have high levels of production techniques. At present, local sourcing is limited to a handful of local suppliers and a number of Malaysian and Singaporean companies, which have achieved international technology levels by means of licensing from industrialized countries or joint research and development efforts with foreign partners. On the other hand, local suppliers and foundries that supply products to the industrial machinery industry cannot meet requirements for electronic parts unless they introduce advanced production technology from outside. Technology transfer or licensing should play a vital part in the process.

### **3.5 Automotive Parts Industry**

#### **3.5.1 SMEs in the Automotive Parts and Supporting Industries**

Most local suppliers, with the exception of wire harness assembly, supply secondary or lower tier parts or manufacture and sell spare parts. Details of their operation are not known, but many of them are specialized in machining, plastics molding, die making and/or assembly and finishing and make automotive parts as part of their business.

#### **3.5.2 Major Issues Relating to Promotion of SMEs in the Automotive Parts and Supporting Industries**

##### (1) Strategic direction

The auto industry has a broad supplier base. Automakers in the Philippines manufacture and export motor vehicles in keeping with the global production strategy established and implemented for the entire MNC group. Procurement of parts and components is also carried out for the interest of globally optimum sourcing. Thus, the BBC and AICO schemes are not intended to serve the country's interest but are based on the premise that the country can supply specific parts under the best terms and conditions.

At the same time, most MNCs are pursuing the policy of promoting local procurement, except for key parts and components that are to be procured from global sources. Thus, local suppliers can win contracts from automakers as far as they can supply products that meet strict technical and cost requirements.

(2) Major issues to be addressed for SME promotion

1) Development of an effective communication channel and tool linking automakers, suppliers, and supporting industries

Generally, auto makers have suppliers form a group for systematic control and guidance in order to communicate and enforce procurement policy and request the improvement of production management practice and standards. On the other hand, local SMEs that do not belong to such group do not understand the needs of auto makers. Also, they do not have an established communication channel whereby they can contact auto makers' representatives in charge of procurement, excepting some medium-sized enterprises.

On the other hand, auto makers intend to use local suppliers by publicizing requirements for parts and components that they willing to procure locally. However, such information is rarely known to local SMEs.

The reverse trade fair is an effective method to create a business opportunity for manufacturers and buyers in many industries, but it has not been widely used for procurement of automotive parts because, although the reverse trade fair has attracted a number of visitors, many of them did not have experience in production of automotive parts and few results have been produced.

Clearly, it is important to develop an alternative system or mechanism to link buyers and suppliers and enable them to exchange information quickly and efficiently. The system should cover not only first-tier suppliers but also second- and third-tier ones. Feasible methods include seminars held by buyers (auto makers or first-tier suppliers) and a supplier database system.

2) Deployment of multi-faceted and focused technical support specifically for certain parts

Generally, an auto maker purchases a new part or component by ordering its prototypes to candidate suppliers and evaluating them for final selection. The selection process usually involves companies that presently supply products to the auto maker, while other companies not on the supplier list do not have access to information, and even if they obtain information, they usually will have difficulty in making the prototype due to technical and/or financial burdens. It is therefore important to disseminate procurement information from automakers to a large number of potential suppliers, while providing technical and financial support for prototyping and other procurement procedures. It should be provided in the form of one-stop shopping support including reference service for proper support organizations and potential partners.

Furthermore, SMEs do not have advanced production technologies - in particular “soft” technology such as die making and design – and do not have an opportunity to learn them. As a result, they cannot respond to procurement information in many cases.

In addition to advanced production technology, local SMEs have to learn quality control and production management techniques and know-how if they are to win contracts from foreign manufacturers.

It is important to provide such multi-level and multi-faceted technical support for prospective SMEs according to the level of technical requirement for candidate parts and components in order to maximize effectiveness.

### 3) Nurturing of technicians

Various public organizations centering on TESDA have provided training courses for nurturing of technicians. Also, there are some training courses provided by foreign donors. However, there are some comments on these training courses that the contents of the courses do not meet the target level. The comments are mostly for courses operated by the public sector.

There are some private enterprises, which are offering training courses, and supply trained technicians not only for their enterprise but also for other enterprises. If the Government utilizes these enterprises entrusting the analysis of the training needs, setting of the training target, formulation of curriculum and the course management, while the Government showing only the basic needs for the training course, then these private enterprises will implement the training more efficiently.

Some success cases of training of supervisors and technicians may be seen in that of Japanese affiliated enterprises. They send their trainees to their parent company or relevant companies in Japan for training. This method has especially been found effective in terms of technical transfer.

In the future, industries are recommended to take initiative in training, as have been seen in the furniture industry in Cebu, formulating practical standardized curriculum in consultation with parts procurement companies, and entrusting the operation to the private enterprises, vocational schools and/or training organizations.

### 4) Encouragement of investment in equipment modernization

Manufacturers in the Philippines are generally cautious about capital spending, especially equipment investment, in the wake of the persistent recession. As a result, they are lagging behind competitors in other countries in terms of productivity and quality, including precision. Even advanced SMEs continue to use obsolete and aging equipment.

5) Improvement of accessibility of SMEs to finance

Few local metalworking companies can have access to commercial loans or credit service. However, they cannot obtain commercial loans for several reasons. First of all, many SMEs do not keep accurate books and records on their business operation or even practice double-entry bookkeeping. Secondly, many companies cannot meet collateral requirements largely because a very small portion of their asset value (say, 20%) is acceptable as security or machinery cannot be used as a collateral. Thirdly, SMEs do not have time and resources to prepare documents that should be attached to a loan application. Many companies do not have any middle manager, and owners have to deal with documentation but have little time to do so.



## **Chapter 4 Current State and Development Issues of SME Finance**

### **4.1 Financial System in the Philippines**

#### **4.1.1 General Outline**

The financial system in the Philippines is roughly divided into two sectors, formal and informal. The formal financial sector is led by Bangko Sentral ng Philipinas (BSP=Central bank) and is composed of various types of institutions, namely commercial banks, expanded commercial banks, governmental specialized banks, thrift banks, rural banks, and finance corporations. The informal financial sector includes private money lenders, Rotating Savings and Credit Associations (ROSCAs), and financing from relatives and friends, but details on the sector are not known. The governmental specialized banks and finance corporations are categorized also as the non-bank institution. The non-bank institutions includes the largest pension funds in the Philippines, the Social Security System (SSS) and the Government Social Insurance System (GSIS), which extend loans for housing and other purposes to their members. Furthermore, they serve as wholesale banks to supply funds, via local financial institutions, for resending to SMEs and MEs.

#### **4.1.2 Regulatory Measures for Financial Reforms**

The Asian currency crisis, which originated in Thailand in July 1997, adversely affected already vulnerable financial institutions in the Philippines and prompted the government to proceed with reforms of the financial system at an accelerated pace. The series of regulatory measures that have been introduced in recent years are summarized below.

- 1) Imposition of an equity capital to risk assets ratio standard
- 2) Setting of a minimum capital requirement
- 3) Loan portfolio regulation
  1. Limit imposed on the amount that can be provided to a single given borrower
  2. Lending requirements were imposed for agriculture and agrarian reform
  3. Real estate loans were restricted
  4. SME loan requirements were imposed

All lending institutions are required to set aside and lend at least 6% of their total loan portfolio to small enterprises and at least 2% to medium-sized enterprises. However, they can satisfy this requirement by making equivalent funds available to BSP or by holding government-issued or government-approved bonds.

- 4) Regulation of the requirement for bad debt reserves

### 4.1.3 Financial Institutions and Their Operation

As of the end of 2002, there were 42 commercial banks (including 17 expanded commercial banks), 94 thrift banks, and 776 rural banks. They operated a combined total of 7,454 branches throughout the country.

## 4.2 Current State of SME Finance

### 4.2.1 SME Finance by the Private Financial Institutions

#### (1) Analysis of SME Loans

Table II-4-1 shows the changes in the balance of SME loans between December 1998 and June 2002. While the total amount of loans has gradually declined since 1998, SME loans gained in share from 23.3% in 1998 to 27.0% in the first half of 2002.

The absolute amount of SME loans, however, remained more or less unchanged. While financial demand has been recovering since 2002, it is reported that SME loans have increased significantly after the introduction of SULONG in 2003.

Table II-4-1 Recent Changes in SME Loans

(Unit: P1 billion, %)

Year	Small		Medium		Small & Medium		Net Loan Portfolio	
	Amount	Share	Amount	Share	Amount	Share	Amount	Total
Dec. 1998	141	13.7	99	9.6	240	23.3	1,028	100
Dec. 1999	148	14.8	100	10.00	248	24.8	1,002	100
Dec. 2000	125	12.7	106	10.8	231	23.4	986	100
Dec. 2001	155	15.6	94	9.5	249	25.1	992	100
July 2002	166	16.9	99	10.1	265	27.0	983	100

Source: BSP.

#### (2) SME loans by type of lending institution

Table II-4-2 shows the composition of SME loans by type of bank, as of June 2002. Clearly, commercial banks have a dominant share in SME loans, i.e., 82.4% for small enterprises, 84.9% for medium-sized enterprises, and 83.3% for SMEs as a whole. In contrast, thrift banks account for 11.7% of the total, while rural banks account for only 5.0%. Thus, it is interesting to see that commercial banks which are based in urban areas are dominant as lenders to SMEs, whereas thrift banks and rural banks, which operate in rural areas where there is a large number of small enterprises and microenterprises, hold relatively small shares.

Table II-4-2 Composition of SME Loans by Type of Bank (June 2002)

(Unit: 1 billion P)

	Small		Medium		Small & Medium		Net Loan Portfolio	
	Amount	Share	Amount	Share	Amount	Share	Amount	Share
Commercial banks	136	82.4	84	84.9	220	83.3	879	89.4
Thrift banks	19	11.5	12	12.1	31	11.7	76	7.7
Rural banks	10	6.1	3	3.0	13	5.0	28	2.9
Total	165	100.0	99	100.0	264	100.0	983	100.0

Source: BSP

According to BSP's data, 58.6% of loans to SMEs have been provided by five banks, and notably, the top bank accounts for 36% of the total amount of loans. The fact that only 5 out of 912 banks in the country provide more than half of SME loans indicates that a small number of banks are accessible to SMEs.

(3) SME loans by region and industry

Table II-4-3 summarizes the balance of loans made by commercial banks, disaggregated by region and industry. Among the three regions, Luzon holds a predominant share of 80%, Visayas 10% and Mindanao 10%. As for industry, the wholesale and retail sector is the largest borrower, followed by the manufacturing sector.

Table II-4-3 Composition of SME Loans Made by Commercial Banks, by Selected Regions and Industry (2002)

(Unit: P million)

	Luzon	Visayas	Mindanao	Total
Manufacturing	46,842	4,530	1,947	53,319
Electricity/gas	409	109	59	577
Construction	6,276	996	1,149	8,421
Wholesale/retail	49,076	7,407	8,674	65,157
Transportation/warehousing	3,734	777	806	5,317
Real estate	20,718	2,109	1,642	24,469

Source: BSP

Manufacturing industries are concentrated in urban areas and Luzon, as reflected in their large shares in SME loans. Rural regions where thrift banks and rural banks are based are dominated by microenterprises and small enterprises and need a financial system that promotes social welfare more than they need industrial development.

## 4.2.2 SME Financing by Government Financial Institutions

### (1) Loan status

#### 1) DBP and LBP

Table II-4-4 shows recent changes in outstanding loans made by government financial institutions, which amount to around P200 billion and account for 12% to 13% of the total balance of loans made by commercial banks. The Government financial institutions play an important role in that they are supplying funds to commercial banks.

The loans made by government financial institutions for SMEs have increased.

Table II-4-4 SME Loans by Government Financial Institutions

(Unit: P million)

	6%		2%		8%		Net	
	Small	Share (%)	Medium	Share (%)	Small & Medium	Share (%)	Lone Portfolio	Share (%)
Dec. 2000	11,290	10.0	6,497	5.7	17,787	15.7	113,053	100
Dec. 2001	12,334	15.9	8,826	11.4	21,160	27.3	77,548	100

Source: BSP

Recently, government financial institutions are playing a more active role in financial services relating to promotion of SMEs, by means such as a special SME loan program offering favorable conditions, and by significant expansion of branch networks. Nevertheless, it is pointed out that the increase in direct SME loans by government financial institutions has intensified competition with private financial institutions, and that they require stricter loan conditions (especially collateral requirements) in order to have assurance of the soundness of retail finance. As a result, government financial institutions do not pay as much attention to fulfilling their role of supporting the private financial sector<sup>1</sup>.

#### 2) SBC (SBGFC)

SBC is a loan guarantee organization the mission of which is to facilitate supply of funds to SMEs by reducing risks for financial institutions that supply SME loans. It was established pursuant to the Republic Act 6977 of 1991 (generally referred to as the “Magna Carta for Small Enterprises”). Since then, it has been expanding its scope of business, including direct lending to SMEs, and it is in the process of establishing a venture capital division. It is therefore becoming a financial institution providing comprehensive credit and loan services for SMEs. It is under DTI’s jurisdiction and primarily operates in line with a policy guideline established by the SME Development Council (SMEDC). SBGFC offers five guarantee programs and six loan programs.

<sup>1</sup> From answer to questionnaire survey.

The total values of loans and guarantees provided by SBC in FY2002 are summarized as follows.

- 1) Guarantee program: P119 million
- 2) Long-term loan: P53 million
- 3) Short-term loan: P242 million
- 4) Wholesale lending: P17 million
- 5) Discount financing: P741 million

The operating results in 2002 indicate that loan and rediscount services as a percentage of SBC's total operations have surpassed that of the traditional guarantee service.

## (2) SULONG Program

The SME Unified Lending Opportunities for National Growth (SULONG) program is a newly started SME loan program created by a presidential decree in December 2002. It is implemented as part of programs under the National SME Development Plan. In particular, it aims to expand fund supply to SMEs by mitigating much-criticized barriers to SME finance, including the difficulty in loan application documentation, strict collateral requirements, and high interest rates. It functions through government financial institutions (GFIs), and started in January 2003.

The government does not provide a special fund for the program, which is basically funded in the form of commitments by the participating banks to make the source fund available to the program.

The participating banks make wholesale and retail loans. Wholesale lending is made through thrift and rural banks that operate throughout the country (which, however, are required to satisfy certain standards). As SMEs can apply for loans to thrift and rural banks by using a unified form of application, they have ease of access to many more banks than before. The program provides short-term operating funds (with a repayment period of one year or shorter) and long-term funds (five years or less, with a one-year grace period), with the maximum amount of loan being limited to P5 million. Interest rates are 9% p.a. for direct loans from GFIs participating in the program and 12.75% p.a. for long-term loans (and 11.25% for three-year loans). The maximum amount of each loan is P5 million for both short-term and long-term loans.

The following differences exist between the previous SEM loans and SULONG loans.

- Interest rates for the SULONG loans are lower than the previous SEM loans. For instance, direct loans from the participating GFIs can be had at 9% p.a., much lower than the 11% - 12% for ordinary SME loans.

- Compared to the 100% collateral requirements for the previous SEM loans, the SULONG loans require collateral to supplement personal guarantees and other forms of security.
- An application form consists of only two pages and is in a uniform format that can be used by all banks handling the SULONG loan. The application is thus much simpler and streamlined than before, with a shorter examination period (although not yet realized significantly due to a larger number of applications).

While it is too early to evaluate the program and its effectiveness as a small number of borrowers have started repayment, the program is being well received by SMEs compared to the previous programs. At the same time, however, it is pointed out that the program has not fully accomplished its main goals, including modification of the lending stance of relying heavily upon collateral, simplification of the examination process, and the lowering of interest rates.

### (3) Micro-enterprise loans

BSP has issued a guideline for loans to micro-enterprises (MEs), separate from that for SME finance. It states that ME loans should be P150,000 or less per case, non-secured and short-term (repayment period of one day, one week or one month). The interest rate should be based on the market interest rate, not necessarily at a concessionary rate. To facilitate ME loans, BSP designates thrift and rural banks as microfinance-oriented banks that are required to lend 15% of total loanable funds to microenterprises and provide funds by means of rediscounting. As of February 2003, there are four microfinance-oriented banks, and in addition, 88 rural banks are designated as financial institutions specialized in ME loans.

In addition, the government enacted the Barangay Micro Business Enterprises (BMBEs) Act of 2002, which establishes new incentives for microfinance. In particular, the law requires GFIs to maintain a special loan desk for ME loans. Similarly, it requires that the credit guarantee service set a special line of credit for micro-enterprises.

#### **4.2.3 Credit Guarantee System**

SBC renders credit guarantee service for a total of 45 financial institutions (20 commercial banks, 15 thrifty banks, and 10 rural banks) through its head office in Manila and four branches. In 2002, 42 guaranteed loans totaling P118,860,000 (average, P2,830,000 per loan) were extended. It was equivalent to only 17% of the annual target. By type of bank, 50% was accounted for commercial banks, 35% thrifty banks, and 15% rural banks. A regional breakdown is as follows.

<u>Region</u>	<u>No. of guaranteed loans</u>	<u>Total amount</u>	<u>Amount per loan</u>
Metro Manila	15	P42.8 million	P2, 850,000
Luzon	9	P27 million	P3, 000,000
Visayas	16	P43.7 million	P2, 730,000
Mindanao	2	P5.3 million	P2, 650,000

#### **4.2.4 Equity Financing**

For SMEs in the Philippines, loan arrangements including loans from the informal sector are virtually the sole means of raising funds. Equity financing facilities such as venture capital (VC) and private equity (PE) are underdeveloped and there is no equity financing market to supply funds to SMEs.

### **4.3 Major Issues for Improvement of SME Finance**

#### (1) Vulnerability of financial institutions

As pointed out earlier, financial institutions in the Philippines are relatively small in terms of asset holdings, while there is a relatively large number of institutions. These characteristics seem to stem from several factors. First of all, national income and the propensity to save are very low. Secondly, reliability of financial institutions is generally low, causing capital flight to overseas or to the informal sector, preventing the healthy circulation of funds. As a result, many financial institutions face difficulty in raising sufficient funds for lending. In particular, they have to borrow funds from larger financial institutions as well as governmental ones to make up for the shortage of deposits, causing a cost increase (including the interest). Thirdly, the small size delays cost reduction efforts, including efforts through use of IT.

#### (2) Overemphasis on collateral requirements

Rarely are project feasibility or creditworthiness of personal security is taken into account when SME loan applications are evaluated. The SULONG program that was launched in 2003 has made significant improvements in financial accessibility, but it is said to give heavy weight to collateral requirements in actual operation. One of the reasons for this may partly be attributable to the inability of lenders to evaluate loan applications on the basis of criteria other than non-personal security.

An immediate solution to deal with the lack of collateral on the SME side is to make the credit guarantee system more accessible to SMEs. Further, personal security should be adopted, where possible, as an alternative to physical assets.

#### (3) The lack of a credit information system and the highly centralized examination system

Large financial institutions operating nationwide examine and decide on most loan applications at their head office. While they have their own reasons for the centralized

system, it is problematic in terms of customer service. In particular, loan application examination often takes a long period of time, causing loss of opportunities for potential borrowers who need to make prompt payment or investment. Further, credit information used for examination (corporate information, land valuation, past credit performance, etc.) is not integrated or updated, so that most financial institutions do not have a formal examination system utilizing advanced information technology.

(4) Reinforcement of the guidance system for SMEs

Commercial banks require SMEs to submit financial statements and present their business plan or project, but they seldom provide consultation service or guidance for SMEs (based on the interview surveys). As financial institutions have a large amount of information on industries, markets and individual companies, together with the ability to analyze financial statements and other data, they should be able to provide systematic advice and guidance for SMEs (including computer-based corporate diagnosis).

(5) Major issues relating to equity financing for SMEs

1) Lack of attractiveness of the SME Board

The SME Board, which is supposed to introduce emerging companies, lacks attractive investment opportunities. As discussed earlier, the SME Board lists only two companies as only three years have passed since its opening.

2) Fostering of investors and investment companies

At the same time, the establishment of a government investment company should be considered. At present, SBC is preparing itself for SME investment. However, the investment business is substantially different from guarantee and loan businesses in terms of risk management as well as fund management. In the initial stage, an SME investment initiative can be started in the form of a pilot project within the same company, but it should be separated from the guarantee and loan unit from the standpoint of asset/liability management.

3) Easing of the IPO requirements

The stock exchange should review and modify IPO requirements and their operation policy in order to provide sufficient incentive for individual companies as well as investment companies to find the IPO an attractive opportunity.

(6) Major issues relating to SBC's credit guarantee system

1) Poor recognition among SMEs

While all the banks knew the content of the system, nearly one half of the SME managers surveyed did not know about SBC or did not have knowledge on the credit guarantee system.



2) Lack of standard credit information and data

In the Philippines, there is no organization that serves as a credit bureau having reliable credit data; financial institutions make credit ratings on the basis of their own customer data. The absence of the credit bureau is considered to be a major factor for the lengthy time needed for examination of SMEs and small loans.

3) Revision of guarantee conditions

Financial institutions using the credit guarantee system complain about expensive fees (guarantee and processing), strict collateral requirements, and a large number of documents to be submitted. The guarantee fee should be based on an insolvency rate and a collection rate determined from past experience and should be set within a range where revenues and expenditures - including gains from investment - can be balanced. In addition, favorable conditions may be set for prospective projects or strategic areas and a mechanism to cover the loss from the government budget (subsidy) may have to be considered.

## **Chapter 5 SME Promotion Policy, System and Organization**

### **5.1 Major SME Related Laws**

(1) Magna Carta for Small Enterprises (RA6977 and amended RA 8289)

The basic law governing SME promotion in the Philippines is generally referred to as the Magna Carta for Small Enterprises (Republic Act 6977; amended and renamed as RA 8289 in 1997). Essentially it sets forth basic rules for SME promotion and provides for the definition of SMEs and mandates the establishment of the institutional framework for the existing SME promotion system, the Small and Medium Enterprises Development Council (SMEDC) and the Small Business Guarantee and Finance Corporation (SBC). It also stipulates the provision of the mandatory quota for SME loans. After the major amendment in 1997, the law has been regularly reviewed and its amendment is currently under discussion.

(2) Barangay Micro Business Enterprises Act of 2002 (RA 9178)

The Barangay Micro Business Enterprises Act was recently enacted to support microenterprises as well as the informal sector, which have survived through the financial crisis. RA 9178 legislates public support in response to programs for the alleviation of poverty. The Act calls for enterprise promotion in rural areas, especially focusing on the use of local resources and creation of employment opportunities. It provides for the following incentives for microenterprises:

- Exemption from the business income tax for two years
- Exemption of minimum wage requirements
- Financial support which can be sourced from government financial institutions such as DBP, SSS and GSIS, and
- Technology transfer, production and management training and marketing assistance through the DTI, DOST, University of the Philippines Institute for Small-Scale Industries (UPISSI), Cooperative Development Authority (CDA), and Technical Education and Skills Development Authority (TESDA).

### **5.2 SME Development Plans**

“SME Development Strategy 1998” which was announced by DTI in June 1998 has served as a general yardstick for SME development to this date. Then, SME Development Plan/SME Core Group Action Plan for 2002 was announced in September 2002, followed by the National SME Development Plan 2002 that was presented in November. The three development plans have the following common elements that are considered to serve as the general framework for the country’s SME development policy:

- 1) To reinforce the industrial (inter-company) linkages;
- 2) To reinforce financial support (accessibility) for SMEs; and
- 3) To review the existing programs and ensure their efficient management as a whole.

National SME development Plan 2002 is considered as the formal SME development plan currently being implemented.

### **5.3 SME Promotion System and Organization**

#### **5.3.1 DTI's SME Promotion System**

(1) Central government level

At present, public policy for SME promotion in the country is formulated by the Bureau of Small and Medium Enterprises Development (BSMED) of DTI.

Another organization that plays a key role in SME-related administration is the Small and Medium Enterprises Development Council (SMEDC), which is chaired by the Secretary of DTI. Established under the mandate of RA 6977 (the "Magna Carta"), SMEDC is the key organization responsible for the formulation of SME promotion policies, organization, system and institution, and offers its opinions and recommendations to other organizations where SME is a major consideration.

Within the framework of the Magna Carta, the establishment of an inter-departmental SME promotion organization is being planned by using the existing organizations, but it has not been materialized.

(2) Local level

SME promotion at the local level is implemented by DTI regional and provincial offices. SME promotion programs are implemented with BSMED's budget. The local DTI offices are under the jurisdiction of the Regional Operation Group (ROG) and thus report directly to ROG. The regional offices employ an average of 55 persons each and supervise all DTI offices within the province.

(3) SME Centers

There are 79 SME Centers throughout the country. They have been established in the provinces since 1996. 65 centers are currently accommodated in DTI regional or provincial offices. Other centers are located in the local chamber of commerce or the municipal/city office. SME Centers are primarily responsible for providing information on SMEs as well as implementing programs and projects.

While 79 SME Centers are reported to be operating throughout the country, the actual number of centers engaged in substantial activities seems to be fairly limited, less than ten as of April 2003. The low budget and limited manpower account for the inactivity of most

SME Centers. Active centers are gaining support from local chambers of commerce and industry.

(4) **SME Production Centers**

DTI is authorized, under the General Appropriations Act of 1994, to establish seven SME Production Centers throughout the country.

These centers are expected to be self-supporting after the government funding has been provided during the initial five-year period. But three centers, namely Los Banos, Bicutan, and Albay have suspended operations due to financial problems. The other centers are facing difficulties in maintaining efficient facilities and equipment due to budgetary constraints.

### **5.3.2 Other SME Support Organizations**

(1) **Other public organizations**

In addition to DTI, there are a number of organizations providing support for SMEs, which are under jurisdiction of various departments.

Department of Science and Technology (DOST) implements a relatively large number of SME support programs, most of which focus on technical support but some are engaged in loan programs relating to equipment upgrading.

(2) **NGOs and SME promotion**

In the Philippines, a number of non-government organizations (NGOs) have been extending a variety of support and assistance services for microenterprises in rural areas. They vary greatly in size and scope of activity, ranging from large organizations that conduct nationwide civilities to local, community-based organizations.

NGOs are mainly engaged in technical training and guidance services, which are largely contracted to various government organizations that are responsible for SME support services. Many NGOs are involved in financial support activity whereby they make use of their close contact with microenterprises in rural areas; they are often used to verify credit standing of small lenders and to help collection of loans.

### **5.3.3 SME Promotion by Local Governments**

The Local Government Code delegates some of its services to the LGUs, including those relating to industrial development. However, actual activities of LGUs funded by their own budget are largely limited to infrastructure development (mainly roads), education and medical service. Few LGUs implement industrial development projects or programs.

## **5.4 SME Promotion Programs**

### **5.4.1 Ongoing SME Promotion Programs by BSMED**

SME promotion programs (short-term programs) underway, as led by BSMED, are described as follows.

- (1) Trade Fairs
- (2) SME Opportunities Caravans
- (3) Entrepreneurship training
- (4) Franchise seminars
- (5) Display House/SME Corner
- (6) SME Centers

In addition, BSMED implements several continuous programs, such as SME Week and SME Awards.

### **5.4.2 Other SME Promotion Programs**

There are 32 leading SME support organizations (13 under the supervision of DTI).

28 organizations are engaged in the service providing market information, although the details of their service have still to be analyzed. Notably, many SME support organizations are engaged in two types of services, education/training and technical assistance, reflecting the fact that these service areas are most suitable for public support. And they generally face problems relating to the shortage of production or training equipment due to aging or obsolescence of the equipment.

### **5.4.3 Major Issues of the Past SME Promotion Policies and Programs**

The country has established its basic SME promotion policy and system relatively early. In fact, the government started its SME promotion initiatives much earlier than other ASEAN countries, but it has been criticized for having failed to produce significant results. Yet it seems to set forth ambitious goals that are to be achieved within a relatively short period of time, and major issues relating to program implementation, such as the delay in budget execution and the shortage of human resources, remain unchanged.

## **Chapter 6 Other Environment related to SME Promotion and Policymaking**

### **6.1 Current State of SME Support by Major Donor Organizations**

#### **(1) Japanese government**

The Philippines is one of the countries to which the Japanese government gives the highest priority in its official development aid. Similarly, for the Philippines, Japan is the top donor country. Japan's current ODA policy for the Philippines focuses on the following four priority objectives or areas.

- 1) To strengthen the economic base and overcome factors restraining sustainable growth  
(including assistance for fostering of supporting industries as part of reinforcement of the industrial structure);
- 2) To reduce poverty and correct regional disparity  
(including development of social and economic infrastructure in rural areas);
- 3) Environmental preservation and disaster prevention  
(including industrial pollution control measures); and
- 4) Human resources development and institution building  
(including the enhancement of skills and technical education to meet the industrial needs of local communities)

In the area of support and assistance for industrial development and SME promotion, Japan's ODA projects concentrate on JICA's development studies as well as technical assistance including consultation and guidance by JODC and JETRO (e.g., the sending of experts). Also, JBIC provides two-step loans for SMEs (ISSEP-II) via the Development Bank of the Philippines.

#### **(2) Support by other major donor countries**

##### **1) GTZ (Germany)**

GTZ in Germany is implementing various support programs in the Philippines, of which the largest program is titled "Promotion of Dual Education" with TESDA being the counterpart. The program was started in 1996 and is designed to train skilled workers using TESDA's facility as well as on-the-job training.

GTZ will also participate in the Private Sector Development Program that will be launched in 2004 by allocating a total budget of \$5 million over three years for reinforcement of the SMEs and provision of business development services. The program is expected to be implemented under the aegis of the chamber of commerce and industry as the counterpart. In addition to GTZ, KfW has been rendering support

in the area of SME finance (particularly microenterprises and small enterprises), which will be continued for limited geographical areas.

Germany's assistance has primarily focused on human resources development such as vocational training, and the program covers the entire country but is highly concentrated in Visayas.

## 2) CIDA (Canada)

CIDA is currently implementing 15 projects.

Among them, Private Enterprise Accelerated Resource Linkages (PEARL) and Promoting Participation in Sustainable Enterprises (PPSE) are closely associated with SME promotion. Basically, they aim to reinforce competitiveness of small enterprises through technical assistance and consulting service. Note that CIDA has discontinued PEARL and is contemplating a new SME support program.

Geographically, CIDA's development assistance mainly takes place in Mindanao (60% of total) and Visayas (30%). Also, CIDA emphasizes support for microenterprises.

## 3) Others

Development aid by the United States has been provided as part of the anti-terrorism campaign in Mindanao. The assistance by the U.S. government emphasizes projects conducive to the island's economic development. Among them, USAID has been conducting the Regional Enterprises Development Project, together with the reinforcement of the chambers of commerce and industry in major cities. It was carried out with PCCI as the counterpart up to 1997.

Australia has been involved in projects to create cash income sources and improve hygiene in rural areas, as well as environmental remediation in Mindanao. Finally, the World Bank and the Asian Development Bank emphasize SME support in the area of assistance targeting eradication of poverty.

## **6.2 SME Statistics and Major Issues**

Business statistics in the Philippines are based on different types of databases maintained by NSO and other organizations, which try to develop their own statistical bases of essentially similar content. It is important to realize that the development of a cost-effective system should start from the linking of different databases of NSO and other organizations, e.g., when DTI takes charge of current statistics, it should develop the list of surveyed establishments by using such linkage. Then, if any shortage of data or information is found, efforts should be made to add it to the existing system in a coordinated manner.

The following statistical data are very important in formulation of SME development policy and monitoring of program implementation.

- 1) Statistical data for quantitative analysis of SMEs from macroeconomy viewpoints, e.g., the number of establishments, employees, geographical distribution, industrial distribution.
- 2) Data for the relation between category of SMEs classification and actual business conditions to formulate SME development policy.
- 3) Data for ascertaining the nature and extent of the influence and impact of specific policy themes (or measures)

Therefore, the institution in charge of SME development (currently, DTI or SMEDC) has to define a category of SMEs or number of employee together with NSO, and apply it to SME statistics. This will make it possible to obtain the necessary data on total numbers relating to 1) and 2) above.

The SME development institution (DTI or SMEDC) is also necessary to conduct, periodically, a dedicated sample survey apart from national statistics for the purpose of grasping the above 2) and 3) data. The survey will be the combination of a standardized survey, which surveys change in business size and management status, and an impact survey (with/without survey) to define the impact of a specific policy or change in economic environment.



### III Recommendation on SME Development Plan

# **Chapter 1 Basic Direction and Policy Framework of SME Development Plan**

## **1.1 Objectives and Challenges of SME Development**

### **1.1.1 Expected Role and Contribution of SMEs in Economic Development**

The SMEs are expected to play an important role in economic and social development in the Philippines, in the following aspects:

- 1) Development of SMEs in the secondary and tertiary industries will contribute to diversification of local industries, and increase the local value added.  
The same also applies to national economy. Development of SMEs in various industries, which the Philippines now lacks, will establish niches, bridge gaps among industries, and contribute toward a reduction in dependence on imports.
- 2) SMEs are suitable to form the supporting industries providing niche services, and contribute to enhancement of the major industries of the Philippines, which have the feature of producing on consignment, and operation with insignificant linkage with local industries. Thus, SME development will contribute to deepening of industrial structure of the Philippines.
- 3) Development of SMEs generates employment and contributes to poverty reduction. If it results in increase and improvement of distribution of income, it will increase domestic demand for industrial products, and form a strong base of industrial development.

### **1.1.2 Goal and Challenges of SME Development**

#### **Goal of SME development**

Prerequisites for realization of the above role of SMEs are the stable operation and growth of the SMEs, and robust activity in the start-up of businesses. This must be accomplished, however, in the economic environment of an internationally open and free market economy, which is basic assumption of Philippine economic policy. These constitute the goal of SME development.

#### **Development challenge**

The development challenge of SMEs to achieve the goals varies depending on the business environment of each sector, and may be summarized as follows:

- (1) Development challenge of SMEs in export-oriented industries using local resources  
SMEs in the Philippines, those exporting products using local resources are facing strong competitive pressure from foreign products in both export and domestic markets, and pressure

especially from Chinese products, except for processed food products in the domestic market, where local large manufacturers are dominant.

As China is the world-leading exporter of products for mass consumption, and has support for this furnished by the gigantic domestic market, Philippine industries have been maintaining their unique position in the competitive environment by offering niche products that appeal to specific consumer groups. Continued efforts to maintain their unique product positioning and customer base are essential to ensure their sustainable growth.

SMEs in these sectors are dominated by those that are characterized by familial or one-person operation, and lack modern management knowledge and skills, while there are some that have gained international competitive through exports. At the same time, many of SMEs that make export products contract the bulk of the production process to specialized SMEs (subcontractors). To meet the quality, delivery and cost requirements for having competitiveness in export markets, therefore, manufacturers must control subcontractors and their operations, while subcontractors must modernize their production and management.

The development challenge of SMEs in these particular sectors, in view of the above, is enhancement of international competitiveness with consideration given to their position in the international markets. In this regard, the key features the SMEs must possess are as follows:

- 1) Creative product development and marketing, based on adequate market intelligence
- 2) Improved management and production capability including what is needed to increase value added of products, and meet the requirements of the markets as to technical regulations, delivery condition and quality maintenance or improvement

(2) Development Challenge of SMEs in the supporting industries

The electronics/electrical and automotive industries, except for the electrical appliance industry, have imported most of their parts or have purchased a portion of their requirements from foreign suppliers operating in the country. As a result, only an insignificant number of local SMEs have become established in the supplier base for the country's key industries. This is because of the significant gap between the requirements of the leading industries and capability of the local SMEs in technology and production management.

In particular, an emphasis should be placed on the automotive industry. Compared to the electronics industry, for which the establishment of a linkage with local SMEs seems to be difficult in the short run, some automakers are interested in improving their international competitiveness by increasing local procurement. As a case in point, at this moment an automobile assembler is selecting potential local suppliers to increase procurement of the local parts at the next model change. These moves will create many opportunities for local SMEs.

The leading industries, however, do not have adequate information on potential suppliers, while the SMEs do not understand the requirements of the leading industries on technology and management, since they have had limited experience in transactions with the former.

Thus, the major challenge for development for the SMEs in this sub-sector is to promote the linkages among them, with the essential points being as follows:

- 1) Promotion of communications between the potential buyers and the potential suppliers, and upgrading of capability of SMEs in technology and management to meet the requirements of the leading industries
  - 2) Expansion of bases of the supporting industries, considering that the number of SMEs, which have potential as suppliers of parts and services to the leading industries, is limited
- (3) Development challenge of SMEs active in the local-demand markets

In the Philippines most of SMEs are concerned with the markets of local demand, a type of market, which is limited to a narrow geographical scope. Such local demand is very diverse, including as it does demand concerning the clothing, food and housing needs of the local residents, demand concerning other everyday needs, education and transportation, and demand concerning supply of services and goods to local industry. They are generally small in scale of management, and lack basic knowledge of business management.

The main obstacles to development include the fact that those SMEs have only limited business opportunities and the fact that they are limited as regards the business management, production and financial capacities needed for market and customer development, but the situation varies greatly from enterprise to enterprise, and it is therefore not possible to deal them in view of specific problems for any particular industry.

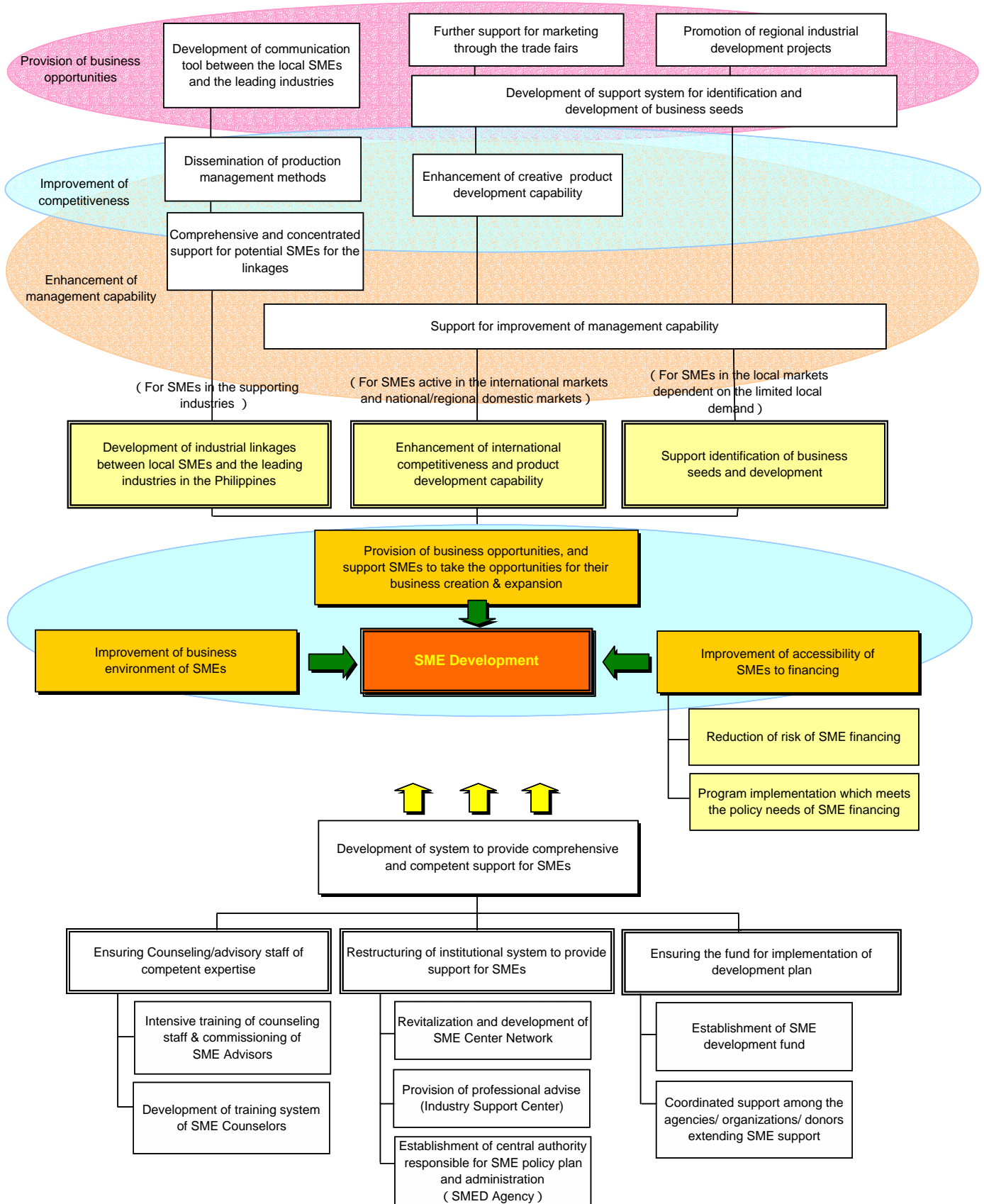
The key requirements in supporting the SMEs in this sector are as follows:

- 1) Provision of services to respond to the diversified problems they are facing in the operation and expansion of the businesses
- 2) Creation, identification, and/or provision of business opportunities

### **1.1.3 Policy Framework for SME Development**

In moving toward the development goal set in the foregoing section (1.1.2), the government should address the following policy framework for SME development (see Fig. III-1-1).

**Figure III-1-1 Proposed Development Policy Framework**



- (1) Provision of business opportunities to SMEs, while providing concentrated and comprehensive support for enhancement of the SMEs' managerial and technological capability to tap the opportunities
- (2) Improvement of accessibility of SMEs to finance
- (3) Improvement of SMEs' business environment in view of diversification and deepening of industrial structure
- (4) Development of an implementation system allowing comprehensive and concentrated support for SMEs

## **1.2 Role of Government**

### **Necessity of Government Support for SME**

While recognizing the role and importance of SMEs in the social and economic development of the Philippines (see 1.1.1), and taking seriously the difficulty of SMEs to sustain themselves under the conditions of a globalization of the economy, the Government needs to take appropriate actions to support SMEs.

### **Role of the Government in SME Support**

Government's direct support in the form of market intervention is desirable to some extent in countries where a large number of SMEs are not ready to compete in the international marketplace, and at the same time, liberalization of the national economy has been selected as a major development goal. In these countries including the Philippines, government is expected to provide active support to reinforce SMEs from their foundation up, so that they can compete with large companies as well as foreign companies on a level playing field.

### **Sustainability and viability of government support**

The concept of service-for-pay for sustainable project on individual project basis, would limit the number of recipients and therefore adversely affect program effectiveness – with a result contradictory to the spirit of SME support policy. This is because that policy is specifically intended to help SMEs that cannot afford to conduct a project on their own.

It does not necessarily mean, however, that any support programs or projects should be justified regardless of their feasibility.

Unnecessary free services and wasteful subsidies should be avoided, and, in general, programs, which involve services that can generate revenues according to general business practice should seek to generate reasonable revenues.

### **Use of private or non-government organizations in providing the support services**

The Government should entrust the implementation of support programs to enterprises or organizations, instead of the government's implementing it by itself, if firms or organizations

having appropriate implementation capability are available. It is also recommended to introduce the market mechanism in selecting the firms or organizations to be entrusted with the implementation, and make most of the capability of private/non-government organizations in the process of policy implementation.

The government, however, is required to be involved in more-direct support activities, considering the insufficient supporting measures presently available in the Philippines.

The active involvement of the private sector and LGUs in the support activities will be useful to make the support more practical and effective. However, the initiatives of the government in planning the policies and administration and monitoring of the implementation, together with the actions needed to ensure the effective implementation of support programs and projects, should remain unchanged.

Further, the government should prepare supplementary measures for LGUs, considering the limited capability of LGUs in providing support services.

### **1.3 Need for the Development Plan**

Despite the fact that SME development is vital for the social and economic development of the Philippines, the fund and resources available for allocation to SME development are very limited.

There is a need for the funds and resources to be concentrated in strategic policy areas and programs selectively and in an optimum manner in order to maximize the impact. Also, there is a need for co-ordination and co-operation among the support agencies in keeping with the clearly defined national strategy framework. The Plan now under development, will provide a road map for support for the development of SMEs, on the basis of thorough analysis of the issues to be focused on.

### **1.4 Discussion on coverage of the SME Development Plan**

#### **(1) SMEs and microenterprises**

Microenterprises require different policy considerations compared to the SMEs.

However, when it comes to the Philippines' case, microenterprises are not a special segment of the SMEs, with microenterprises accounting for 92% of total enterprises, and 38% of total employees including large enterprises.

The SME development policy is different from the policy, which seeks to contribute to livelihood support for poverty groups. The SME policy deals with enterprises (and entrepreneurs intending to start up businesses) engaging in economic activities. The policy measures are provided to encourage and support their business activities.

If the businesses had been started with the objective of improving the livelihood of people in target groups, but developed so as to become involved in economic activities as enterprises or cooperatives, then, such businesses will be the target of the SME policy.

(2) Industrial policy vs. SME policy

Many countries including Japan, have implemented development policy targeting development of SMEs in specific sub-sectors (namely, sectoral development approach).

In the case of SME development in the Philippines, there are many cases wherein the sector-focused policy programs including market development and technology development, are deemed effective in achieving the policy goal. These include the cases of SMEs in local-resource-based industry active in the export markets, and SMEs in the supporting industries of the leading industries.

On the other hand, there are some cases where a policy or program relating to the development of SMEs may not be suitable for implementation by an agency in charge of SME policy. Such policies and programs are roughly divided into two types: those that affect not only SMEs but also a large number of large enterprises, and those that require a specific or technical consideration other than SME development.

The SME development support system, nevertheless, should have a mechanism to grasp the problems of SMEs through the field contacts with SMEs or industrial associations, to analyze the problems, and to generate proposals of measures to solve the problems, and be coordinated with appropriate agencies in the problem solving process. Establishment of a central government agency, which is responsible for SME policymaking, program development, and implementation, is urgently needed also in this point of view, as discussed later.

## **1.5 Limitation of Current Policy, System and Measures for SME Development**

There are some critical constraints in implementation, as follows:

- (1) Limited resources, particularly insufficient funding and lack of required staff.
- (2) Lack of adequate training of staff, which can extend the appropriate counseling and advice to SMEs.
- (3) The contact windows for the support services are limited to metropolitan areas.
- (4) Insufficient involvement of LGUs.
- (5) Need to establish an agency, which is responsible for SME policy planning, administration and monitoring of implementation in a totalized manner. SMED Council and SME Core Group are not sufficient take the expected responsibility, since they are ad-hoc organizations run by periodical meetings, and lack permanent organizations of their own staff, though each has a secretariat organization.



## Chapter 2 Recommended SME Development Plan

### 2.1 SME Development Strategy

#### 2.1.1 Confirmation of Development Strategy

In formulating the development strategy of SMEs in the Philippines, we proceed to roughly divide SMEs into three types and set forth development goals that are designed to address the needs facing each type, as described below.

- 1) SMEs requiring (a) strengthening of their international competitiveness, and typically local-resource based industries as furniture, export general merchandise, and food processing firms, which are active in the international markets and (b) stabilizing of operations and promoting of growth
- 2) SMEs with existing or potential relations with the leading industries in the Philippines, such as the electronics and electrical, and automotive industries, whereby there is high potential to form backward linkages, and therefore where promotion of industrial linkages with the local SMEs and entrepreneurs having potential of forming the supporting industries is desirable policy
- 3) SMEs that need assistance to secure their growth; these SMEs are active in local markets in many areas of the nation, and potential SME entrepreneurs that need support for starting up of new businesses, support that can be through provision of business opportunities and support for development of business seeds.

#### 2.1.2 SME Development Strategies

It is recommended that **use of available funds and resources should be concentrated in the strategically most-important policy areas**, so that the policy measures and actions to be taken will be effective and efficient.

Access to markets, customers, and/or business opportunities is the key factor for SME development, but at the same time the markets, customers, and business opportunities will become accessible to SMEs, only when the SMEs can utilize these opportunities. Taking this into consideration, provision of business opportunities, and support to SMEs so as to enable them to utilize these business opportunities, are the proposed strategic focus for each of three SME sectors.

(The development challenge, and overall system of the strategies and programs are shown in Figure III-2-1.)

### 2.1.3 Policy Measures and Programs of Priority

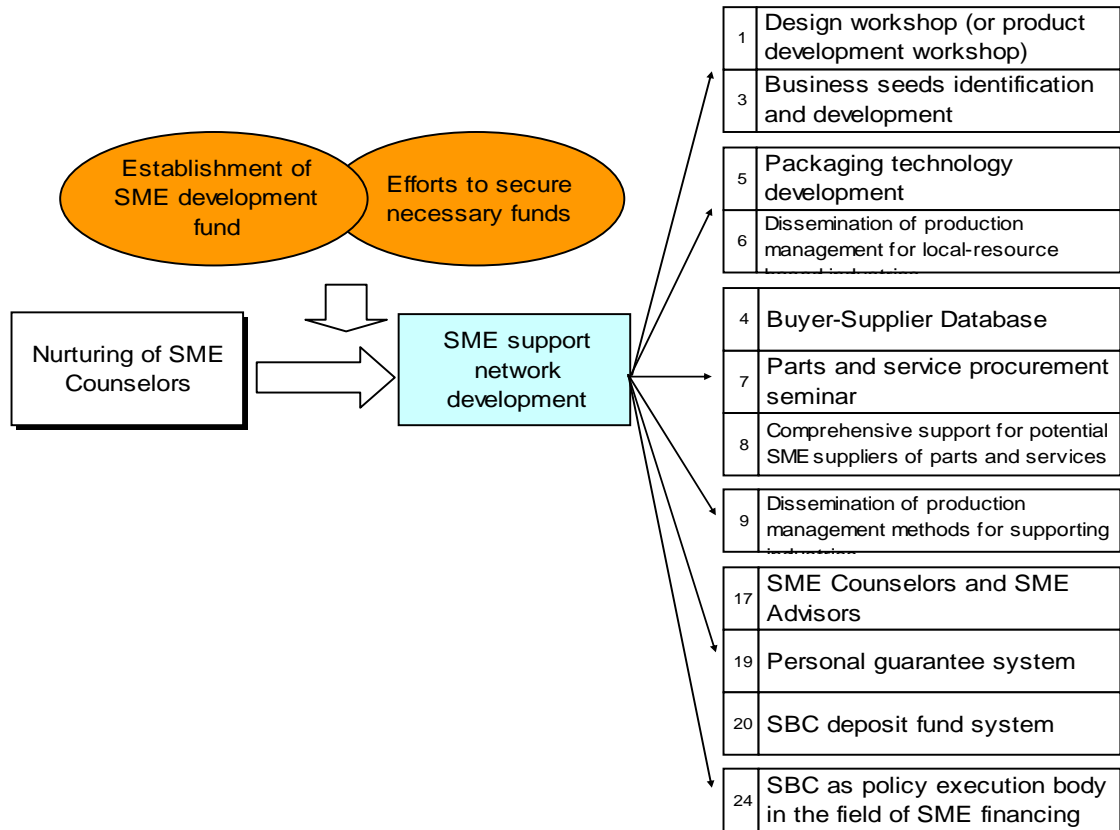
Among the programs proposed in 2.2, **the most urgent one is nurturing of SME Counselors (#17)<sup>1</sup>**, who are expected to play the key role in revitalizing the SME support network. As presented in 2.2, Industrial Support Centers and SMED Regional Centers will be the key organizations in implementing most of the proposed programs, and these organizations are expected to provide professional consultation and guidance services. The SME Counselors are the professionals in these organizations. Nurturing of the SME Counselors takes considerable time, and therefore, there is need to start as soon as possible.

**The priority next to the above is to secure the fund for program implementation.** For this purpose, the Government should exert every effort possible for this purpose (see 2.3.2), including establishment of the SME Development Fund (#23).

Among the proposed programs and projects, the following should be given of priority:

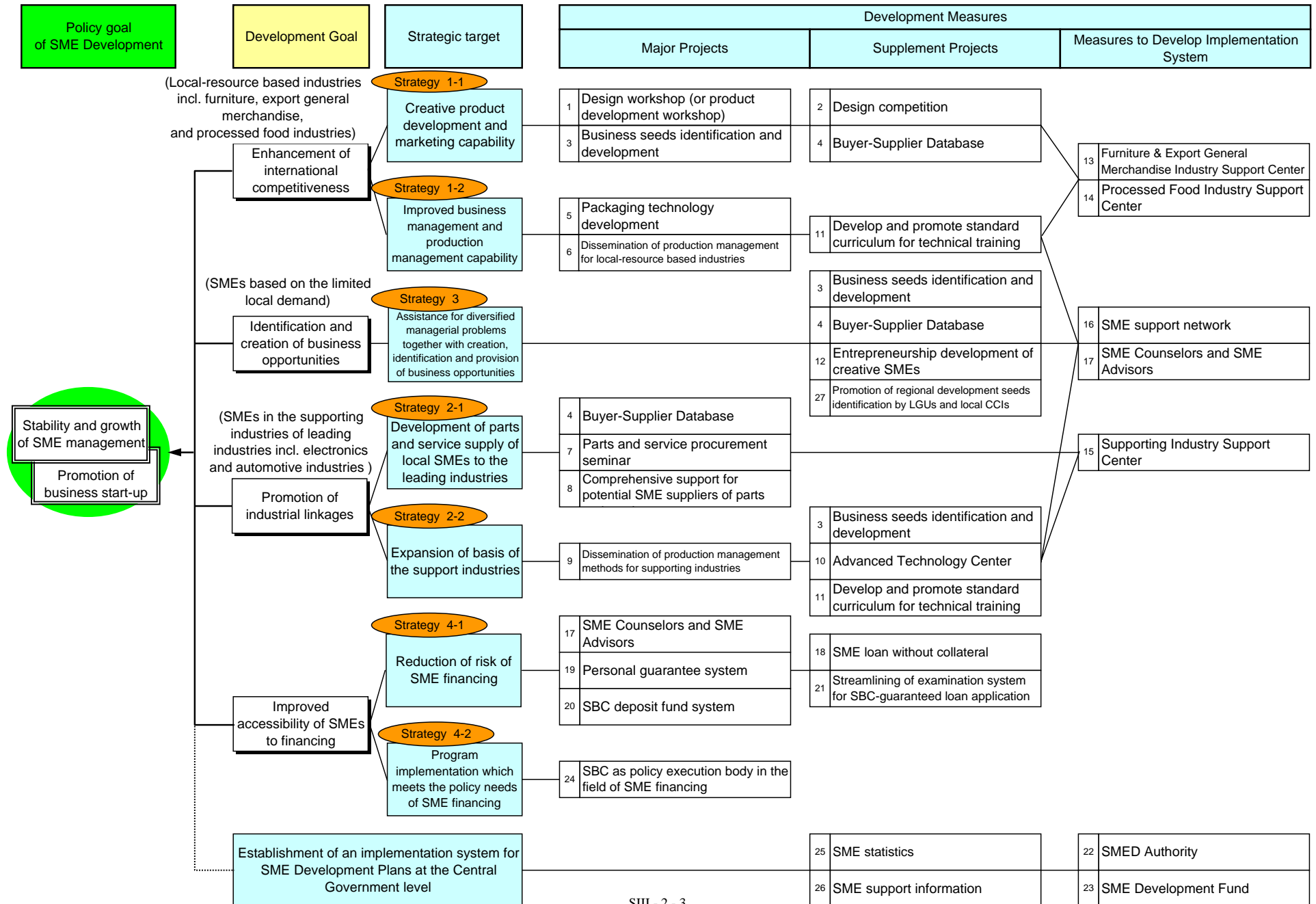
- 1) Those that would be directly effective on market creation and exploration; and
- 2) Those designed for upgrading of management and technology capabilities, which would be required in penetrating the markets created in 1) above.

#### Policy Measures and Programs of Priority



<sup>1</sup> The numbers with (#) in this section and following sections mean the reference numbers of projects/programs shown in Figure III-2-1.

Figure III-2-1 Outline of Development Challenges, Strategies and Measures for SME Development



## 2.2 Recommended Action Plans for SME Development

Strategy 1     Strengthening of support for SMEs of local resource-based industries active in international markets (including furniture, export general merchandise, processed food industries, etc.), in the area of creative product development and marketing

### A Background and Outline of the Strategy

Figure III-2-2 shows the way schematically to achieve the goal targeted with the Strategy 1 through implementation of the proposed projects and programs.

Strategy I gives priority to a development program (1-1 below) that provides support for individual companies to upgrade their creativity in product development and marketing, followed by another program (1-2) that is designed to improve the management and production capabilities of individual companies and industries through development of a system for extending the appropriate supports.

### B Development Programs for Strategy I

#### 1-1 Programs to support enhancement of creativity and product development capability of local-resource based, and export-oriented industries

This program focuses on the enhancement of the ongoing measures to support SMEs that participate in national and international trade fairs, which have been implemented with BSMED and CITEM, respectively. The program consists of support measures for (1) the upgrading of design and product development capabilities, (2) information gathering and analysis of target markets and consumer groups (by stepping up the CITEM program), and (3) initiatives to identify and promote business seeds including development of new materials.

#### Major projects

- (1) Provision of comprehensive support for participants in trade fairs

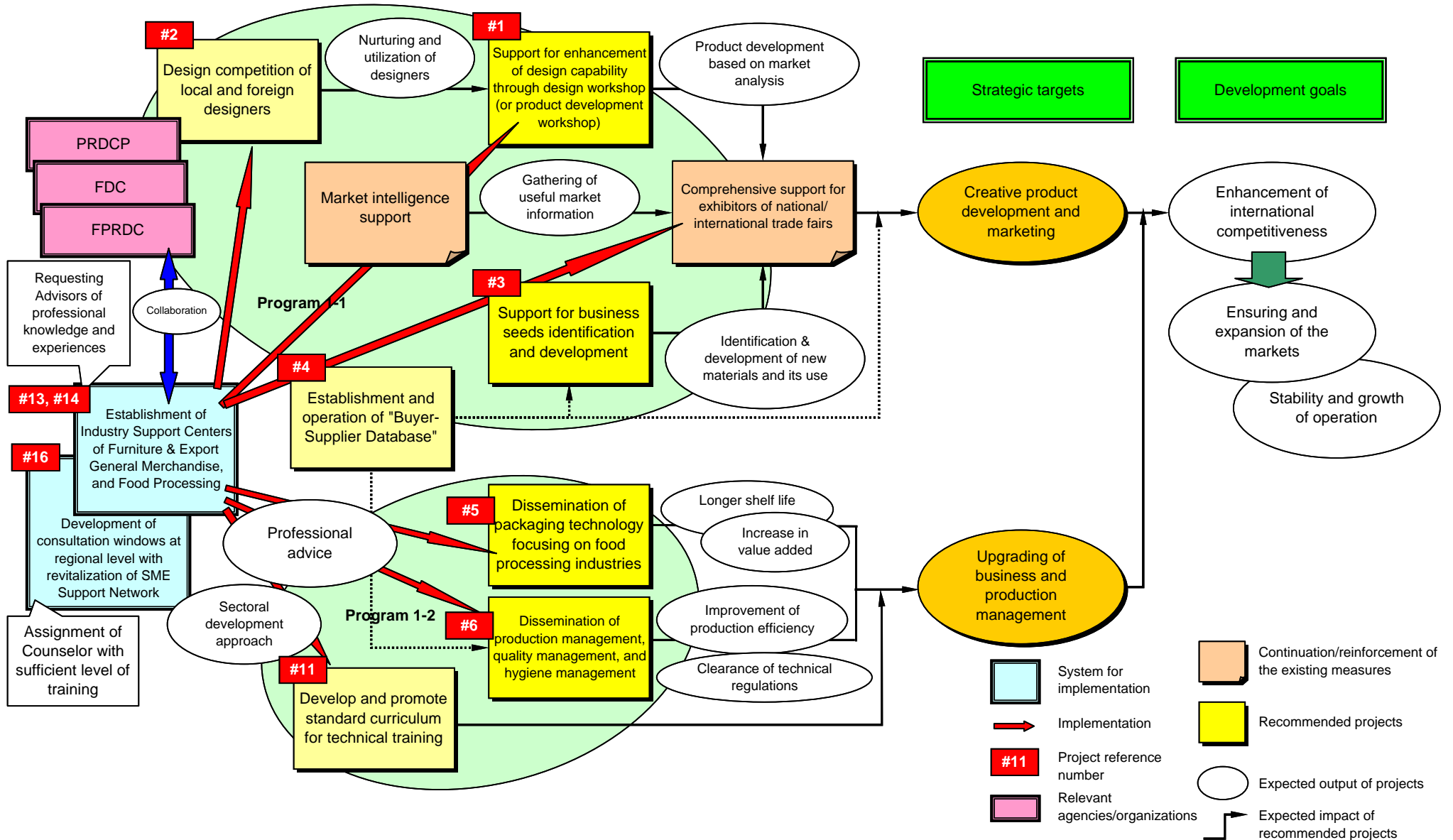
This is a continuation and enhancement of the ongoing support program.

This project recommends that this assistance be continued, and improved in effectiveness in collaboration with Projects (2) and (3) below.

- (2) Design Workshop (or Product Development Workshop) to support the upgrading of design development capability (#1)

The Design Workshop is a tool for learning a design and product development process that is based on the detailed analysis of new target markets and customer groups. It will help participants to understand techniques for analyzing market and customer trends as well as product development techniques that incorporate the results of market and consumer analyses (including due consideration given to production technology).

Figure III-2-2 Strengthening of support for SMEs of local resource-based industries active in the international markets (including furniture, export general merchandise, processed food industries, etc.), in the area of creative product development and marketing to enhance their international competitiveness



(3) Market study support project

The project is a continuation and enhancement of the ongoing program. The project calls for provision of subsidies to the participants to cover part of their costs for such market studies as trade missions and market study missions, which will be conducted by relevant industrial organizations or groups. The project is to enhance the ongoing program implemented by CITEM in collaboration with the Philippine embassies abroad, and the chamber of commerce and industry, in the following points:

- 1) To secure the funds required for the market study, and expand the scope and target of the study;
- 2) To digitize data and information obtained from the market studies, and make it available to related parties who do not participate in the mission; and
- 3) To build up a system to make the market information owned by CITEM and BETP accessible from regions, with networking for information exchange among the Industry Support Centers and SMED Regional Centers.

(4) Support for development and commercialization of business seeds and new materials (#3)

The project is intended to build a mechanism to refer entrepreneurs, who have business ideas or technologies, to qualified consultants or technical institutions, thereby to facilitate support for commercialization.

**Projects that supplement the major projects**

(1) Design competition for domestic and foreign designers (#2)

This program is designed to hold design competitions for the purpose of encouraging designers to improve their design capability, and work with product development in these sectors.

The program will organize a competition open to designers active domestically or internationally.

The focus should be placed on a high-level design competition that meets the above objectives. It will be held annually with an award ceremony to be scheduled concurrently with a major international trade fair, such as Cebu X and Manila FAME, so as to draw the attention of international buyers and obtain their evaluation.

(2) Development and operation of a buyer-supplier database that can be used as a unified database among SME support activities including the business matchmaking service (#4)

This project builds a database that includes information on buyers and suppliers, and will be used by government agencies and technical support organizations engaged in SME support. In particular, the database will be used primarily by Industrial Support Centers, SME Centers, and SMED Regional Centers for business matchmaking and other support service purposes.

Although it can be made accessible by the general public, the database per se does not produce any meaningful result. It is recommended to establish an ad-hoc board to coordinate operation of the database by organizations that have access to it and define the rules for database maintenance and updating.

### **1-2 Provision of measures by the Industry Support Centers to support SMEs of the local-resource based industries, in upgrading their managerial and technological capability**

To provide better service for SMEs that face a variety of problems, and to meet the needs for professional support focusing on a specific industry or market, Industrial Support Centers are recommended to be established within SMED Authority to serve key industries. Initially there should be three centers - Furniture and Export General Merchandise Industry Support Center (#13), Processed Food Industry Support Center (#14), and Supporting Industry Support Center (#15). Also, local offices will be established within selected SMED Regional Centers, in consideration of industrial concentration.

#### **Major projects**

- (1) Dissemination of packaging technology that focuses on the processed food industry (#5)

The project proposes a nationwide system to provide technical guidance on packaging, including a system to provide this service to regional SMEs. Its primary purpose is to enhance the capacity of PRDCP in terms of both equipment and personnel and to develop local contact points using the SME Support Networks. The project will start with the establishment of a plan to enhance the support delivery system by identifying the specific needs for improvement of packaging technology among SMEs, while dissemination of modern packaging technology should be promoted at the same time using the existing organizations and resources.

- (2) Dissemination of production management, quality management, and hygienic management (for the processed food industry) through coordinated training and guidance programs including seminars, workshops, and training courses (#6)

As pointed out earlier, SMEs in the Philippines rely on a flexible production strategy (characterized by large variety/small lots) in order to compete with foreign products, especially those made by Chinese manufacturers. It should be noted, however, that flexible production is, by its nature, inferior in efficiency and is susceptible to cost increase without careful production management. The high cost offsets the product's advantage in serving a niche market. Also, many of the SMEs that make export products are contracting the bulk of the production process to outside subcontractors. To meet quality, delivery and cost requirements for competitiveness in export markets, therefore, manufacturers must be able to control subcontractors and their operations, while subcontractors are required to modernize their production as well as management. However, most SMEs in these sectors do not

realize the importance of production management, which is a vital element in the effort to secure and maintain competitiveness.

In addition, SMEs in the processed food industry, especially small enterprises, do not have necessary knowledge on modern hygienic management and fail to incorporate such knowledge in their production system or employment education. Meanwhile, export markets and major distribution channels in the country (e.g., fast food and franchise chains, and large supermarkets) are increasingly demanding adoption of and compliance with strict standards (such as HACCP and GMP).

Furthermore, some foreign buyers tend to select suppliers who can comply with the operational conditions set by the latter, such as working conditions (including the working environment) and waste treatment practice. Thus, SMEs intending export are increasingly required to keep abreast of relevant regulations and requirements and to apply them to their production system properly.

The proposed project focuses on guidance as the activities by Industrial Support Centers to raise awareness of SMEs in their day-to-day operation, and the development of a training program on production management, which takes into consideration SMEs' prevailing conditions such as available time after work, etc.

#### **Projects that supplement the major projects**

- (1) Development of a standard training curriculum for specific industries by reflecting the needs of each industry in cooperation with industrial organizations, establishing training program applicable to the actual operation, and dissemination of the standard curriculum to TESDA and vocational training organizations for their use (#11)

At present, a large number of training courses for technicians are offered at vocational schools and other technical training organizations. However, since most courses are intended to teach general skills and do not address industry-specific needs, many companies have to conduct in-house training in order to develop their human resources. This creates a heavy burden for SMEs that cannot afford to maintain an organization or personnel dedicated to human resource development. CFIF has created its own training curriculum and furnished it to vocational training schools for customized training of skilled workers. This should be applied to other industries that face a similar problem.

### **C Institutional Framework for Implementation of the Strategy**

Furniture and Export General Merchandise Industry Support Center (#13), and Food Processing Industry Support Center (#14) will play a critical role in implementation of Strategy 1. Both centers should hire advisors who have expertise in the respective industries, and in



markets, to meet the needs of SMEs. At the same time, they should upgrade their expertise by inviting foreign experts as required.

<p><u>Strategy 2</u> Provision of comprehensive and concentrated support for selected SMEs of high potentials to supply parts or services to the leading industries in the Philippines (such as electronic and electrical industries, and automotive industries), which are estimated to have high backward linkage potentials, to promote industrial linkages between them</p>
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## **A Background and Outline of the Strategy**

Figure III-2-3 shows the way schematically to achieve the goal targeted with the Strategy 2 through implementation of the proposed projects and programs.

Under the strategy, Program 2-1 will be firstly deployed to provide intensive support for selected SMEs with a high “linkage” potential.

At the same time, the focus of Program 2-2 should be placed on expansion of the supplier base by disseminating modern production management, which is one of the basic requirements for SMEs that supply parts and services to the leading industries. The efforts will be led by the Supporting Industry Support Center. Other projects under this program include that of building the infrastructure for dissemination and promotion of advanced technologies and skills, in collaboration with other technical support organizations and skills training institutes.

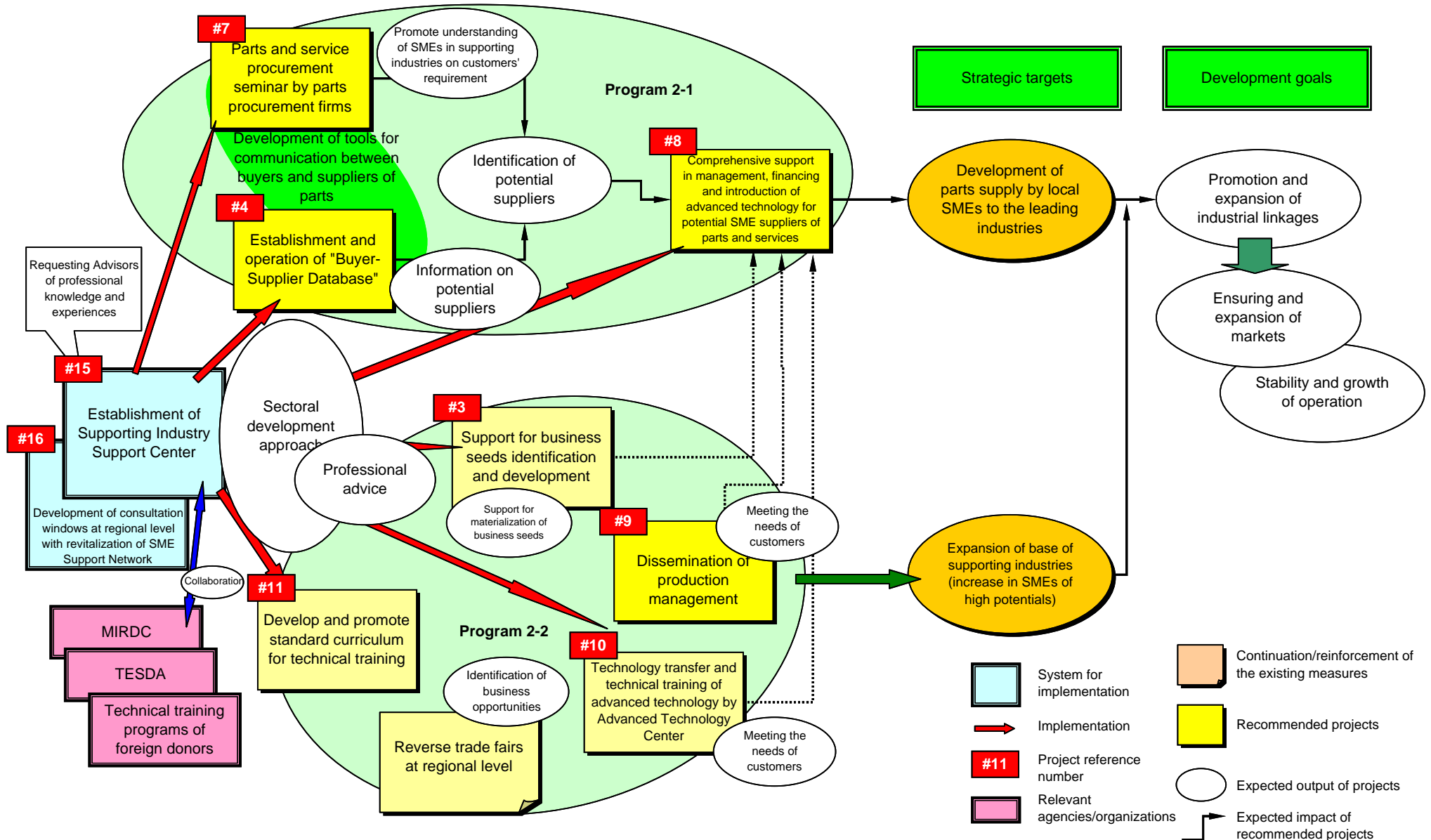
## **B Development Programs for Strategy 2**

### **2-1 Program to develop communication tools for linkage needs of the leading industries, and to provide comprehensive support for promotion of linkages for the high-potential local SMEs in the supporting industries**

Development of measures to communicate the needs of the leading industries (potential customers) to SMEs is of primary importance in promoting the assembler/supplier linkages. Actually, most local SMEs do not have contact with foreign manufacturers in the Philippines, and lack understanding of their needs. On the other hand, the leading industries do not have sufficient information on local suppliers and supply capabilities.

Next to the establishment of the communication channel, integrated support also must be provided for SMEs with a high potential for linkages with the leading industries, including support in financial and technical fields.

Figure III-2-3 Provision of comprehensive and concentrated support for selected SMEs of high potentials to supply parts or services to the leading industries in the Philippines (such as electronic and electrical industries, and automotive industries), which are estimated to have high backward linkage potentials, to promote industrial linkages between them



## **Major projects**

- (1) Development of a buyer-supplier database, and support for business matchmaking (#3)

This program is intended to build a unified buyer-supplier database that can be used by government agencies and technical support organizations involved in SME support, allowing them to use it for responding to the inquiries from buyers and suppliers.

To ensure the effective use of the database, it must be operated and maintained by an organization with the proper personnel. As for supporting industries, the Supporting Industry Support Center should be responsible for database maintenance and updating.

- (2) Parts and service procurement seminars by parts procurement firms (#7)

Seminars are to be held to help potential parts (and services) suppliers find requirements of automakers and parts suppliers (who are the buyers of parts and services at the same time), who intend to procure parts locally. Automakers and the parts suppliers (buyers) will be invited to the seminars, with participation of potential suppliers. The buyers are expected to present procurement requirements including product specifications, price, delivery schedule, and requirements relating to production management and specific technology to be used by the potential suppliers.

The seminars will help the SMEs to obtain specific information that they must have, and will help them to realize what they need to improve to become qualified as a supplier.

- (3) Integrated support for SMEs who have won contracts from the leading industries, in the areas required to perform their contract such as finance, management, and introduction of advanced technology (#8; also #15 Supporting Industry Support Center; and #16 SME Support Network)

The project is intended to provide consulting service for SMEs that have been awarded or are expected to be awarded a contract from manufacturers in the leading industries. The service will range from evaluation of project feasibility to preparation of loan application.

For consultation in the areas of management and finance, including the development of a business plan and the support for making loan applications, SME Centers, SME Desks and/or SMED Regional Centers will provide consultation. For SMEs that have a high prospect for landing a contract, venture capital could be referred to provide funds for business expansion and capital investment.

If production of the parts requires special technology or know-how, and the customer can introduce the supplier to the company that has such technology, the project will assist the supplier in licensing negotiation and technology transfer.

**2-2 Provision of measures by the Supporting Industry Support Center together with their regional operation arms, for expansion of potential supporting industries to form linkages with the leading industries, assisting the SMEs in improvement of enterprise management, production management, and production technology**

The program is intended to provide measures for expanding the base of supporting industries, including dissemination of production management, which is a minimal requirement for formation of a linkage with an advanced industry, and formulation of the technological and skill base relating to advanced technology.

**Major projects**

- (1) Dissemination of production management through a combination of seminars, training courses and factory diagnosis and guidance (#9)

Understanding of production management, and putting it into practice is the minimum requirement for those who are intending to supply parts and services to the leading industries, such as electronics and automobiles.

For understanding and application of production management, learning the theory of production management is not enough. Guidance for application on the shop floor is also necessary. In this project, dissemination of production management is to be achieved through various methods of dissemination. The Supporting Industry Support Center is to organize and operate the project in collaboration with technical personnel of the leading industries, technical institutions, etc.

**Projects to supplement the major projects**

- (1) Advanced Technology Transfer Center for promotion of linkages between local SMEs and the leading industries and their parts supply industries (#10)

It is necessary to set up a system to transfer advanced technology, selecting the object technology, on the basis of consultation with the leading industries, in order to select technology which has demand sufficient for actual utilization in the Philippines.

Nevertheless, even at this point the following technologies can be considered to be likely candidates:

- Metal surface treatment technology
- Precision metal processing technology
- Press die technology
- Die cast technology
- Powder metallurgy technology

The possible methods of technical transfer include not only training, but also temporary supply with guidance on its utilization (equipment open for use by the public).

The training course should be designed also on the basis of consultation with the leading industry side regarding the skills which the leading industry expects at the supporting industries in the Philippines.

Since there are no personnel presently in the Philippines capable of carrying out such technology transfer, it will be necessary to invite instructors from abroad for implementation of such training programs. Besides implementation of the training, it will also be necessary to train future training personnel.

(2) Reverse Trade Fairs in Regions

This project is the continuation and reinforcement of the project currently under implementation.

Trade fairs should be prepared targeting the linkages with enterprises other than in the advanced industries, and according to the conditions of the regions, with initiatives taken by SMED Regional Centers, LGUs, and private sector.

(3) Support for identification and development of business seeds (#3)

This is to build a mechanism capable of providing support for the whole process of business seeds development, including consultation on business ideas originating at SMEs, and introduction of the originators to parties having the appropriate expertise, as well as help all the way to starting up such new businesses. Particularly, in the supporting industry field, collaborative efforts by SMEs each with different type of expertise will be useful in starting new parts production that requires a development process, since it requires a variety of kinds of technical know-how in solving problems, or making developmental production.

(4) Formulation of standard training curricula in collaboration with industrial organizations, the curricula to reflect the need for effective and practical skill training; and dissemination of the curricula to TESDA and other vocational training organizations for implementation (#11)

Although there are many vocational training schools and skilled worker training courses, few of them meet the real needs of industries. Most SMEs have no alternative other than to train their skilled workers in-house. It is therefore proposed to formulate standard training curricula in collaboration with the relevant industrial organizations reflecting the organizations' needs for effective and practical skill training, and then to disseminate the curricula to vocational training organizations for implementation.

### **C System for Strategy Implementation**

The Supporting Industry Support Center is to play a center role in carrying out the projects. The Center is an organization within the SMED Authority, and has local branches at SMED Regional Centers as places that SMEs can contact for first-stage consultations. Technical

advisors with experience in the supporting industries and capability for providing SMEs with guidance will be appointed at the headquarters and regional branches for providing the consultation services. Technical guidance will be carried out in close collaboration with MIRDC.

<p><u>Strategy 3:</u> Facilitation of supports for diversified needs of SMEs active in local markets, through nurturing of SME Counselors and SME Advisors, and assignment of them to local contact window networks to be developed</p>
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## **A Strategy Background and Summary**

### **Development Challenges**

Figure III-2-4 shows the way schematically to achieve the goal targeted with the Strategy 3 through implementation of the proposed projects and programs.

The first component of the strategy is to establish a system for assisting SMEs to achieve stable operation and growth. This system should respond to the specific management problems faced by individual enterprises. The second component is support focusing on creation of business opportunities for local SMEs with full utilization of the potential of local governments and local private sectors.

To provide assistance to individual enterprises to help them adequately respond to the problems they face, there is an urgent need for training of personnel capable of providing local SMEs with management, marketing, financial and other guidance. It is firstly proposed that such training be undertaken, together with assignment of the trained personnel to local contact windows.

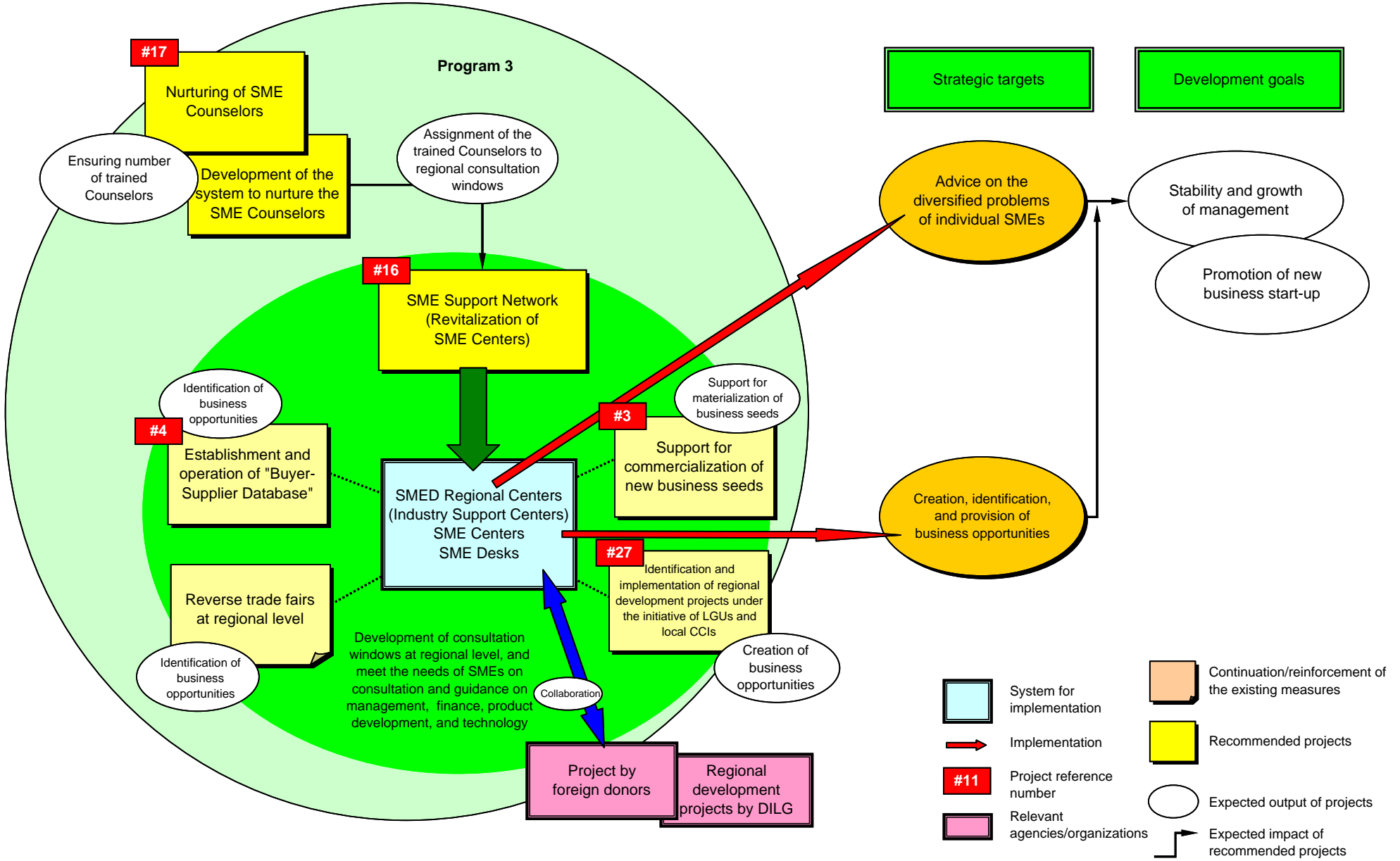
Next to the above, SMED Regional Centers should be established according to the needs in the region, as the core of the SME Network, which provides SMEs with the local contact windows. The SMED Regional Centers are expected to be the key for revitalization of the existing SME Centers, by means of concentrated use of the limited funds and personnel available. Under the SMED Regional Centers, SME Centers will be newly developed or revitalized at the initiative of LGUs and local CCIs, thus enhancing the guidance for SMEs on management.

The Network will provide guidance for enhancement of competitiveness to the SMEs engaged in export business, and those active in the nationwide markets (Strategy 1), and guidance to help ensure management stability for small-scale enterprises catering to limited local demand. At the same time there will be provision of appropriate advice to SMEs regarding finance and tax payment obligations so as to enhance their capability to furnish financial institutions with appropriate credit information for improvement of their access to financing (Strategy 4).

The second major component is to establish a support system for identification and development of business “seeds” that individual SMEs have. Also important is to encourage and assist LGUs and local private sectors to provide business opportunities for SMEs when they plan and launch regional development projects.



Figure III-2-4 Facilitation of supports for diversified support needs of SMEs in the local markets, through nurturing of SME Counselors and SME Advisors, and assignment of them to local contact window networks to be developed



## **B Development Measures for Strategy 3**

### **Major projects**

- (1) Nurturing of SME Counselors and establishment of a system for SME Counselor training (#17)

The SME Support Center Network to be discussed next assumes the active presence of SME counselors and SME Advisors. The SME Counselors are expected to provide consultation services to SMEs at the Centers in the field of management and finance, and introduce them to appropriate institutions when needed. The SME advisors are characterized by having business experience, and provide guidance in specialized areas such as marketing, technology and product development.

Since so far almost no staff members are available to provide such advice, it is necessary to create a group of persons who are capable of providing such guidance. This must be done on an urgent basis, and by using the existing system, while also establishing a new system to nurture the Counselors.

- (2) Development of an SME Support Network consisting of SMED Regional Centers, SME Centers, SME Desks and Industry Support Centers; Assignment of SME Counselors and SME Advisors to the Network; and provision of support on management and finance through One-Stop Service Windows at the Support Network (#16)

The project is to revitalize the SME Support Network following the basic concept of SME support system based on SME Centers, but with concentrated allocation of limited personnel and funds to the strategic points. Namely, SMED Regional Centers, which constitute the core of SME support, will be set up in a few places where the demand for the support is great. It is assumed that eventually 16 Centers will be established, in as many Regions. As for the SME Centers, only the Centers that are active will be retained, while other centers that are operated by DTI provincial offices only with their own staff will be converted to SME desks. The SME guidance system will be enhanced by nurturing and assigning the SME Counselors.

### **Projects that Supplement the Major Projects**

- (1) Establishment of a buyer-supplier database for broad utilization in SME support activities, together with business matching support (#4)  
(For further details, see aforementioned description.)
- (2) Support for identification and development of new materials and business "seeds", and development for commercialization of it (#3)  
(For further details, see aforementioned description.)
- (3) Local Reverse Trade Fairs  
This is a continuation and reinforcement of the current project.

Reverse trade fairs will be held targeting large companies, food product chains, etc. in the provinces, taking into account the conditions special to each region. The SMED Regional Centers, LGUs, and local private sector players should take the initiative in planning and implementing the fairs.

- (4) Encouragement and support for regional development projects based on identification and development of business seeds with initiatives by LGUs and local CCIs (#27)

The project is intended to support local SMEs for creation and growth of small businesses through identification and utilization of regional resources to serve as business opportunities for them.

One possibility is support for the review and redrafting of plans of presently advocated “1 Municipality, 1 Product, 1 Million Projects” that has run aground because of business planning and organization difficulties. Coordination with regional promotion projects being carried out by the DILG would be also useful, and projects provided by foreign donors should be coordinated also from the standpoint of making most of them.

### **C Strategy Implementation System**

The SME support network consisting of the SMED Regional Centers, SME Centers, SME Desks and SMED Authority (including the Industry Support Centers) will play a central role. Since one of the keys for succeeding with the strategy is the consultation personnel, an important requirement is securing of SME counselors, who have received appropriate training, and appointment of SME advisors.

Strategy 4: Development of SME financing programs which depend not on collateral heavily, but on cash flow of the project and personal credit of entrepreneurs, centering on SB Corporation as the policy execution body for SME financing

## **A Strategy Background and Outline**

### **Strategy Recommendations**

Figure III-2-5 shows the way schematically to achieve the goal targeted with the Strategy 4 through implementation of the proposed projects and programs.

The strategy is composed of measures and proposals for promotion of short-term procedural improvements, and proposals regarding medium-term improvement of the SME financing system.

The short-term, procedural, aspect consists of measures to promote introduction of supplementary means for alleviation of the high risk of SME financing by financial institutions, including furnishing of reliable credit information, and preparation of credit guarantee instruments that can replace physical collateral, and proposals for improvement of efficiency of SME-loan application screening. As for the medium-term, the program proposes clear definition and positioning of SBC as a core policy institution responsible for SME financing and enhancing the SME financing system.

## **B Development Measures for Strategy 4**

### **4-1: Promotion of supplementary measures to reduce the risk of SME financing**

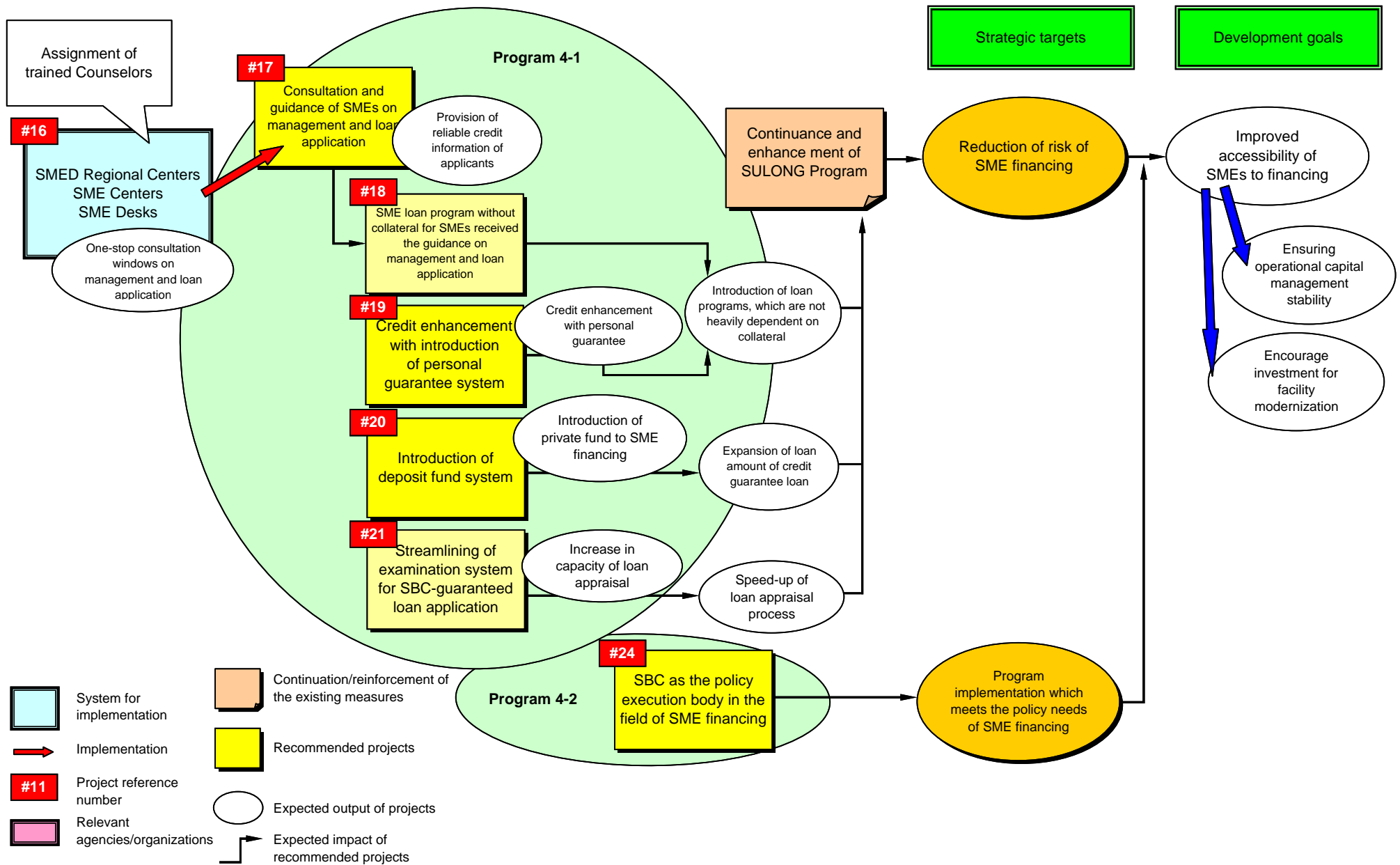
#### **Major projects**

- (1) Guidance for management and making applications for financing, as means to enhance capability of SMEs in furnishing credit information (#16)

The project is intended to increase the confidence of financing institutions in credit information prepared by SMEs, providing management guidance (introduction of standardized forms and entries, and assistance for preparing business plans, etc.) and guidance in preparing applications for financing.

At the same time, the program provides a scheme of financing without collateral for SMEs that make use of this program, as an incentive to use this program (#18, to be described later).

Figure III-2-5 Development of SME financing programs which do not depend heavily on collateral, centering on SB Corporation as the policy execution body of SME financing



(2) Supplementation of physical collateral by promotion of a credit guarantee system (#19)

This program aims to make SME financing easier through promotion of credit supplementation by personal guarantees as opposed to the present system of financing of SMEs that relies too heavily on physical collateral. Namely, insufficiency of physical collateral is supplemented by guaranteeing of the credit standing (credit debts) of SMEs by personal guarantees furnished by corporate representatives and third parties. In promotion of the system it will be necessary to have means of limiting the scope of responsibility of the guarantor to a certain degree and avoids excessive guaranteed debt. This project includes preparation of the legal structure for that and promotion of guaranteed debt.

(3) Increase in the available amount of loans which are guaranteed with a credit-guarantee issued by the SBC, through introduction of a deposit fund system (#20)

This is complementary scheme to the present SME financing using the credit guarantee system to encourage financial institutions to increase the amounts of loans. The government makes a contribution to the SBC at an amount equivalent to a guarantee target. Then, the SBC deposits that contribution at financial institutions that have concluded guarantee contracts with the SBC, and at the same time the SBC requests those financial institutions to increase the granting of loans using SBC's credit guarantee to an amount approximately three times of the deposit received.

That increases the amount of financing to SMEs under the credit guarantee system. Further, it also serves to create new funds, since the additional funds come from private funds held by the private financial institutions.

**Projects supplementing the major programs**

(1) Provision of collateral-free finance to SMEs that receive management and financial guidance from the SME Support Network (#18)

This program aims to provide financing without collateral and without guarantees to SMEs that have received guidance on management for at least 6 months and guidance on loan applications through the above-mentioned SME support network (#16), provided that they meet the other conditions required for loan application. The project is intended to promote supplementary credit by methods other than physical collateral, and also serves making SMEs more aware of the importance of actively working for improvement of their management methods.

(2) Improvement of loan application appraisal systems for loans which use a credit guarantee (#21)

This is a project to shorten the time required for loan appraisal, which is a problem point in SME financing.

The project is intended to enable SBC to increase the number of loan appraisals to be handled, by changing the appraisal practice from the current group screening to the screening

to be performed by individuals who are delegated the appraisal work according to their positions.

#### **4-2: Increased presence of the Government in SBC to ensure its position as the policy execution body in the field of SME finance**

This recommendation is to increase the presence of Government in SBC, to enable the SBC to implement programs and measures in line with the policy needs of the Government.

In the case of SME financing in the Philippines, however, they are significantly affected by the prevailing business conditions of the financial sector, and many factors impede the improvement of the system. These include the application of the same regulatory rules as private banks to GFIs, the tendency of banks to tack the loan processing costs on the interest in addition to applying the market rate of interest, and the immaturity of retail financing institutes as such. Thus, the SME financing system in the Philippines is yet to show significant effects as a tool of policy implementation in the areas where the market mechanism does not function freely.

The Magna Carta has designated the SBC as the primary agency in the field of SME financing. The Government is recommended to increase its influence on the SBC to guide the SBC as the policy-directed financing institute, increasing the number of Board members representing SME policy.

### **2.3 Implementation System of SME Development Plan**

#### **2.3.1 Establishment of an Implementation System for SME Development Plans at the Central Government Level**

The central government system is weak with regard to work on the formulation and administration of SME development plans, including monitoring, reviewing, and revision after a certain time of implementation, together with supporting implementation of the Plan.

- Establishment of the SMED Authority as the central organization for support of SMEs (#22)

The concept of this recommendation is to establish a government organization (SMED Authority) capable of taking responsibility in implementing the National SME Development Plan, which is now being formulated, making the administration of SME development under DTI unified and strategic manner by concentrating the available funds and resources at strategic points, and making the SME support comprehensive and competent, consolidating the fragmental efforts.

The Project proposes to create a government agency responsible for overall SME development, reorganizing and integrating the BSMED and other Government agencies and institutions extending SME support under DTI, including those for regional operations. The agency is to be:

- Responsible for all the administrative matters on SME Development currently under the DTI.
- Responsible to undertake coordination among the relevant departments on the SMED related administration, representing the DTI's position of the lead agency in implementing the government programs of SME development.

The function of the SMED Authority assumes:

- Policy planning, administration and monitoring of financial and non-financial matters related to SME development within the jurisdiction of DTI
- Implementation of the non-financial matters; SBC is assumed to be responsible for implementation of the financial matters

### **2.3.2 Securing of Funds Required for SME Development**

Table III-2-1 summarizes the input requirement of each project.

The government needs to make every possible effort to secure the necessary funds for implementation of this SME development plan.

A major financial source for program implementation is the annual government budget. As the budget is constrained by revenues, however, it is proposed to establish a development fund as a supplemental source in addition to the ordinary budget. While efforts should be made to increase budget allocations, the establishment of the SME Development Fund is recommended to serve as a stable basis of program implementation.

In addition to the direct funding, there are several ways to finance the development program, which are recommended for consideration.

- 1) Pay for service
- 2) Effective use of programs implemented by foreign donor organizations
- 3) Centralized control of development budget execution
- 4) Contribution from LGU budgets
- 5) Generation of event-related advertisement and sponsorship revenues

- **Establishment of SME Development Fund (#23)**

The development measures should be reassessed as to importance in view of the fund secured for implementation. For that purpose as well it is necessary to get a good idea beforehand of the funds that can be secured. Although the annual government budget allocation to this plan is the basis of the implementation funds, it is also necessary to consider securing other funds as well, including the following:

The establishment of an SME Development Fund is proposed to receive and disburse these funds.



- Fees for registration of business name
- Fees for business license
- A certain percentage of the LGU's budget

### **2.3.3 Recommendation of Measures for Efficient Implementation of SME Development**

#### (1) Utilization of IT in SME support programs (#26)

It is important to utilize IT in SME development for the sake of more efficient and effective attainment of development results. The Philippines is lagging considerably behind Malaysia, Thailand and other neighboring countries in that respect.

The proposed recommendation focuses particularly on business matching, provision of support information, and remote consultation services, as the first step of IT utilization.

#### (2) Development and utilization of SME statistical data (#25)

Statistics provide a basis for quantitative evaluation that is indispensable in policy formulation and monitoring. The existing statistics system can hardly be said to adequately meet the need for creation of data relating to SME development policy. The following are minimal practical methods of collection of necessary data regarding SME development policy:

- Periodical surveys for collection of related data (sample surveys for identification of general trends and problem points)
- Processing of existing statistical data into data relating to SME development
- Unified application of standard classification of SMEs to existing industrial and economic surveys on establishments and employees

### **2.3.4 Efforts for Change in Policies and Measures for Improvement of the Business Environment of SMEs**

Authorities engaged in SME development should address the issues listed below by analyzing them, including analysis of their impacts on SMEs, developing and proposing improvement measures to related authorities, and evaluating their effects.

Under the present system, authorities participating in the SMED Council can negotiate directly among them for coordination. However, there is no formal mechanism to grasp the actual situation and problems, and develop improvement measures.

Establishment of the SMED Authority, particularly creation of a mechanism to examine issues raised by related authorities and propose solutions and programs, is expected to fulfill such role (See “Executive Director for Policy & Planning” of Project #22)

- (1) Review of public service charge and taxation in view of SME development
- (2) Review of measures for encouragement of business cooperatives

## **2.4 Timeframe for SME Development Plan Implementation**

The timeframe set for implementation of the SME Development Plan is 7 years starting from 2004 up to 2010. All the recommended measures are assumed to be implemented within the first 3 years. The mid-term review is scheduled to be made at 2.5 years after the implementation, and revised and enhanced measures will be implemented on the basis of the mid-term review.

Nurturing of counselors should be addressed first of all. In this case, counselors to assigned to the SMED Authority and SMED Regional Centers should be first secured for them to take a central role in implementing the plan. At the same time, a few persons who will take charge of formulating the counselor-training program should be secured. With these staff as the core, staff will be gradually increased while supporting the present staff in charge of DTI. Securing of the counselor personnel will be completed by the end of September 2004 and policies relating to consulting and guidance will be developed based on the work of these persons after October (the follow-up instruction for these counselors at actual work sites will be concurrently continued).

Next to nurturing of Counselors, development of Industry Support Centers and of SMED Regional Centers are essential. The nucleus for implementing Strategies 1 and 2 are the Industrial Support Centers (Industrial Support Centers for Processed Food, Furniture/Export General Merchandise, and Supporting Industry). The time frame for implementing the strategies will closely relate to the establishment time of these centers. Since the establishment time for these centers will be October 2005 in consideration of various procedural processes, provisional alternative organizations utilizing existing organizations within the range of current laws, regulations etc. should be established at the time of October 2004, by which time the plans should be implemented provisionally.

With regard to the SME support networks, SMED Regional Centers will be first established within the DTI local offices in Cebu and Davao. At the same time, a center with functions both of being a future base for SMED Authority and of the regional center in the Luzon area will be established as the Manila Regional Center within BSMED or DTI-NCR (the organization which is the base of future Industry Support Centers should be included). In this regard, the proposed organization need to have internal organizations which are clearly separated between that of policy planning, and administration, and that of implementation, to avoid a heavily lopsided burden on the plan implementation.

Taking into consideration that it takes time for implementation in a perfect form in either case, the base for future organization will be planned within 6 months in such a manner that existing organizations are used and the above mentioned provisional organizations will be

completed by the end of September 2004 (implemented within the range of current laws, ordinances, regulations, etc.)

These are provisional organizations and the formal organizations will be established as soon as detailed plans are formulated and required approval procedures are completed relating to functions of organizations, organizations to be integrated, and personnel assignment, etc.

In addition, for important policies in the development plan, the activities will be started by utilizing the aforementioned organization scheme and existing organization scheme (within the scope of the SMED Council).

In implementing the measures, those measures which require no special budget and can be implemented basically by internal personnel, should be implemented ahead of the others.

Among projects supporting strategies, some assume financial backing or invitation of professionals. Consultation on these projects for requesting cooperation to overseas donors needs to be launched at an early stage.

Table III-2-2 shows the outline of implementation time frame.

Table III-2-1 Summary of Input Requirement

(Unit: US\$)

		Manpower			Equipments/ facilities (Investment)	Additional costs & expenses (annual basis)	Remarks
		Foreign	Local				
		Foreign Experts (Incl. remunerations, transportations, accommodation and per diem expenses)	Local staff (Staff of Government agencies; annual basis)	Outside sources			
1	Design workshop (or product development workshop)	75,600	6,300	13,000		32,800	2 Workshops at 2 different locations each.
2	Design competition		3,200	8,500		23,000	To be held once a year.
3	Business seeds identification and development						As a part of ordinary operation.
4	Buyer-Supplier Database			500	(*) 30,400		(*) Computers to be installed at SMED Regional Centers and Industrial Support Centers.
5	Packaging technology development	(*) 430,900	5,400		120,000	27,600	(*) Including 14,500 as costs for local staff.
6	Dissemination of production management for local-resource based industries		2,200			19,800	3 sessions a year.
7	Parts and service procurement seminar		500			800	1 session a year.
8	Comprehensive support for potential SME suppliers of parts and services						As a part of ordinary operation.
9	Dissemination of production management methods for supporting industries	73,800	2,200			24,800	Including a half-day seminar, factory diagnosis program, and training course.

		Manpower			Equipments/ facilities (Investment)	Additional costs & expenses (annual basis)	Remarks
		Foreign	Local				
		Foreign Experts (Incl. remunerations, transportations, accommodation and per diem expenses)	Local staff (Staff of Government agencies; annual basis)	Outside sources			
10	Advanced Technology Center	330,000	32,400		1,800,000	34,200	
11	Develop and promote standard curriculum for technical training		900	7,600		1,500	
12	Entrepreneurship development of creative SMEs		7,900	3,200		6,000	
13 14 15	3 Industrial Support Centers		133,200	22,500		5,000	3 Centers.
16	SME support network			(* 64,800)	12,500	58,000	(* Increase in salaries of local staffs.
17	SME Counselors and SME Advisors			9,000	(* 68,000)	31,500	(* Plan and preparation of the training courses.
27	Local development project promotion	330,000	36,000			75,000	

Notes:

- 1) 30% of the above should be added as contingencies to obtain the total costs and expenses.
- 2) US\$ 1.00= 55 Pesos.

Table III-2-2 Outline of Implementation Time Framework

