MCSME PROMOTION POLICY AND LEGISLATIVE AGENDA: FOCUS ON MONETARY POLICY, FINANCE AND CREDIT PROGRAMS

Mario B. Lamberte

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(Abstract)

This paper analyzes the impact of monetary policy, finance and credit programs on Micro, Cottage, Small and Medium Enterprises (MCSME) development in the Philippines. It also examines corresponding monetary policies, finance and credit programs in Japan, Korea and Taiwan and attempts to draw for the Philippines some lessons and implications from their experience. The ultimate objective is to recommend specific policies and legislative actions for the promotion of MCSMEs in the country.

The Philippine monetary and banking policies have gone through several changes. Between the creation of the Central Bank (1949) and 1985, cheap credit policies had been maintained. Highly specialized banks were created to serve specific sectors of the economy. The result was that the financial system was not able generate enough resources and create instruments to meet the rapidly growing demands of the real sector. Although MCSMEs were specifically targeted by these policies, still they were left out by the formal credit system. The more repressed the financial system, the more they were left out. In other words, the subsidy in credit went to those who did not need the subsidy. The myriad of special credit programs hardly helped the MCSME.

The reforms in 1985 were significant in the sense that instruments for repressing the financial system were gradually removed. For instance, most subsidized credit programs were either closed or rationalized. The reason is because small borrowers, like the MCSMEs, are willing to pay the market rate of interest provided they are given access to credit. In addition, restrictions on bank entry and branching are gradually being removed.

Interestingly, however, the government has not only maintained but increased the number of special credit programs. Most of them charge the market rate of interest and utilize NGOs as conduits of the funds. This raises some questions. First, the viability of these programs could not be immediately ascertained because subsidies are hidden. For instance, the salaries of the staff managing the programs are not reflected in any appraisal of the program. Second, these programs are small, fragmented, and overlapping in function with each other. Understandably, efforts to assist MCSME are also fragmented. Thus, MCSMEs are left without any support from the government.

Threats of policy reversal have become more pronounced given the number of bills filed in Congress that recommend the re-institution of subsidized credit policy and ceilings on lending rates.

There are several lessons that can be drawn from the experience of Japan, Korea, and Taiwan in assisting the development of their MCSMEs. First is appropriate macroeconomic policies. Small banks were allowed to proliferate in the Japanese landscape. The historically low inflation rate of Japan was conducive to savings mobilization. This explains why lending to SMEs from special credit programs comprised only a small proportion of total credit obtained by SMEs. Second, Japan has a legal framework for the promotion of SMEs. An example is the law that protects subcontractors from unfair practices of the mother companies. This has contributed to the growth of subcontracting business in Japan. Third, Japan provides ample technological and marketing support to their SMEs to make them competitive even in the world market. And finally, Japan created a lead agency to assist the SMEs. Being a corporation, it has greater flexibility in meeting the changing demands of the SMEs.

Korea basically followed the footsteps of Japan, i.e., its government is heavily involved in the promotion of SMEs. The assistance is focused on knowledge-intensive SMEs by providing technology and venture capital. However, it is encountering some difficulties because in the past, its industrial

policies favored the establishment of large industries. Subcontracting in Korea is not as well developed as that of Japan.

Taiwan sharply differs from the approach pursued by Japan and Korea. In fact, it is only recently that this country started some programs to assist SMEs. But Taiwan's overall economic policies had been conducive to the development of SMEs. For instance, Taiwan's rural infrastructure system is far superior to that of Korea. Thus, SMEs in the rural sector were able to operate viably.

No matter how monetary policy is made conducive to the development of MCSMEs, it cannot work independently of the rest of macroeconomic policies. The first task therefore is to finetune macroeconomic policies so that their biases against MCSME will be reduced, if not totally eliminated. As regards monetary policy, a tighter control on the movements of monetary aggregates is desirable to achieve a stable movement of the general price level.

There is a need to create a body which will promote the cause of the MCSME. Its task will be to concretize policies and not to formulate them. A corporation similar to Japan Small Business Corporation is suggested. It may set up its own research and training institutes or incorporate in it existing research and training institutes. It will be funded by integrating the existing lending programs for MCSMEs including the six major lending programs of Technology and Livelihood Resource Center (TLRC).

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*Mario B. Lamberte***

I. INTRODUCTION

The importance of micro, cottage, small and medium enterprises (MCSMEs) in developing as well as developed economies has been well recognized.[1] In terms of number, MCSMEs dominate the economic landscape. Their contribution to employment and output is by no means small. They simultaneously fulfill several desirable objectives of any society such as employment, equity, and geographical dispersion of industries. They also figure out prominently in the export drive of several countries. They tend to produce products that greatly depend on locally-available factor inputs. It is therefore understandable that most developing economies try hard to develop and promote MCSMEs. Interestingly, the concern towards MCSME development is not often reflected in development policies of several countries including the Philippines. MCSME promotional programs have therefore been rendered less effective, if not totally ineffective at all. It might also be argued that appropriate policies may not automatically produce an environment conducive for MCSME development. In LDCs, MCSMEs face several bottlenecks, and MCSME promotional

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** Vice-President, Philippine Institute for Development Studies.

[1] Per resolution of the National Economic and Development Authority (NEDA) dated 12 February 1986, enterprises are classified according to the following asset sizes: 1) micro enterprises - less than P50,000; 2) cottage enterprises - P50,000 to P500,000; 3) small-scale enterprises - P500,000 to P5 million; and 4) medium-scale enterprises - P5 million to P20 million.

programs such as entrepreneurial and skills training programs, and technology and marketing information systems can help MCSMEs overcome these bottlenecks.

Recently, there has been a resurgence of interest in promoting SMEs in highly developed economies like Japan and the USA and newly industrializing economies like Korea and Taiwan. In this age of high technology, MCSMEs have been relied upon to push the frontiers of development. The policy environment has been altered to allow MCSMEs to develop, apply, and commercialize new technology and products. In these high-risk ventures in which success or failure can only be felt after five to seven years, new ways of financing have been developed by the financial markets. In LDCs where financial markets are less developed, the MCSMEs' role in developing, applying, and commercializing new products and technology is severely limited. Thus, unless those factors that constrain the development of their financial markets are adequately dealt with, LDCs will be further left behind in this age of high technology.

This paper attempts to undertake a detailed analysis of the impact of monetary policy, finance and credit programs on MCSME development in the Philippines. It also examines corresponding monetary policies, finance and credit programs in Japan, Korea and Taiwan and tries to draw for the Philippines some lessons and implications from their experience. The ultimate objective of the paper is to recommend specific policies and legislative actions for the promotion of MCSMEs in the country.

Chapter II makes a detailed assessment of current monetary policy, finance and credit programs for SMEs. It includes a brief situationer on SMEs in the Philippines and a discussion of the methods of financing their business. Chapter III reviews corresponding monetary policy, finance and credit programs in Japan, Korea and Taiwan and discusses some lessons and implications from their experience for the Philippines. Chapter IV provides a critical assessment of the pending bills in Congress that have some bearing on SME development in the country. The last chapter presents some recommendations for government legislative action and private sector adoption.

II. ASSESSMENT OF CURRENT MONETARY AND CREDIT POLICIES

This chapter assesses the current monetary and credit policies with special reference to MCSME financing. It is divided into four sections. The first presents a simple framework that describes the role of major participants in the financial markets and the process of intermediation. The second section discusses the present structure of the Philippine financial system, while the third assesses the current monetary and credit policies within the context of the framework developed in the first section. The fourth section describes the important features of special credit programs for MCSMEs in the country. Finally, the last section of this chapter provides a brief situationer on small and medium enterprises in the country and discusses the methods of financing their business.

A. Theoretical Framework

There are seven major players in the financial markets, namely, the deficit units, the surplus units, financial intermediaries, the Central Bank, the government (fiscal sector), foreign private financial institutions and external donors. The network of relationships

among the agents in the financial markets is described in Figure 1. Producing units may either be self-financing or net borrowers in the financial markets. Net borrowers or deficit units have alternative sources of funds. They may borrow from surplus units directly or indirectly through financial intermediaries. Note that financial intermediaries also borrow funds from surplus units that are, in turn, lent to deficit units. Financial intermediaries are supposed to mobilize and allocate resources in a more efficient manner. If financial intermediation is inefficient, then both surplus and deficit units will be better off if they directly make the financial transactions.

The government, foreign donors, and foreign private financial institutions are alternative sources of funds for deficit units. The funds provided by these institutions to deficit units may be coursed either through the financial intermediaries, the Central Bank, or through non-financial conduits such as non-government organizations (NGOs) that have lending programs.

The Central Bank is an important agent in the financial market because of its dual role. It regulates the financial system to protect the interest of surplus units, financial intermediaries, and deficit units, and at the same time, stabilizes the economy through its power to create and destroy money. Its regulatory functions include, among others, the granting to or withdrawal from entities of a banking license and examination of the book of accounts of financial intermediaries. Its stabilization function may be accomplished by injecting into or withdrawing money from the financial system through the financial intermediaries and/or the government. This is made possible through the use of its monetary instruments such as reserve requirement on deposit liabilities, rediscounting facility, and open market operations.

It is important at this point to describe the process of intermediation and examine the impact of alternative policies on the price and volume of loans and deposits. Figure 2 presents a simple framework of the intermediation process. Deficit units express their demand for external funds given alternative lending rates. To meet the credit demand of deficit units, financial intermediaries mobilize deposits by offering surplus units with attractive deposit rates. Under an ideal situation where intermediation cost and profit are zero, and where there are no distortions in the financial market, demand for loanable funds will be satisfied at the equilibrium interest r where deposit and lending rates are equal. Projects that yield rates of return greater than or equal to r will be funded by the system. Now consider a ceiling on lending rate, r', which is below the market rate, r. Since this implies lowering the deposit rate as well, fewer funds will be mobilized by the financial intermediaries as depositors, especially the large ones, shift their funds to high-yielding foreign or physical assets, resulting in the reduction in the supply of funds. Excess demand occurs, and some of those that were previously serviced by the financial intermediaries could not obtain loans anymore. Under this situation, rationing is likely to take place, and financial intermediaries might exploit this situation by charging higher effective rates on loans through various means such as requiring deposit hold-out, increasing service charges, etc. Some will be completely rationed out while those who are not being rationed out will be paying a rate, say r^*, which is more than the rate under a liberal interest rate regime.

One may think of a situation in which interest rate ceiling is binding; that is, there is a regulation which authorities can effectively enforce against imposing additional charges

Figure 1
FINANCIAL MARKETS

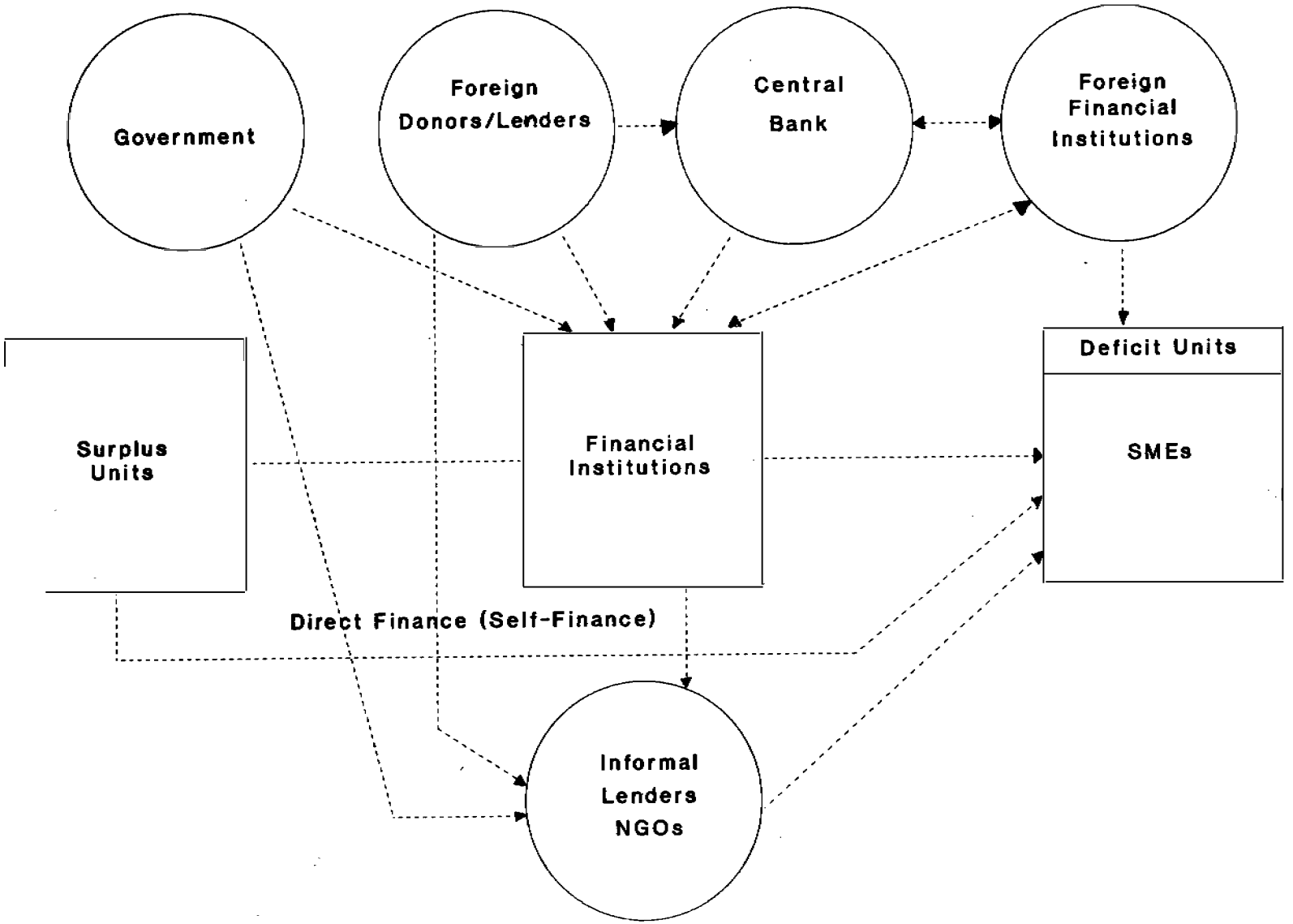
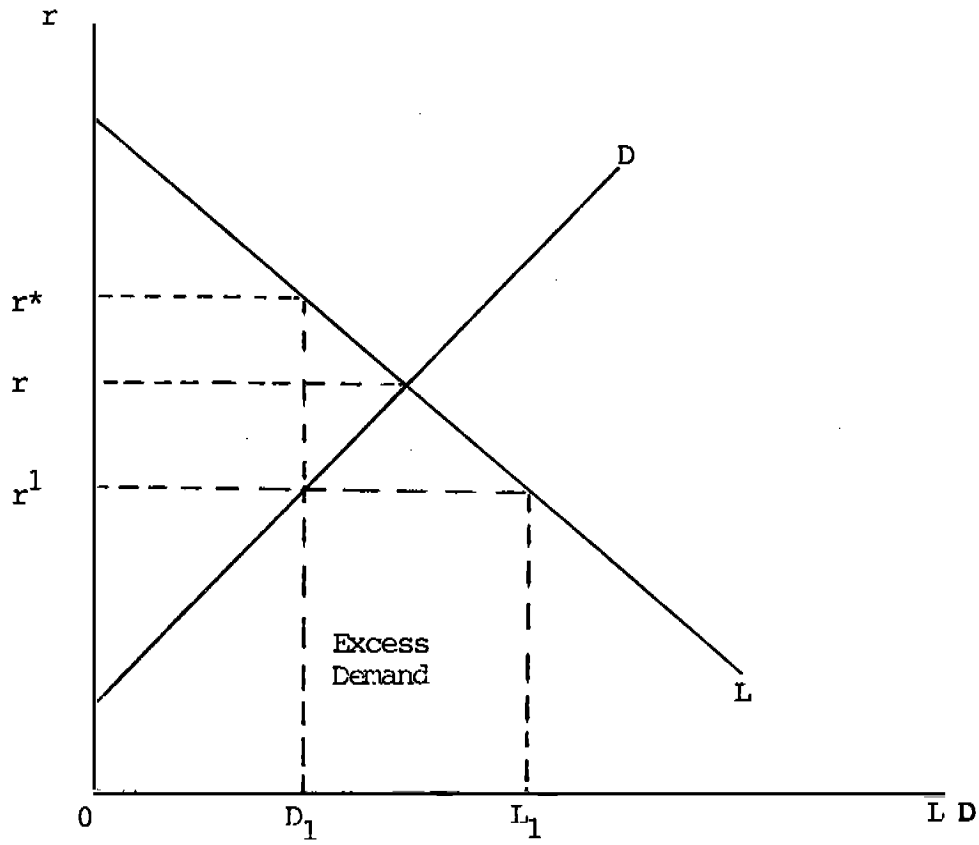


Figure 2
INTERMEDIATION PROCESS



on loans that can make the effective lending rate higher than the prescribed rate. Figure 3 shows that it will have a different effect on large and small borrowers. $D1$ and $MC1$ respectively, are the demand and marginal cost curves of small borrowers while $D2$ and $MC2$, respectively, represent the demand and marginal cost curves of large borrowers. Note that $MC1$ is steeper than $MC2$, reflecting the higher cost of lending to small borrowers than large borrowers. At the interest rate ceiling r^*, large borrowers obtain loans, $L2^*$, while small borrowers get $L1^*$. If the interest rate ceiling were further reduced to r^{**}, large borrowers will obtain a larger amount of loans, $M2$, while small borrowers will secure only $M1$, which is smaller than if the interest rate ceiling were set at r^*. This suggests that as the interest rate ceiling becomes more restrictive, more loans will be concentrated in the hands of large borrowers at the expense of small borrowers. This is the "iron law of interest rate restriction" hypothesized by Gonzales-Vega (1984).

So far, the possible effects of imposing interest rate ceilings on the supply and price of loanable funds have been discussed. There are Central Bank/government actions that could drive a wedge between the deposit and loan rates, the ultimate effect of which is to drive the deposit rate downwards and the lending rate upwards. Consider, for example, the case of imposing a uniform reserve requirement on all deposit liabilities of banks. Let

$$L = (1-k)D \qquad (1)$$

where L = supply of loanable funds;
D = volume of deposits; and
k = reserve requirement ratio.

It is immediately clear from the above that the supply of loanable funds is now less than the volume of deposits, i.e., $L < D$. Assuming zero transactions cost and that banks were to attain at least zero profit, then

$$rL = iD$$

or

$$r = i/(1-k) \qquad (2)$$

where r = the nominal lending rate; and
i = the nominal deposit rate.

Equation (2) suggests that the lending rate increases with the reserve requirement ratio. This is shown in Table 1 where different values for k are assumed.

The above analysis may be modified by adding a requirement that all banks allocate a certain proportion, a, of their loanable funds for lending to a priority sector. Assume, for the sake of simplicity, that the interest rate on the loans to this priority sector is set at zero, which is below the market rate. Equation 2 may be modified as follows:

$$r'L' = iD \qquad (3)$$

where $L' = (1-a)L$ = the free loanable funds for the less favored sector of the economy that pays the market rate;

Figure 3
THE IRON LAW OF INTEREST RATE RESTRICTIONS

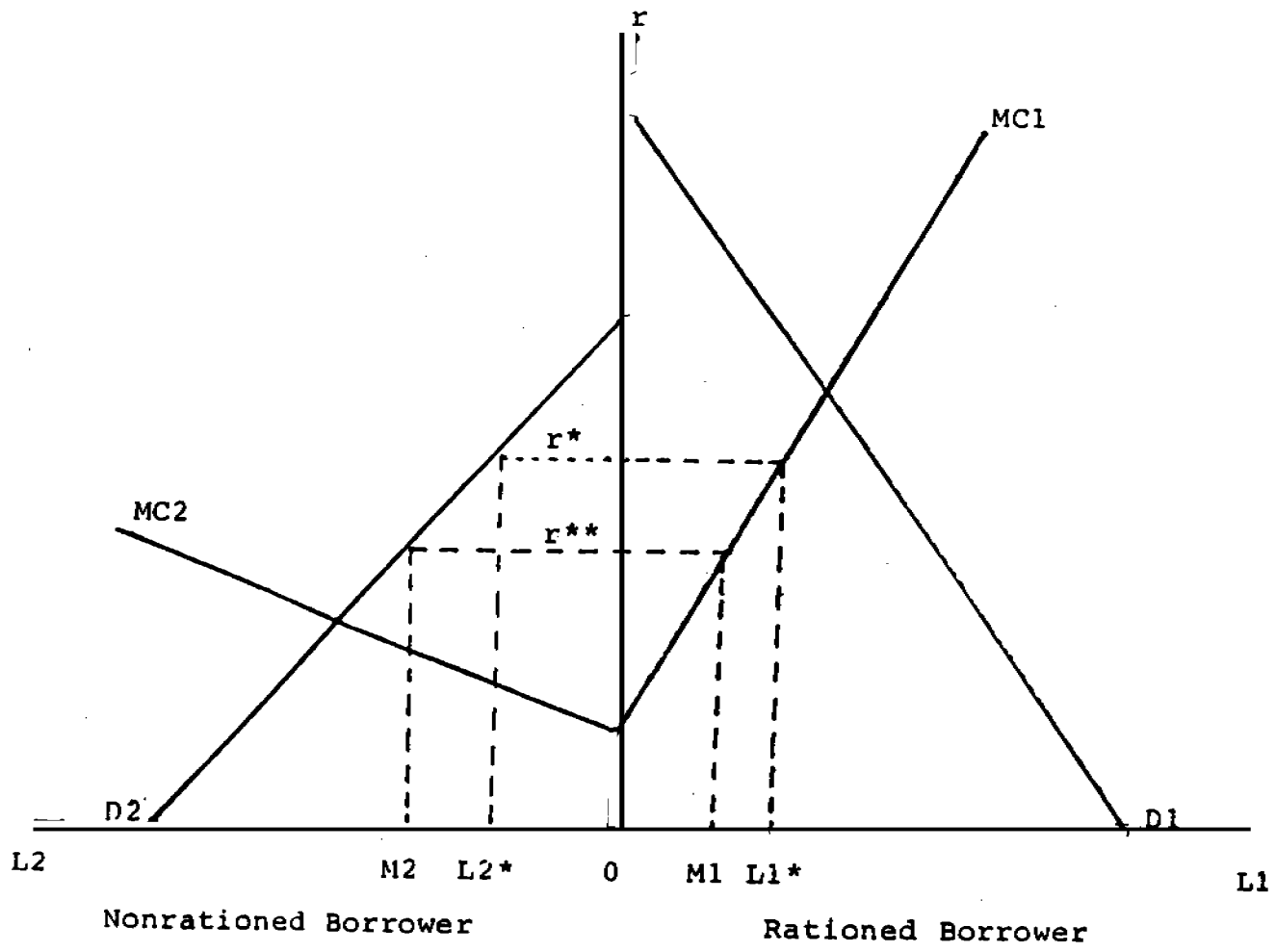


Table 1
NOMINAL LENDING RATES GIVEN DIFFERENT RESERVE REQUIREMENT RATIOS AND ZERO PROFIT
(In Percent)

k	i	r
5	5	5.26
10	5	5.56
15	5	5.88
20	5	6.25
25	5	6.67
30	5	7.14

Notes: k = reserve requirement ratio
i = nominal deposit rate
r = nominal lending rate

r' = the nominal market rate that would be charged to less favored sector of the economy;
a = the mandated proportion of total loanable funds allocated to the priority sector;
aL = total loanable funds allocated to the priority sector;and
i, D, L as defined before.

Then, $r'(1-a)L = iD$
or $r' = i/(1-a)(1-k)$ (4)

This suggests that the lending rate, r', increases with the loan portfolio requirement, a, for the same reserve requirement, k. This is illustrated in Table 2 where different values for a are assumed while fixing the value for k. Note that r', the lending rate on loans to the less favored sector when the reserve requirement and loan portfolio requirement ratios are simultaneously imposed, is greater than r, the lending rate when only the reserve requirement is imposed. Thus, under the policy described above, banks tend to increase the rate they charge to the less favored sector of the economy to compensate for the income loss they suffer due to the requirement to lend to the priority sector at a rate less than the market rate.

Some complications to the basic model may further be introduced by considering the impact of inflation on intermediation cost and lending rate. Let

$r^* = r - ep$ = the real lending rate, and
$i^* = i - ep$ = the real deposit rate,

where r = the nominal lending rate,
i = the nominal deposit rate, and
ep = the expected inflation rate.

Subtracting ep from both sides of equation (2) and substituting $i^* + ep$ for i, we obtain

$$r^* = i^*/(1-k) + ep(k/(1-k)) \quad (5)$$

Equation (5) states that the higher the real deposit rate (i^*), the reserve requirement ratio (k), and the expected inflation rate (ep), the higher is the real loan rate that the bank would charge even if it does not realize a profit. The loci of real lending rates shown in Figure 4 for different inflation rates are derived from Table 3. It shows, for example, that if the reserve requirement and expected inflation rate were 20 percent and 10 percent, respectively, then for a zero real deposit rate, the bank's lending rate should be 2.5 percent to obtain at least a zero profit. But if the expected inflation rate were 20 percent, then for the same reserve requirement ratio and real deposit rate, the bank's lending rate would be raised to 5 percent to attain a zero profit. This means that a higher inflation rate would lead to a higher bank spread, which in turn would raise the lending rate even if banks were to realize a zero profit. Thus, inflationary monetary policy would hurt borrowers, especially the MCSMEs. Bringing the inflation rate down from an initially high level will not

Table 2
NOMINAL LENDING RATES ASSUMING DIFFERENT LOAN PORTFOLIO REQUIREMENT RATIOS AND ZERO PROFIT
(In Percent)

k	i	a	r
10	5	5	5.85
10	5	10	6.17
10	5	15	6.53
10	5	20	6.94
10	5	25	7.41
10	5	30	7.94

Notes: k = reserve requirement ratio
i = nominal deposit rate
r = nominal lending rate
a = loan portfolio requirement ratio

Figure 4
INFLATION RATES AND INTEREST RATES

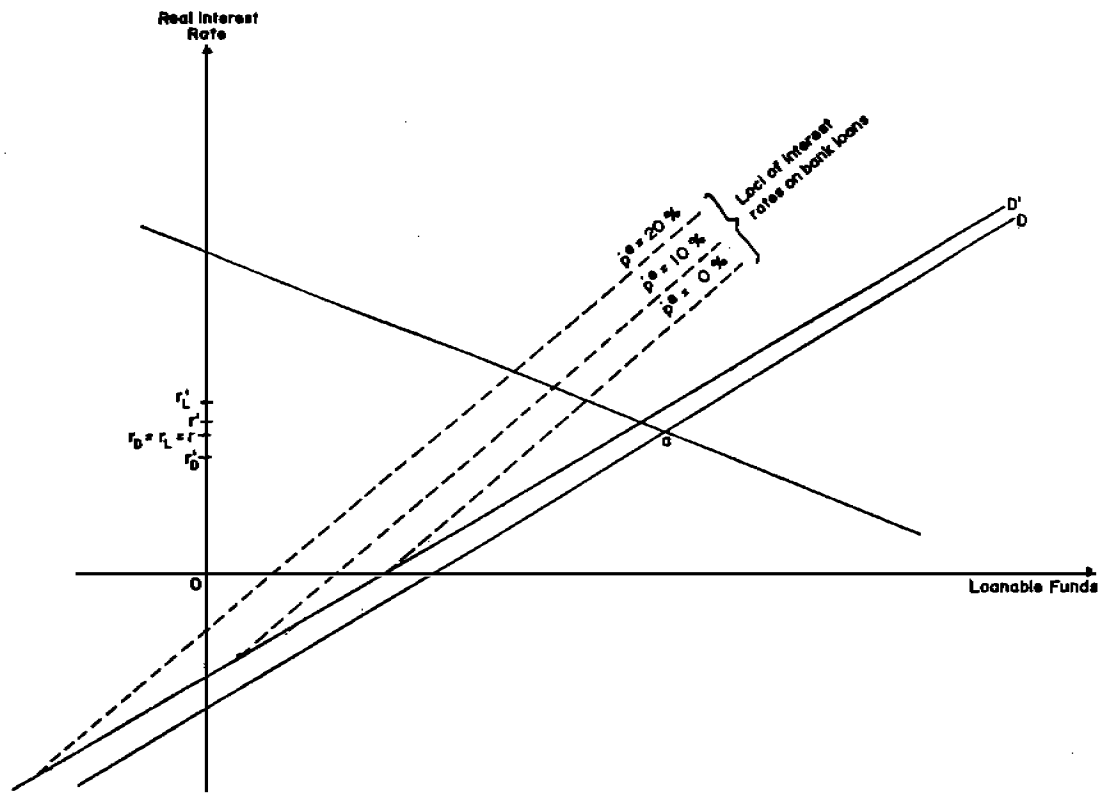


Table 3
LENDING RATES WITH A 20 PERCENT RESERVE REQUIREMENT RATIO
ON DEPOSITS AND VARIOUS EXPECTED INFLATION RATES
(In Percent)

ep = 0				ep = 10				ep = 20			
i	i"	r	r"	i	i"	r	r"	i	i"	r	r"
0	0	0.00	0.00	0	-10	0	-10.00	0	-20	0	-20.00
5	5	6.25	6.25	5	-5	6.25	-3.75	5	-15	6.25	-13.75
10	10	12.50	12.50	10	0	12.50	2.50	10	-10	12.50	-7.50
15	15	18.75	18.75	15	5	18.75	8.75	15	-5	18.75	-1.25
20	20	25.00	25.00	20	10	25.00	15.00	20	0	25.00	5.00
25	25	31.25	31.25	25	15	35.00	21.25	25	5	31.75	11.25
				30	20	37.50	27.50	30	10	37.50	17.50
								35	15	43.75	23.75
								40	20	50.00	30.00

Notes: i = nominal deposit rate
i" = real deposit rate
r = nominal lending rate
r" = real lending rate
ep = expected inflation rate

automatically reduce the intermediation cost. This depends on the monetary instrument being used by the monetary authorities. If reserve requirement were increased to siphon off excess liquidity to reduce inflationary pressures, then the intermediation cost would not decline as clearly shown in equation (5).

B. Present Structure of the Financial System

The financial system of the Philippines has grown in size and complexity since the Philippines gained her independence in 1946. However, it has remained underdeveloped compared to those of the fast growing economies of her Asian neighbors.

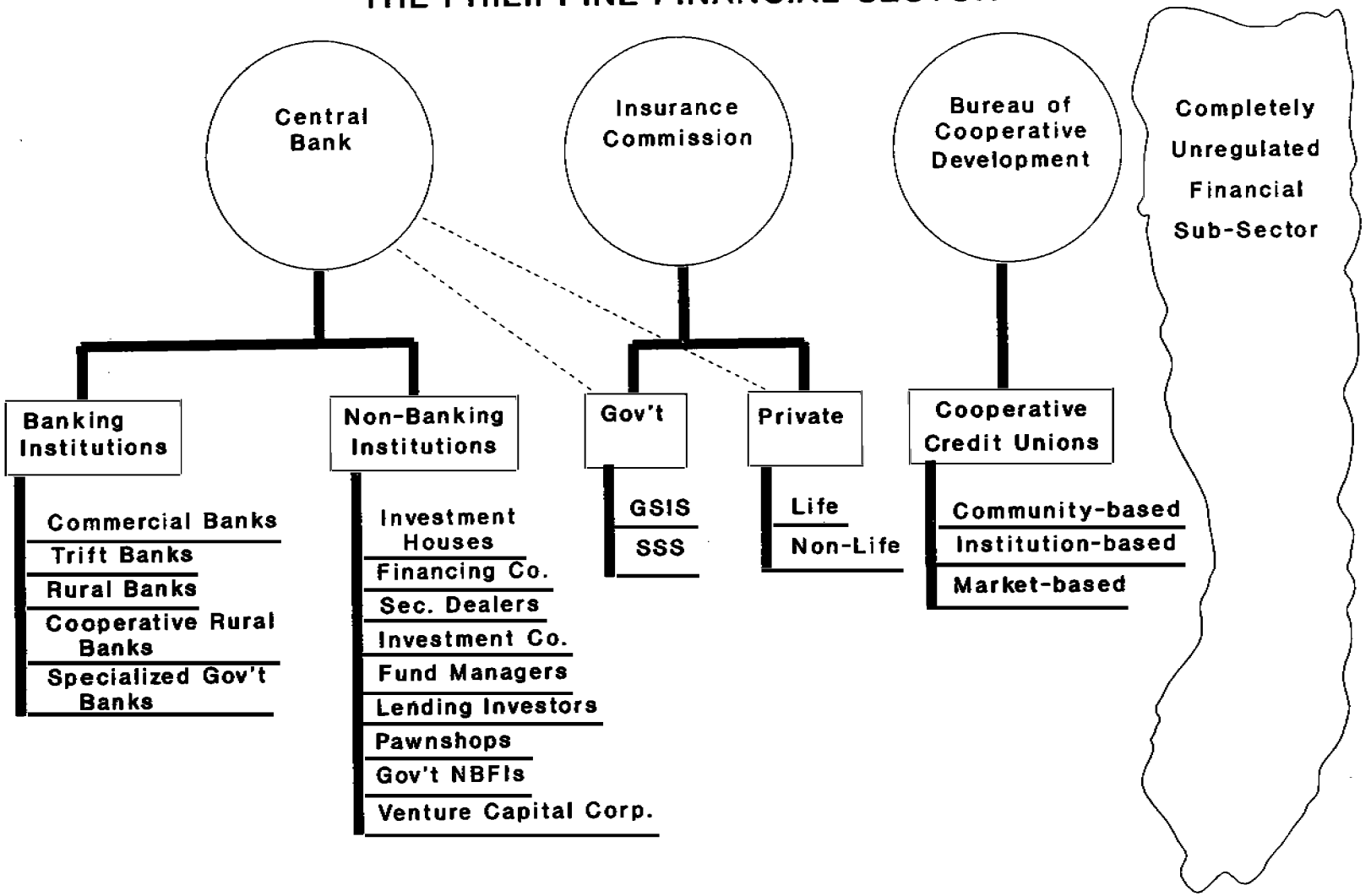
The financial system has two large sub-markets, namely the formal and the informal markets (Figure 5). Several studies have shown the importance of the informal financial markets in efficiently mobilizing and allocating resources. The informal financial markets have remained large and active especially in the last few years when the entire financial system encountered some difficulties because of a series of bank failures and the economic crisis in the mid-1980s (Lamberte 1988, and Lamberte and Lim 1987). They have been the main sources of funds for the small farmers and MCSMEs (Agabin *et al.* 1989). This topic will be discussed again later.

The formal financial markets, meanwhile, are supervised mainly by the Central Bank. Thus, the discussion in this section will focus on the structure of the formal financial system under the supervision of the Central Bank.

The total real assets of the formal financial system had been growing fairly well in the early 1980s until an economy-wide crisis struck in 1984 and 1985 (Figure 6). It plunged precipitously in 1983 as a result of high inflation rates and capital flight that got out of hand between 1983 and 1985. It started to recover in 1987 but as of 1988, total real assets of the financial system were still far below the 1983 level.

The formal financial system has two major sub-systems, namely, the banking system and the non-bank financial system. The main difference between the two is that institutions belonging to the former are licensed to accept traditional deposits (i.e., demand, savings, and time deposits) while those belonging to the latter are prohibited from accepting deposits. As of December 1988, both systems have about the same number of outlets (Table 4). On the average, there were 4 outlets per municipality/city in the country (Table 5). However, there was a great concentration of outlets in Metro Manila, which is considered as the financial capital of the country. MCSMEs, majority of which are located in rural areas, are definitely placed in a seriously disadvantageous position compared to large industries located in Metro Manila, given the existing distribution of financial outlets in the country. In terms of assets, the banking system clearly dominated the financial landscape, contributing 89 percent of the total assets of the financial system in 1988. Within the banking system, the commercial banking system appears to be the biggest sub-system. Its assets comprised 74 percent of the total assets of the financial system in 1988. Being national banks, commercial banks have the most extensive branching network in the country. However, their branches are located mostly in more affluent cities and towns in the regions. Banking services in smaller cities and towns have been dominated by the rural banking system, and in certain areas, by thrift banks.

Figure 5
THE PHILIPPINE FINANCIAL SECTOR



Source : Lamberte, Mario B. and Joven Z. Balboza, "Informal Savings and Credit Institutions in the Urban Areas: The Case of Cooperative Credit Unions", PIDS Working Paper Series No. 88-06, April 1988.

Figure 6
PHILIPPINE FINANCIAL SYSTEM

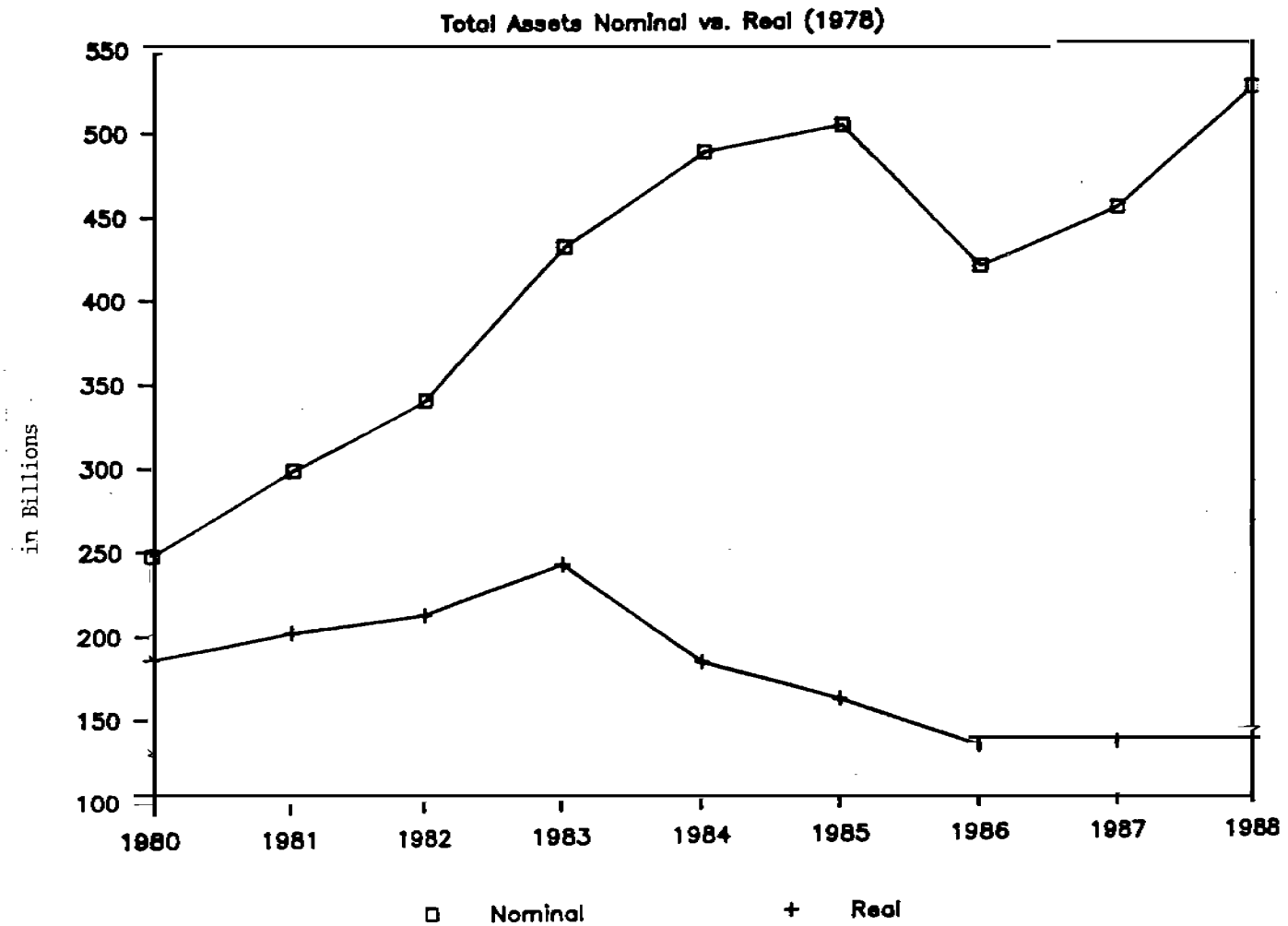


Table 4
NUMBER OF INSTITUTIONS AND FINANCIAL ASSETS
OF THE FINANCIAL SYSTEM, DECEMBER 1988

Institutions	Number of Institutions		Total Assets	
	Head Offices	All Outlets	In million Pesos	Distrib'n. (In Percent)
TOTAL	3,697	6,805	404,895	100.00
A. Banks	982	3,562	360,377	89.00
Commercial Banks	29	1,746	299,618	74.00
Thrift Banks	110	664	24,877	6.20
PDBs	41	25	66,660	1.70
SMBs	8	250	14,192	3.50
SSLAs	61	209	4,025	1.00
Rural Banks	840	1,048	10,693	2.60
Specialized Government Banks	3	104	25,189	6.20
Non-Bank Financial Institutions	2,631	3,158	41,898	10.30
Investment Houses	15	31	8,456	2.10
Financing Cos.	143	237	7,364	1.80
Securities Dealers/ Brokers	132	132	1,706	0.40
Investment Cos.	75	75	5,615	1.40
Fund managers	12	12	1,777	0.40
Lending Investors	659	697	636	0.20
Pawnshops	1,574	1,953	1,666	0.40
Money Brokers	-	-	-	-
Government Non-Bank Financial Institutions	3	3	14,578	3.60
Venture Capital	13	13	100	-
Non-Bank Thrift Institutions	84	85	2,620	0.70

Source: CB Fact Book: Philippine Financial System, 1988.

Table 5

DENSITY RATIOS: PHILIPPINE FINANCIAL SYSTEM

December 31, 1988

	Banks (1)	Non-Bank Financial Institutions (2)	Total (3)	Municipalities and Cities (4)	Ratio (3) - (4)
NCR - Metro Manila	1,083	1,417	2,500	17	147.0
I - Ilocos	270	114	384	176	2.2
II - Cagayan Valley	109	41	150	118	1.3
III - Central Luzon	369	428	797	121	6.6
IV - Southern Tagalog	516	505	1,021	221	4.6
V - Bicol	141	77	218	115	1.9
VI - Western Visayas	253	145	398	131	2.2
VII - Central Visayas	213	167	380	132	2.9
VIII - Eastern Visayas	85	43	128	142	0.9
IX - Western Mindanao	74	64	138	103	1.3
X - Northern Mindanao	155	75	230	123	1.9
XI - Southern Mindanao	184	125	309	86	3.6
XII - Central Mindanao	86	42	128	107	1.2
TOTAL - PHILIPPINES	3,538	3,243	6,781	1592	4.3

Source: CB Fact Book: Philippine Financial System, 1988.

The deposit markets appear to be more competitive compared to the loans market. Commercial banks are the biggest mobilizers of private deposits even in the countryside. However, the data shown in Table 6 suggest that most of their mobilized funds are transferred to highly commercialized and industrialized regions, specifically Metro Manila, where there is excess demand for funds by low-risk borrowers such as the prime large domestic and multinational companies.

The financial system suffered three major crises during the past 20 years. From 1970 to 1987, the Central Bank already closed a total of 221 banks, more than half of which were rural banks. Thrift banks also suffered a number of closures (Table 7).

One feature of the Philippine financial system is the presence of a large government-owned commercial bank (i.e., the Philippine National Bank or PNB) and two specialized government banks (i.e., the Development Bank of the Philippines or DBP and the Land Bank of the Philippines or LBP).[2] Providing financial services to MCSMEs is one of the mandates explicitly incorporated in their charters. PNB has remained the biggest in terms of total assets even when its assets were already reduced by half in 1986 because of the transfer of its non-performing assets to the National Government. The government already started the process of privatizing PNB by successfully selling 30 percent of its total outstanding shares in June 1989.

The DBP was created by the government primarily to provide long-term funds to agriculture and industry. It was also given the task of promoting the establishment of private development banks through direct equity participation.

DBP's role was purely developmental. Unlike PNB, it did not compete with private commercial banks in mobilizing deposits. Instead, it mainly relied on subsidies from the government, deposits of government corporations, notably the Government Social Insurance System and the Social Security System, and foreign loans, which were earmarked for special projects. On the lending side, it concentrated in financing long-gestating projects such as steel, cement, shipping, mining, etc., that were deemed crucial to the economic development of the country but required huge financial outlays. It also provided guarantees to several foreign loans contracted by private corporations. In the early 1980s, it was heavily involved in rehabilitating private financial institutions by either infusing fresh capital or lending to ailing ones.

DBP used to be the second largest financial institution in the country next to PNB. Between 1980 and 1985, its total assets more than doubled from P27 billion to P72 billion. In 1986, DBP underwent a rehabilitation program that involved the transfer to the National Government of its non-performing assets totalling P61.4 billion and certain liabilities and related accounts amounting to P62.2 billion. This drastically reduced DBP's total assets to P9.5 billion in 1986. As of the moment, DBP has already resumed its normal lending operations. Government subsidies to DBP are being gradually phased out. But it remains

[2] The other specialized government-owned bank, i.e., the Philippine Amanah Bank, is now moribund. LBP has recently been reclassified as a commercial bank.

Table 6
LOAN-TO-DEPOSIT RATIO OF COMMERCIAL BANKS

Region	1985	1984	1983
NCR	1.07	1.28	1.44
I	0.21	0.24	0.29
II	0.42	0.52	0.75
III	0.29	0.34	0.48
IV	0.30	0.32	0.44
V	0.44	0.43	0.64
VI	1.24	1.20	1.63
VII	0.43	0.55	0.81
VIII	0.42	0.45	0.68
IX	0.30	0.50	0.66
X	0.45	0.46	1.07
XI	0.43	0.47	0.70
XII	0.37	0.42	0.55

Source: Central Bank, Fact Book: Philippine Financial System (1983-1985)

Table 7
NUMBER OF CLOSED PDIC BANKS

Bank Group	1970-1987
Commercial Banks	6
Savings and Mortgage Banks	5
Private Development Banks	4
Stock Savings and Loan Associations	26
Rural Banks	180
Specialized Government Banks	-
All Banks	221
Percent to Total Member Banks	

Source: PDIC Annual Reports (various years).

as the major conduit of externally funded special credit programs such as the Industrial Guarantee Loan Fund.

LBP was created primarily to assist land reform beneficiaries of their financial needs and to finance the acquisition by the government of landed estates for division and resale to small landholders. But it functioned mainly as a commercial bank using deposits of the National Government and government-owned corporations as its main resources. Its loans to land reform beneficiaries comprised only less than 10 percent of its total loan portfolio. Its total assets as of December 1987 stood at P12.6 billion. Unlike PNB and DBP, it did not encounter any major financial difficulties. Recently, the role of LBP has been expanded to meet the demands of small farmers who are going to be the beneficiaries of the Comprehensive Agrarian Reform Program (CARP). It has now concentrated on wholesale lending to financial and non-financial intermediaries operating in the rural areas.

There are 12 types of non-bank financial institutions in the country. We will highlight here the performance of two of them, namely leasing companies and venture capital corporations, because of the role they play in providing funds to MCSMEs. In the Philippines, leasing companies are classified under financing companies. In fact, financing companies may engage in leasing upon securing authority from the Securities and Exchange Commission and registering with the Central Bank. Only 38 of the 237 existing financing companies have been engaged in leasing. Most of them, especially the larger ones, are subsidiaries of banks. Their clients consist of households and small and medium enterprises. The regulation pertaining to the single borrower's limit force them to lend only to SMEs. For the first semester of 1987, they generated leasing transactions equivalent to P123 million (Lirio 1987). Leased assets mostly consisted of motor vehicles, and business equipment and office machines. Admittedly, the total leasing volume generated by leasing companies had gone down tremendously right after the 1984-1985 economic crisis. It started to pick up only in the last two years when the economy grew fast.

There are at least three factors that adversely affect the growth of leasing transactions. The first is the 10 percent value added tax (VAT) slapped on goods to be leased. This increases the cost of the lessee. The present VAT system discriminates against leasing transactions in that a borrower who buys an equipment through a loan can immediately use the VAT in relation to his other VAT requirements while in the case of a lease, it is the financial institution (as owner/lessor) who buys the equipment and the same cannot use the VAT but recoups the VAT through the lease rental payments (Lirio 1987). The second factor is that leasing firms are not allowed to lease capital goods with a value of more than 30 percent of unimpaired capital. This is in effect the single borrower's limit for leasing companies. Indivisibility of capital goods constrains them under this regulation from going into highly profitable leasing transactions. The third factor is that leasing companies are only allowed to sell their receivables to banks, investment houses, and other financial institutions. They are not allowed to float bonds to raise funds from the public. Borrowing from the public is limited only up to 19 creditors. Thus, the growth of their resources is severely constrained.

Venture capital corporations in the Philippines started only in the early 1980s when banks were allowed to invest in these corporations up to a maximum of 60 percent of the total equity. The rest were contributed by two separate government-owned corporations. They were created to facilitate the movement of long-term funds to SMEs. There was a

spurt in the growth of venture capital corporations in the initial years. The government's incentive in terms of equity participation was one of the factors that attracted private banks to set up their own venture capital corporations. However, the unprofitability of the business that was affected by the recent economic crisis prompted some investors to close their venture capital corporations. Thus, the number of venture capital corporations has been dwindling from 17 in 1985 to 13 in 1988. Four more were in the process of liquidation in 1989. As of December 1988, the aggregate resources of venture capital corporations amounted only to P100 million. Half of their assets consisted of investments, but most of these were in high-yielding Treasury bills. Venture capital corporations in the Philippines are not real venture capital corporations like those that have emerged in the USA, Japan and Korea which promote and commercialize ideas concerning technological innovations. Most of the equity participation and loans of Philippine venture capital corporations went into companies/projects that have nothing to do with the commercialization or application of new technology.

The capital market is the least developed market in the Philippine financial system. The resources in the non-securities market are very thin and only large firms have access to them. In the stock market, there are only 147 listed firms at present, 62 of which belong to the top 1000 corporations in the country. The two stock exchanges are more like gambling casinos than a market for trading securities.

C. Current Monetary and Credit Policies

From the 1950s to the 1970s, cheap credit policy had been pursued to encourage more investments in the fledgling economy. Monetary policies had been designed to support this policy. First, ceilings on lending rates were imposed. Second, the rediscount rate of the Central Bank was set at a bargain rate, making the Central Bank a "lender of first resort" instead of a "lender of last resort." There was a variety of rediscount rates for more favored priority sectors, including the MCSMEs which obtained the lowest rediscount rate. Third, the government heavily participated in the credit markets through its own specialized banks.

Referring back to Figure 1, this policy virtually turned financial institutions into "one-armed" entities because they became heavily dependent on cheap funds from the Central Bank and National Government and failed to mobilize deposits as real financial institutions should do. The effect of this policy on the development of the financial system may be seen in Table 8. The Philippine financial system has remained shallow compared to those of Korea, Malaysia, and Thailand. The wide margin between the rediscount and prescribed lending rates offered financial institutions ample opportunities for "rent-seeking behavior." This was aggravated by the Central Bank's policy of restricting bank entry and branching. Insider abuse, i.e., diverting cheap government funds to the business concerns of bank owners and other related interests, became widespread. It led to the collapse of several financial institutions (Lamberte 1989).

Reforms in the financial system were initiated earnestly in the early 1980s. Upon assuming power in 1986, the new government further accelerated the much needed financial reforms. These are embodied in the *Medium-Term Philippine Development Plan, 1986-1992*. The reforms were aimed at strengthening the stabilization function and, at the

Table 8
M/GNP IN SELECTED ASEAN COUNTRIES

Country	1975	1980	1985	1987
Indonesia	0.16	0.18	0.26	0.31
Malaysia	0.46	0.54	0.67	0.75
Philippines	0.17	0.21	0.21	0.22
Singapore	0.60	0.66	0.70	0/85
Thailand	0.34	0.39	0.60	0.67
Korea, Rep. of	0.31	0.34	0.39	0.41
Taiwan	0.56	0.64	1.08	1.32

$M = M = M$ = quasi money
$\quad\;\; 3 \quad 1$

Source: Key Indicators of Developing Member Countries of ADB Vol. XVII-July 1987; Vol. XIV-April 1983; Vol. XVIII-July 1988 Vol. XVIX, July 1989, cited in Tan (1989).

same time, shedding off the development function of the Central Bank. Efficiency in intermediation is to be achieved through improved competition in the system. In particular, freer entry into all areas of banking and finance to enhance the efficiency of financial intermediation has been allowed as expressed in CB Circular No. 1188. From May to December 1989, the Central Bank already approved 54 applications for branches from banks (23 from commercial banks, 18 from thrift banks, and 13 from rural banks). A savings bank's application for a commercial banking function has also been recently approved. These reforms are meant to increase financial intermediaries' loanable funds through deposit mobilization.

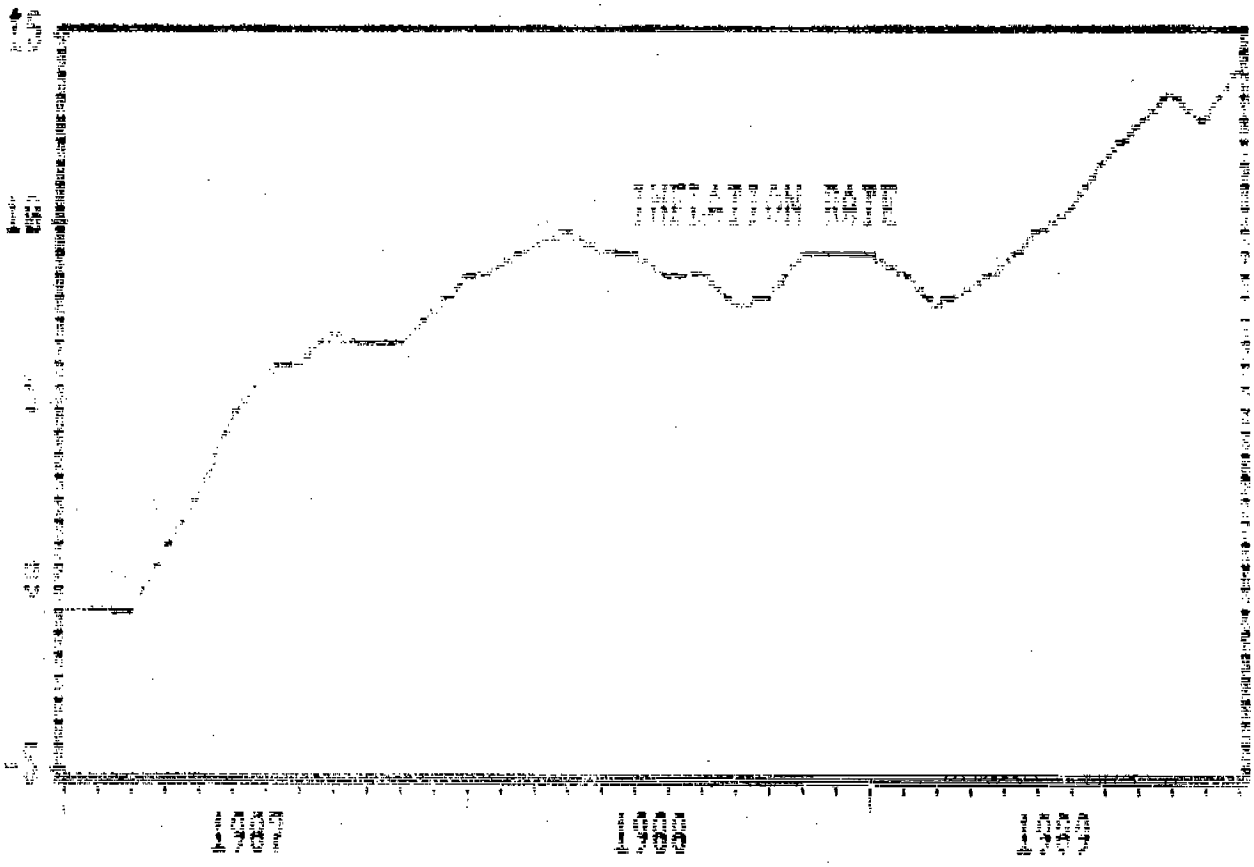
The Central Bank has also spelled out a policy towards improving the stability and soundness of the banking system by refraining itself from sustaining weak banks as it used to do in the past. This is to gain surplus units' confidence in the banking system so that it would be easier for banks to mobilize deposits. Special privileges and subsidies given to government-owned banks have gradually been phased out to force them to become competitive.

The determination of the interest rate is now left to market forces. More importantly, the rediscount policy of the Central Bank has been changed. At present, a uniform rate that is aligned with the market rate is charged on all rediscounts with the Central Bank, thus ending the era of preferential treatment for some sectors of the economy including the MCSMEs. This is also a signal that the Central Bank now gives greater emphasis on savings mobilization, thus changing itself into a truly lender of last resort. It now has a better control over money supply movements and, therefore, inflation. In the past four years, the growth in money supply had been moderated, partly to comply with IMF conditionalities. As a result, a single-digit inflation rate had been achieved throughout the period, except in the last few months when supply bottlenecks became more pronounced (Figure 7). This was further aggravated by additional "cost-push" pressures arising from the rise in the price of oil and the recently legislated increase in the minimum wages.

The policy reforms also led to changes in the strategy in providing financial support to MCSMEs. The Plan specifically states that: "Focus shall be directed toward increasing MCSMEs' access to financing through a market-oriented interest rate policy" (p.153). The shift in policy takes cognizance of the view that the problem of MCSMEs is not so much the price of credit but access to it. Moreover, subsidized credits are mostly enjoyed by those who can afford to pay the market rate rather than by those who need the subsidy most, as found out by Llanto and Neri (1985).

The authorities have recognized the adverse impact of some regulations on intermediation cost. A gradual reduction in the reserve requirement ratio and abolition of the agri-agra requirement and gross receipts tax have been planned to reduce bank intermediation costs. Between 1986 and 1988, the Monetary Board twice reduced the reserve requirement ratio on deposit liabilities with original maturities of 730 days or less from 23 percent to 21 percent. For deposits with maturities over 730 days, the reserve requirement was reduced to 5 percent from 6 percent in 1986. However, in June 1989, the Monetary Board raised the reserve requirement of deposits with original maturities of more than 730 days from 5 percent to 7 percent. This will eventually be aligned with that of the short-term deposits. More recently, however, the reserve requirement ratio for all types of

Figure 7
MONTHLY INFLATION RATE IN THE PHILIPPINES, 1987-1989



deposits had been raised to 22 percent as a reaction to rising inflationary pressures experienced by the economy in the last few months and also, to meet the reserve money target included in the IMF conditionalities. Going back to equation (5) as mentioned earlier, the reduction in intermediation cost that might result as inflation rate declines may partly be offset by an increase in the reserve requirement ratio. Thus, the domestic lending rates are likely to remain high for quite some time unless both the inflation rate and the reserve requirement ratio on deposits are reduced.

Regarding the Central Bank's proposal to abolish the agri-agra requirement and gross receipts tax, Congress has not yet acted on them. As a whole, the reforms virtually left the intermediation cost untouched. With very high intermediation cost, it is not surprising then that the bank lending rates have remained high at between 25 to 35 percent, with small and medium enterprises that have access to bank credit obtaining the higher rate.

Perhaps the most disturbing policy that has been adopted by the monetary authorities is defending the value of domestic currency in the face of a deteriorating trade balance. This is made possible by pursuing a high interest rate policy. The biggest casualty of having an overvalued currency and a high interest rate is the export sector, which also includes many small direct and indirect exporters (Lamberte *et al.* 1989). They are hurt in two ways. First, they pay an interest rate on their loans that is much higher than if the exchange rate is not defended; and second, they receive lower exchange rate for their export earnings than they should have had the exchange rate been left to seek its own level.

D. Special Credit Programs for MCSMEs

Special credit programs are instruments for directing credit to specific sectors. The present government seems to be ambivalent with regard to its policy towards special credit programs. On one hand, it consolidated 20 separate agricultural loan programs into the Comprehensive Agricultural Loan Fund (CALF), which is used solely as a guarantee fund. On the other hand, it has maintained and even allowed the proliferation of special credit programs in the last four years. The Agricultural Credit Policy Council (ACPC) listed 35 major on-going programs for credit assistance as of January 1990. Four credit programs have been inadvertently excluded in the list. In the following discussion, focus will be made only on those credit programs that wholly or partially cater to the MCSMEs. At least 16 direct lending programs and 3 credit guarantee programs for MCSMEs have been identified. IGLF is included in the first group because it is essentially a lending than a guarantee program. Note that one-half of the 16 direct lending programs for MCSMEs were created after 1986. The detailed profiles of these programs are presented in Annexes A.1 to A.12. Meanwhile, the features and performance of the 16 direct lending programs will first be analyzed.

1. Direct Lending Programs

The special credit programs were created for different purposes. Some of them have broad objectives such as generating livelihood opportunities, while others have very specific objectives such as providing PVOs with revolving funds for lending to micro enterprises. There is no relationship between the range of objectives and total financial resources of the programs. That is, some well-funded programs have broad objectives while

resources of the programs. That is, some well-funded programs have broad objectives while others have very specific objectives. Admittedly, many of these credit programs have similar broad and specific objectives and are serving practically the same clientele.

The funds for these special credit programs come from various sources such as the National Government, government-owned corporations specifically SSS which has always had excess funds, multilateral donors, and agencies of foreign governments. Funds from the National Government and government-owned corporations are mere reallocation of domestically available resources to priority sectors while those that come from foreign sources are considered as addition to domestic resources. Note that foreign funds come into the country in the form of foreign loans to the National Government, which bears the exchange risk since loans to ultimate borrowers are disbursed and repaid in domestic currency. In the end, soft foreign loans may turn out to be costly if the domestic currency is sharply depreciated against the currency in which the foreign loan is denominated.

Almost all the initiators of the special credit programs are non-financial institutions. They are either regular government agencies or government-owned corporations. The implementors of the programs are not necessarily the same initiators. There are two types of program implementors, namely, financial and non-financial government institutions. The latter setup has some cost disadvantages over the former since a new administrative structure that includes credit evaluation and collection department has to be put up, not to mention the lack of expertise of the personnel in handling credit programs. The administrative cost is often not reflected in reports of these programs, which makes it very hard to calculate the social costs of these programs. The implementing agencies are all located in Manila. Unlike government financial institutions that have several branches outside Metro Manila, non-financial program implementors do not have such facility. Hence, despite the claim by all special credit programs for MCSMEs that they have national coverage, their presence in the provinces is hardly felt at all by target borrowers (Lamberte *et al.* 1989). There is also a disadvantage if such programs are implemented by government financial institutions. That is, the availability of funds would make them less willing to mobilize deposits from private depositors.

One innovative approach to the delivery of credit to the MCSMEs that the Plan suggests is the use of private voluntary organizations (PVOs) and non-government organizations (NGOs) as "credit conduits of these financing facilities." Like informal moneylenders, PVOs/NGOs deal with their clients in a more personal basis and over time accumulate adequate information about them that could help ensure high repayment rates on their loans. Several PVOs/NGOs have already incorporated a credit facility in their package of services to MCSMEs. Thus, it is just a matter of increasing their resources so that they can service more clients. Some newly-created special credit programs took this cue and are now using PVOs/NGOs as lending conduits. Besides ensuring high repayment rates on loans and seeing to it that the loans would go to their target clientele, this approach substantially reduces transactions cost in administering the credit programs since wholesale loans are lent to PVOs/NGOs, which in turn retail them to MCSMEs, compared to the approach in which the program implementors distribute small loans to sparsely located clientele. There are, however, issues related to this approach that need to be addressed. One is that it involves some implicit subsidies provided by PVOs/NGOs in the delivery of credit to MCSMEs for the government. It is well known that most PVOs/NGOs

have volunteer officers and staff. Another one is sustainability. Over time, successful PVOs/NGOs have to grow and assume a more formal character to service the growing number and demands of their clientele, thereby losing their comparative advantage over banks. In another vein, the strength of PVOs/NGOs may have been sustained only by the presence of dedicated leaders who are willing to work for the organization on a voluntary basis. When they leave, the PVO/NGO they are working for may not find similarly dedicated leaders.

Other special credit programs use as conduits private financial institutions, which are given the responsibility of approving and collecting loans under certain guidelines given by the initiators/implementors of the programs. However, not all financial institutions automatically qualify as conduits of these funds. They have to be accredited first, which means that they have to satisfy certain criteria formulated by the initiators/ implementors of the credit programs. For some programs, the criteria for accreditation are so restrictive that only a few financial institutions could qualify. The spread between the cost and lending rate of the channelled funds provides private financial institutions with an incentive to implement the programs. There is therefore a natural tendency for them to depend heavily on these funds than on mobilized deposits if the spread they obtain from channelled funds is large. This now leads to the next issue-- the price of credit.

As already mentioned in the previous section of this chapter, the government's effort to increase MCSMEs' access to credit has to be done under a market-oriented interest rate policy. It is even explicitly stated in the Plan that "All remaining forms of interest rate subsidies to specific sectors (including the government) through the Central Bank credit facilities shall be eliminated" (p.47). However, most of the existing special credit programs do not pass through the Central Bank. Being beyond the reach of the Central Bank, these programs have the discretion to determine the price of their loanable funds.

It has been mentioned above that some programs lend directly to MCSMEs while others course the funds through participating financial institutions and PVOs/NGOs. For the latter, it is necessary to distinguish between the interest rate charged by the programs to intermediaries and to final borrowers, i.e., MCSMEs. Of the five programs that lend directly to MCSMEs, three fix the interest rate below the market rate while the remaining two use the market rate. Of the remaining nine programs that course the funds through participating financial institutions and PVOs/NGOs, some variation in the interest policy being applied can be observed. Three programs fix the lending rates to their target clientele below market rates. The other six programs fix the interest rate on funds they lend to intermediaries but leave the latter to determine their lending rate (which is usually the market rate) to final borrowers. In this arrangement, the intermediaries reap the subsidies granted by the special credit programs. For PVOs/NGOs, the subsidies compensate partly, if not fully, the implicit subsidies they confer to their clientele while for financial intermediaries, the subsidies are fully captured by them. Comparing the interest rate that intermediaries pay for the channelled funds and the prevailing market rate, it can be concluded that the subsidies they enjoy from such programs are not insignificant.

One program, i.e., IGLF, aligns the interest rate it charges on the funds it lends to participating financial institutions to the market rate. However, it follows a two-track interest rate structure on the funds it lends to participating financial institutions -- one is

fixed and the other is variable with the former higher than the latter -- and discriminates between borrowers located in well-off and depressed regions in the country, with the latter receiving a subsidy.

It is indeed very difficult to assess the performance of the various credit programs. In the first place, information about the performance of the programs are not readily available to the public in published form. For instance, reports about income and expenditures of most of the programs, especially those that are managed by regular line agencies, could not be easily obtained. Secondly, several of them have multiple objectives. This is further complicated by the fact that some objectives are so broad. Thirdly, while some programs identify both the intermediate beneficiaries (conduits of the funds such as PVOs and NGOs) and ultimate beneficiaries (i.e., the ultimate borrowers), there is no assurance that the conduits will direct the funds to target beneficiaries unless rigorous verification, which would increase the cost of implementing the program, is regularly done. This type of information (not mere reports of intermediaries) is what is needed but is not readily available from most programs.

Apart from reaching the target beneficiaries, these directed loan programs also have to be sustainable. Two important indicators of sustainability are high repayment rate and low past due ratio. As shown in Annexes A.1 to A.12, several programs provide these pieces of information. Others have just started and, therefore, have not encountered these problems. Reported repayment rates range from 61 to 100 percent. Majority of the programs obtained repayment rates of more than 90 percent. However, the reported past due ratios of most programs are alarmingly high. This is reminiscent of several special credit programs for agriculture that could not be sustained due to high default rates (Lamberte and Lim 1987).

2. Credit Guarantee Programs

As mentioned above, there are three credit guarantee programs for SMEs, namely, the Guarantee Fund for Small and Medium Enterprises (GFSME), the Philippine Export and Foreign Loan Guarantee Corporation (Philguarantee), and the USAID-supported credit guarantee program.

The first--GFSME--supports projects that are directly or indirectly engaged in food production, up to one level of backward or forward integration or linkage, like small scale food processing industries. It has four regular subsystems, namely, guarantee, mortgage, interest rate subsidy, and liquidity. The last two subsystems are going to be phased out. Three newly-created facilities are now being added to the regular subsystems. These are: CALF-GFSME guarantee facility, farm machinery dealer discount line facility, and LIVECOR-GFSME guarantee facility which is an extension of the LIVECOR's loan program for non-agricultural livelihood projects. The orientation of GFSME is towards the small and medium enterprises (i.e., those projects with assets of not less than P82,500 but not exceeding P10 million after financing). It excludes from the program cottage industries and microenterprises. It also requires that all loans be covered by a collateral.

GFSME principally operates through a network of accredited financial institutions composed of commercial banks, development banks, rural banks, and thrift banks (Table 9). Lately, it has accredited two nonfinancial NGOs which have been providing financial

Table 9
THE GUARANTEE FUND FOR SMALL AND MEDIUM ENTEPRISES (GFSME)
OPERATING HIGHLIGHTS
As of 2 January 1990

1. Accredited Banks

Commercial Banks	8
Development Banks	6
Rural Banks	10
Thrift Banks and Other Financ'l Inst.	17
TOTAL	41

II. Distribution By Loan

Size	No.	Amount	% to Total
P 50,000> = LOAN < = P 500,000 --->	82	22,752,250.00	27.33%
P 500,000> = LOAN < = P 1,000,000 --->	77	65,318,085.75	25.67%
P 1,000,000> = LOAN < = P 2,000,000 --->	68	106,658,500.00	22.67%
P 2,000,000> = LOAN < = P 5,000,000 --->	66	212,705,604.06	22.00%
P 5,000,000> = LOAN < = P 10,000,000 --->	7	47,198,745.29	2.33%
P 10,000,000> = LOAN < = P 20,000,000 --->	0	.00	.00%
TOTAL	300	454,633,185.10	100.00%

III. Distribution By Project Sites

	No.	Amount	% to TOTAL
Region I (Ilocos)	10	17,525,000.00	3.85%
Region II (Cagayan Valley)	1	50,000.00	.01%
Region III (Central Luzon)	79	126,134,750.00	27.74%
Region IV (Southern Luzon)	99	112,984,766.00	24.85%
Region V (Bicol)	2	3,000,000.00	.66%
Region VI (Western Visayas)	72	122,834,840.00	27.02%
Region VII (Central Visayas)	12	14,580,000.00	3.21%
Region VIII (Eastern Visayas)	0	.00	.00%
Region IX (Western Mindanao)	1	3,360,000.00	.74%
Region X (Northern Mindanao)	3	2,850,000.00	.63%
Region XI (Southern Mindanao)	9	18,195,000.00	4.00%
Region XII (Central Mindanao)	0	.00	.00%
National Capital Region	12	33,118,829.10	7.28%
TOTAL	300	454,633,185.10	100.00%

Source: GFSME

services to their clients. GFSME provides 85 percent cover of the amount of the individual loans, with the remaining to be shouldered by the accredited institutions. The loan size averaged P1.6 million. Seventy-five (75) percent of the 300 loan accounts were below P2 million. The projects are concentrated in Regions III, IV, and VI. As of year-end 1989, GFSME's past due rate posted 8.02 percent.[3] The recent shift in its focus in target clientele from the traditional agribusiness entrepreneurs to the smaller farmholders, while desirable, given the government's recently-implemented comprehensive agrarian reform program, will adversely affect SMEs' access to bank credit unless the slack will be picked up by another institution.

Meanwhile, unlike GFSME, the second program, the Philguarantee, carries only a guarantee program for export-oriented enterprises. It offers two major facilities, namely, the general guarantee facility, which is for guarantee of more than P5 million; and the export credit program for small and medium industries (ECGP-SMI), which is for guarantee of P5 million or less. The former has remained inactive for more than three years now due to the huge losses Philguarantee incurred while the latter still continues operating. Only accredited banks can tap the guarantee facilities. Philguarantee provides a maximum guarantee coverage equivalent to 70 percent of the approved credit facility.

The ECGP-SMI program excludes cottage industries and micro enterprises since it caters only to small- and medium-size enterprises with assets of between P500,000 and P20 million. It also excludes small- and medium-size enterprises that are producing solely for the domestic markets. Examples of such enterprises are those belonging to the metal working industries. Since its inception, the ECGP-SMI facility has reached only a limited number of clientele. As of 1989, the number of accounts outstanding was only 13 (Table 10). Its default rate posted 8.8 percent.

The third credit program refers to the one being supported by USAID. Introduced in 1985, the program allows four major Philippine banks to provide small and medium size enterprises with export or agriculture loan guarantees up to a total ceiling of $2.4 million for each bank.[4] Table 11 shows the participating banks, the features of the program, and beneficiaries of this program. Eligible loans are provided with a 50 percent guarantee cover. Accordingly, it is popular among participating banks because of its administrative simplicity and automaticity of guarantee coverage and guarantee payment. However, it has a very limited impact on improving SMEs' access to bank credit in general since it confines itself to only four participating banks. Moreover, like the two previous guarantee programs, it is not clear whether it has really facilitated SMEs' access to bank credit or whether banks simply tap it to provide themselves with additional protection.

E. MCSME Situationer

Like her neighboring countries, the Philippines relentlessly pursued an import-substitution industrialization strategy beginning in the early 1950s. High tariff rates, import

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[3] Past due rate is equal to the sum total of delayed payments, accounts with guarantee called, and the outstanding balance of accounts in litigation divided by the total outstanding balance of all accounts.

[4] This part draws heavily on the report by Rhee *et al.* (1990).

Table 10
PERFORMANCE HIGHLIGHTS OF PHILGUARANTEE
(In Million Pesos)

	1980	1985	1989	Total
Guarantees Outstanding, Beginning	-	53.0	37.9	
Add: Guarantees, Issued for the year (Net of Extensions)	29.7	18.9	12.9	348.7
Guarantees Outstanding, for the year	29.7	71.9	50.8	348.7
Less: Previous Guarantee Accommodations	-	13.6	4.8	164.2
Net Guarantees Outstanding, for the year	29.7	58.3	46.0	184.5
Less: Cancelled Guarantees	-	15.4	13.6	121.2
Guarantees Outstanding, Before Defaults	29.7	42.9	32.4	63.3
Less: Guarantees in Default	-	10.0	-	30.9
Guarantees Outstanding, Ending	29.7	32.9	32.4	32.4
Number of Outstanding Accounts	24	35.0	13.0	

Source: Philguarantee

Table 11
LOAN PORTFOLIO GUARANTEE PRIVATE SECTOR REVOLVING FUND OF USAID
THE PHILIPPINES AS OF SEPTEMBER 30, 1989

	Funding (M)	Terms			Disbursement		
Name of Bank	Loan	Rate	Grace Period	Term	$	%	Project Description
1985 Obligated Projects							
Far East Bank & Trust 1	2.0	3 year T-note plus .1%	15 yrs.	5 yrs	20 M	100	Guarantee generates at least $4 million in credit to small and medium-sized pre-export firms.
1986 Obligated Projects							
Bank of the Philippine Islands	2.4	90 Day T-Bill plus .6%	2 yrs.	55 yrs.	0	0	Guarantee generates $4.8 million to finance small and medium-sized rural agri-business.
Metro Bank	2.1	90 Day T-Bill plus 5%.	2 yrs.	55 yrs.	500,000	24	Guarantee generates $4.2 million to finance rural lending.
Philippine Commercial International Bank	2.4	90 Day T-Bill plus .375%	2 yrs.	55 yrs.	24 M	100	Guarantee generates $4.8 million to finance rural lending to small and medium enterprises.
1988 Obligated Projects							
Far East Bank and Trust II	2.186	3 Month T-Bill plus .6%	24 mos. from first disburse-ment	6 yrs.	0		Guarantee generates $4.372 million in loans to business importing U.S. capital goods

Source: AID, Private Sector Revolving Fund. Annual Report Fiscal Year 1988.

controls, overvalued exchange rate, and low interest rates were the main policy instruments used to support that strategy. The overall policy environment induced the creation of large, capital-intensive industries that absorbed much of the limited financial resources of the country. Since most of the basic infrastructures were concentrated in Manila and the neighboring cities and provinces, the import-substituting industries located themselves in these areas. While in the 1960s, neighboring countries like Korea and Taiwan switched to an outward-looking development strategy, the Philippines continued with its inward-looking development strategy up to the first half of the 1980s.[5]

The MCSMEs were heavily penalized by the development strategy pursued by the Philippines in the past. Interestingly, despite macroeconomic policy biases against MCSME, they still have continued to flourish and have remained a major sub-sector in the economy. Out of an estimated number of 5,294 organized manufacturing establishments in the country as of 1986, 89 percent were considered small and medium establishments.[6] They can be found practically in all industrial sectors although they tend to concentrate in the food, wearing apparel, leather and leather products, printing and publishing, and machinery industrial sub-sectors. Their contribution to employment is by no means small. Out of the 636,219 employed in the manufacturing sector in 1986, 29 percent were in the small and medium enterprises. They contributed 17 percent to the total census value added of the manufacturing sector which was estimated at P97 billion in 1986. Small and medium enterprises are well dispersed geographically compared to large scale industries which are heavily concentrated in Metro Manila. Of the total number of small and medium enterprises, 44 percent are located outside Metro Manila. Most of them have to deal with poor infrastructure.

How did MCSMEs finance their business? Available pieces of evidence suggest that the initial capital mainly came from their own savings, inheritance, and informal sources (Table 12). But as they became more established, ploughed back profits became the main source. Still, own savings remained a significant source of funds in the subsequent years. Interestingly, the proportion of those who had access to the formal sources of credit increased over the years as MCSMEs successfully built their good track record. There is evidence that small firms have been operating profitably which made them decide to re-invest their profits. Thus, they grew faster (Lamberte 1990). This evidence is portrayed in Table 13. In particular, nominal assets of a typical small firm had been growing at 44 percent per year. In 1986, the firms included in the sample realized an average net monthly income of P14,388, implying an average rate of return on assets of 54 percent. This compares with the 56 percent average rate of return on assets realized by the top 50 corporations in the country for the same year.

Although small firms grew faster mainly through self-financing, access to bank credit at the start of business counts a lot in determining their asset growth and labor-absorptive capacity. Table 14 compares the performance of small firms with and without access to bank credit. As shown, the assets of those which have access and those which do not have

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[5] Refer to Chapter III for a related discussion on this.

[6] The figures here are taken from UP-ISSI, *Small and Medium-Scale Enterprises in the Philippines: An Overview*, 2nd Revised Edition (Diliman, Q.C.: UPISSI, 1989).

Table 12
SOURCES OF FINANCING

Sources of Investment/Years	Subsequent		Initial	
	No.	% to total (230)	No.	% to total (230)
Own Investment				
Own savings	185	71.2	206	88.6
Inheritance	29	12.6	38	16.5
Profit re-investment	203	98.2	3	1.3
Others	5	2.1	-	-
Borrowings				
Formal Sources	90	38.1	22	8.5
Informal Sources	52	22.6	28	12.6

* Multiple response

Source: Salazar, Melito S. et al., "Financial Factors and Small and Medium Enterprises," in Kenneth James and Narongchai Akrasanee (eds.), Small and Medium Business Improvement in the ASEAN Region: Financial Factors (Singapore: ISEAS, 1986).

Table 13
PERFORMANCE OF FIRMS

Item	Means	Standard Deviation
1. No. of years in operation	11.6	9.4
2. Total assets		
Start (pesos)	60,573	243,623
Present (pesos)	321,748	1,108,060
3. Average monthly sales in 1986 (pesos)	79,125	557,908
4. Average monthly net income in 1986 (pesos)	14,388	93,071

Sources: Lamberte, Mario B., "Impact of Special Guarantee Programmes for SMEs on Employment and Productivity." Paper presented during the Conference on"Strategic Approaches Toward Employment Promotion," 21-23 March 1990. Manila, Philippines.

Table 14
PERFORMANCE AND LABOR PRODUCTIVITY INDICATOR OF FIRMS WITH AND WITHOUT ACCESS TO BANK CREDIT AT THE START OF BUSINESS

Item	With Access	No Access
1. No. of years in operation	11.70	10.77
2. Assets		
a. Start*	131,164	49,786
b. Present*	810,032	246,096
3. Total number of workers		
a. Start*	10.33	8.49
b. Present*	22.00	10.55
4. Monthly gross revenue/sales, 1986 (in pesos)	88,824	78,168
5. Monthly net income 1988 (in pesos)	14,090	14,494
6. Assets per worker (in pesos)		
a. Start*	17,684	9,220
b. Present*	44,240	21,981
7. Monthly gross revenue per worker, 1986 (in pesos)	6,058	4,981
8. Monthly net income per worker, 1986 (in pesos)	1,068	1,008

*Significant at one percent level.

Sources: Lamberte, Mario B., "Impact of Special Guarantee Programmes for SMEs on Employment and Productivity." Paper presented during the Conference on "Strategic Approaches Toward Employment Promotion," 21-23 March 1990. Manila, Philippines.

access to bank credit were growing fast rapidly over the years, but their difference has widened in favor of the former. The same can be said of their labor absorptive capacity.

While it is shown above that access to bank credit is crucial for the growth of small firms, many have argued that loans to MCSMEs should be below market rate so that their profitability would not be undermined. The general view being held is that MCSMEs cannot afford to pay the prevailing market interest rate which is excessively high. Available evidence, however, suggests that interest cost is only a minor component of the total cost of production of SMEs which are proned to borrowing from informal sources (Table 15). Lamberte and Jose (1988) found similar results in the case of small footwear manufacturers which already had been paying between 60 percent to 115 percent per annum for their loans from informal sources. This only shows that high interest rate is not a major deterrent for small firms to borrow. For them, access is more important than the price of credit.

III. MONETARY POLICY, FINANCE AND CREDIT PROGRAMS FOR SMEs IN JAPAN, KOREA AND TAIWAN

This chapter reviews monetary policy, finance and credit programs for small and medium enterprises (SMEs) in Japan, Korea and Taiwan and tries to draw important lessons from their experience. It should be pointed out at the outset that SME development programs, whether explicit or implicit, in these countries are part and parcel of their overall industrial development strategy. Monetary policy and credit programs are just supporting instruments in that overall strategy. Ideally, the effects of monetary policy on the local economy are neutral to all sizes of firms. However, if other macroeconomic policies such as trade, industrial and fiscal policies, tend to have differential impact across sizes of firms, then monetary policy will likely reinforce such bias. The worst case is when monetary policy is also made to conform to such bias at the outset. Thus, certain groups of firms will be left out in the development process. Countervailing measures then become a necessity. This issue will be raised again as the experience of the abovementioned countries in developing and supporting their SMEs is reviewed.

This chapter is divided into two sections. The first reviews the monetary policy, finance and credit programs for SMEs of Japan, Korea, and Taiwan; and the second discusses some lessons from the experience of these countries for SME development in the Philippines.

A. Monetary Policy. Finance and Credit Programs for SMEs in Japan. Korea and Taiwan

1. The Case of Japan

The Small and Medium Enterprise Basic Law of Japan defines SMEs in terms of both number of employees and capital which varies by type of industry. For manufacturing/mining industries, SMEs are those with 300 employees and below and a capital of Y100 million and below; for wholesale enterprises, 100 employees and below and a capital of Y30 million and below; and for retail/service, 50 employees and below

Table 15
COST COMPOSITION, 1986

Cost Items	Percent
Labor	22.6
Interest	3.8
Materials	51.9
Rent	2.8
Transportation	7.5
Others	11.5
Total	100.00

Source: Lamberte, Mario B., "Impact of Special Guarantee Programmes for SMEs on Employment and Productivity," Paper presented during the Conference on "Strategic Approaches Toward Employment Promotion," 21-23 March 1990. Manila, Philippines.

and a capital of Y10 million and below.[7] Although Japan has achieved one of the highest levels of economic development in the world today, the contribution of SMEs to her economy is by no means small. As of 1986, SMEs contributed 57 percent to the total value added of all manufacturing industries and 81 percent to the total number of employed persons. Japan has a well-developed subcontracting system that helps maintain the relatively large contribution of SMEs to her economy. As of 1981, 65 percent of the total number of SMEs acted as subcontractors (Yokokura 1988).

The Japanese government has practically steered the growth and development of SMEs through specific policies and programs. Changes in policies and programs have been prompted by changes in the general economic environment. The post-war period may be divided into three distinct sub-periods which were characterized by specific set of policies and programs for SMEs. Enactment of laws and establishment of specialized institutions catering for the SMEs were the major instruments.

In the first sub-period, which covers the period between the end of the Second World War and the mid-1950s, policies for SMEs were generally passive in the sense that they were confined to responding to the needs of SMEs for their survival. Access to credit was considered the crucial factor for their survival. Thus, during this period, the Japanese government organized several specialized financial institutions which provided cheap credit to SMEs (Table 16). A credit guarantee program was also established to guarantee the borrowings of SMEs from private lending institutions. However, loans were not given indiscriminately. Rather, they were granted to SME borrowers who were deemed to have greater probability of repaying the said loans (Yokokura 1988). Apart from facilitating SMEs' access to credit, the Japanese government also sought to protect SMEs from the onslaught of competition waged by large firms while at the same time, stimulated competition among SMEs by regulating the activities of SME associations. Subcontractors were well protected by law against unfair transactions that might be imposed by parent firms which have undue advantages over them.

In the second sub-period, which includes the years starting from the mid-1950s through the 1970s, the Japanese government attempted to modernize the operations of SMEs and at the same time, encouraged them to increase their size. All this was aimed at increasing SMEs' capital-labor ratio to increase their productivity and at the same time, to allow them to cope with the rapidly rising cost of labor. Enactment of laws, establishment of credit facilities/institutions, tax measures, and technical assistance programs were the major instruments utilized to carry out the objectives of the SME promotion policy.

There were at least two developments that should be noted. One, was that the lending facilities had been decentralized by allowing the prefectural governments to serve as credit conduits for SMEs. The other was the establishment of the Japan Small Business Corp. which provides both financial and technical assistance to SMEs. Its specific tasks are as follows:

1) Guidance and financing for the structural upgrading projects of SMEs;
2) Personnel training for SMEs;

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[7]The peso/yen rate as of 10 April 1990 was 0.142.

Table 16
SME POLICIES IN JAPAN

Period/Laws/Institutions	Specific Purpose
1. End of WW II - mid-1950s	Passive and protected policies were developed to save SMEs
a. People's Finance Corp. (1949)	Government financial institution that specialized in SME financing
b. Small Business Finance Corp. (1953)	Government financial institution that provided long-term funds to SMEs
c. Shoko Chukin Bank (1936)	The Central Bank of Commercial and Industrial Cooperatives which was used as a conduit of government funds
d. Credit Guarantee Corporation Law (1953)	Guarantees borrowings by SMEs form private financial institutions
e. Credit Insurance Program (1950)	Guarantees the liabilities of the credit guarantee associations
f. Small and Medium Enterprises Cooperative Association Law (1949)	Developed further cooperative activities in associations
g. Small and Medium Enterprises Stabilization Law (1952)	Regulated activities of SME associations
h. Department Store Law (1956)	Restricted the activities of department stores and cooperatives in retailing
i. Law on Special Measures for the Adjustment of Retail Business (1959)	- same as above -
j. Law on the Prevention of Delay in the Payment of Subcontracting Charges and Related Matters (1956)	Regulated transactions where a parent firm can utilize its dominant position in transaction to unfairly impose unprofitable conditions on subcontractors

Table 16 (cont'd)

Period/Laws/Institutions	Specific Objectives
2. Mid-1950s through 1960s	Active modernization policies were introduced for modernizing facilities and increasing the scale of SMEs
a. Facilities Modernization Capital Lending Program (1954)	Provided financing facilities to SMEs seeking to modernize their operations
b. Law on Financing and and Other Measures for Aiding Small and Medium Enterprises (1956)	Permitted the central government to provide grants to the prefectural governments for loans to SMEs
c. Small and Medium Enterprise Modernization Promotion Law (1963)	Provided financing and tax measures in a more systematic and organized fashion than in the past for the modernization of facilities and the consolidation of firms
d. Small and Medium Basic Law (1963)	Provided the basis for the next two laws
e. Small and Medium Enterprise Guidance Law (1963)	Expanded the Enterprise Consulting Program
f. Small Business Investment Company Incorporation Law (1963)	Provided financing for increasing capitalization of SMEs
g. Public Procurement Law (1966)	Permits SMEs to obtain orders from the government and other public agencies
h. Japan Small Business Promotion Corp. (1967)	Provided one body for the counseling and financing of SMEs

Table 16 (cont'd)

Period/Laws/Institutions	Specific Objectives
3. From the 1970s onwards	Policies emphasize the building up of "soft" management resources for advancing "knowledge-intensity" in SMEs and assisting firms to change their line of business
a. Revisions of the Small and Medium Enterprise Modernization Promotion Law (1973, 1975)	Emphasizes the development of soft management resources such as the development of new products and technologies and of human resources. Also introduced programs for structural adjustment through firms switching their line of business
b. Law on Temporary Measures for Line-of-Business Conversion by SMEs (1976)	Provides financing and tax breaks for firms to change their line of business
c. Law on Temporary Measures for SMEs in Specific Depressed Regions (1978)	- same as above -
d. Law on Temporary Measures for Regional Small and Medium Enterprises	- same as above -
e. Large Retailer Law (1973)	Restricts entry by large firms into the domain of SMEs
f. Industry Opportunity Law (1977)	- same as above -

Source: This is culled from the paper of Takashi Yokokura, "Small and Medium Enterprises," in Ryutaro Komiya, *Industrial Policy of Japan* (Tokyo: Academic Press, Inc.,1988).

3) Collection and provision of information for SMEs;
4) Management of the Mutual Relief System for SMEs; and
5) Management of the Mutual Relief System for Preventing Chain-Reaction Bankruptcies for SMEs.

The last two programs of the Corporation are something unique. They are designed to soften the impact of any untoward incident that might befall on the SMEs. The details of these programs are shown in Annexes B.1 and B.2. The Corporation has six institutes conducting managerial and training programs for SMEs. It has also an active research institute which does experimental research on new technologies useful for SMEs. Table 17 shows the general financial condition of the Corporation and its accomplishments as of March 1988.

The government also worked on the demand side to ensure SMEs markets for their products. Specifically, it enacted a law encouraging government agencies to purchase products/supplies produced by SMEs.

In the third sub-period, i.e., from 1970s to the present, the Japanese economy was subjected to a number of external shocks. Restructuring was needed to allow the economy to cope with the new environment. This required the finetuning of SME promotion policies. More specifically, emphasis was given on the building of "soft" management resources for advancing "knowledge-intensity" in SMEs and on assisting firms to change their line of business. The ultimate goal is to push SMEs to enter the age of high technology producing new products in a more efficient manner. The restructuring of SMEs has been accomplished by revising laws promoting SMEs, and by providing better financing facilities and tax breaks to SMEs willing to undergo the restructuring.

The financial implications of the various SME promotion programs of the Japanese government from 1960 to 1980 are shown in Table 18. Government budgetary support to SMEs through the years were not inconsequential. Special financial support to SMEs provided by the various financing institutions had been large. However, the share of government financing in total SME financing had been small, not exceeding 13 percent. This suggests that SMEs in Japan are not very much dependent on government support when it comes to financing.

In general, SMEs in Japan have access to external finance. However, financial policies had put them in a disadvantageous position compared to large firms. Teranishi (1982) pointed out that in postwar Japan, the allocation of long-term outside funds had been more or less under strict government regulation, and preferentially given to large enterprises. In particular, the interest rate on long-term loans was subjected to a ceiling, whereas that on short-term loans was not. Trust funds were confined to lending to large firms because of the provision in the Long-Term Bank Act that required them to lend only to safe borrowers. Moreover, only large firms can be listed in the stock exchange and are allowed to issue corporate bonds. Table 19 shows that there is a significant difference in the share of long-term sources of outside funds between small and large firms, with the former depending more on short-term funds. The figures in Table 20 suggest that small firms substituted short-term funds for long-term funds, and that the degree of dependence on short-term funds increases as firm size decreases. Table 21 further shows the extent of the bias of banks towards large firms. All these suggest that while small firms have access

Table 17
GENERAL FINANCIAL CONDITION OF THE JAPAN SMALL BUSINESS CORPORATION
(As of the end of March 1988)

1.	Funds ¥987.8 billion (Wholly financed by the Government)	
2.	Balance of loans for the structural upgrading projects of small and medium enterprises	¥943.7 billion
	a. System A	¥679.3 billion
	b. System B	¥247.1 billion
	c. Land Acquisitions	¥ 17.3 billion
3.	Number of persons trained at the Institute of the Japan Small Business Corporation	91,000 (approx)
	a. Managerial training	60,000 (approx)
	b. Technical training	31,000 (approx)
4.	Number of subscribers in the Small-Scale Enterprise Mutual Relief System	1,617,000 (approx)
5.	Number of subscribers in the Small and Medium Enterprise Mutual Relief System for Preventing Chain-Reaction Bankruptcies	257,000 (approx)

Notes: System A - Financing with prefectural government as a channel
System B - Financing with the corporation as a channel.

Source: *Japan Small Business Corporation.*

Table 18
SMALL BUSINESS POLICY BUDGET AND OTHER STATISTICS

Fiscal Year	1960	1970	1980
General Budget (¥ million)			
1. Promotion of SME modernization	1,475	3,710	8,147
2. Institutions for SME modernization	-	26,278	92,034
3. SME consulting activities	711	6,043	40,387
	(403)	(4,081)	(31,247)
4. Financing measures	-	11,750	90,300
		(-)	(18,400)
Total (including miscellaneous items)	2,581	50,318	243,475
FILP investments (¥ 100 million)			
5. Small Business Finance Corporation	315	2,263	15,265
6. People's Finance Corporation	290	2,364	15,066
7. Shoko Chukin Bank	30	122	723
8. Japan Small Business Corporation	-	204	164
Total (including miscellaneous items)	744	5,523	34,004
Share of government financing in total SME financing (%)			
9. Fixed capital	29.0	17.9	20.1
10. Working capital	5.2	6.6	10.3
Total financing (9 + 10)	8.7	9.3	12.6

Note: (1) is for assistance for facilities modernization, promotion of subcontractors, and modernization of SMEs in commerce and services; (2) is for investments in and subsidies for the Japan Small Business Corporation; (3) is for assistance for small enterprise counseling, for consulting and internship programs, for technical consulting and subsidies for promoting R & D, and for organizational policies; (4) is for investments, subsidies and loans to the three government small business financial institutions, loans to the Credit Insurance Corporation, and loan guarantees; For (3), the figures in parentheses indicate amounts for small enterprise programs and for (4), amounts for the program for financing small enterprise management reform; financial shares are as of year end for the outstanding balance of all the loans to SMEs by all financial institutions.

Source: Takashi Yokokura, "Small and Medium Enterprises," in Ryutaro Komiya *et al.* (eds.). *Industrial Policy of Japan* (Academic Press, Inc., Tokyo: 1988).

Table 19
PERCENTAGE COMPOSITION OF CORPORATE FINANCING AND INVESTMENTS
(1963 - 1967)

	Japan			U.S.A.
	Large Business (1)	Small Business (2)	Total (3)	(4)
(A) Sources of Funds	100.0	100.0	99.8	100.0
Short-term funds				
(1) Short-term borrowings from financial intermediaries	24.0	19.6	24.4	4.8
(2) Net trade credit	-	30.4	3.6	-
Long-term funds				
(3) Long-term borrowings from financial intermediaries	22.6	11.3	19.6)	29.6
(4) Issue of corporate bonds	5.5	0.0	3.6)	
(5) Issue of stocks	11.5	5.7	10.0	10.0
(6) Retained earnings	7.8	8.7	8.9	40.9
Others	28.8	24.3	29.7	13.4
(B) Uses of Funds	100.0	100.0	100.0	100.0
(7) Fixed assets/ investments	51.8	34.7	49.4	57.5
(8) Liquid assets investments other than trade credit	31.4	65.3	50.6	32.9
(9) Net trade credit	16.8	-	-	-

Table 19 (p.2)

	Japan			U.S.A.
	Large Business (1)	Small Business (2)	Total (3)	(4)
(C) Ratio of long-term outside funds to fixed assets investments (3) + (4) + (5)/(8)	76.4	49.0	67.2	71.1
(D) Ratio of long-term funds to fixed assets investments (3)+(4)+(5)+(6)/(8)	91.5	74.1	65.2	142.3

Notes:
(1) Average of 1963 - 67.
(2) For Japan, corporate firms of all industries. Small (large) businesses are with less (more) than 100 millions yen paid-in capital. For USA, manufacturing corporations.
(3) There is a minor change in the number of firms covered during the perios, so that figures are approximate ones.

Source: Juro Teranishi, "A Model of the Relationship Between Regulated and Unregulated Financial Markets: Credit Rationing in Japanese Context," Hitotsubashi Journal of Economics Vol. 22, No. 2 (February 1982).

Table 20
DESIRED AND REALIZED COMPOSITION OF CORPORATE FINANCING
FROM OUTSIDE BY SIZE OF BUSINESS (1968)
(In Percent)

Scale of Business by paid-in capital	One billion yen and up		100 million yen one billion yen		50 million yen 100 million yen		10 million yen 50 million yen		10 million yen and down	
	realized	desired	realized	desired	realized	desired	realized	desired	realized	desired
Short-term Funds										
(1) Short-term borrowings	7.3	7.8	23.1	16.9	25.1	16.5	27.7	14.8	33.7	20.2
(2) Trade credit	2.8	1.8	3.6	1.8	3.9	3.5	8.4	3.6	12.9	3.9
Long-term Funds										
(3) Long-term borrowings	73.7	73.0	61.0	67.8	55.0	64.1	47.7	64.8	35.4	53.9
(4) Issue of bonds	3.8	5.3	0.0	0.0	0.0	0.9	0.0	0.0	0.3	0.0
(5) Issue of stocks	7.2	9.3	3.1	8.3	2.2	9.1	4.2	10.6	2.2	10.7
No answer	5.3	3.0	9.1	5.2	13.9	6.1	11.9	5.8	15.7	11.2
(7) Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note: (1) Result of interviews with 1,932 with businesses by the Ministry of Finance.
(2) Each percentage is the share of number of businesses for which the most important source financing (realized and actual) corresponds to each item.

Source: Juro Teranishi, "A Model of the Relationship Between Regulated and Unregulated Financial Markets: Credit Rationing in Japanese Context," *Hitotsubashi Journal of Economics* Vol. 22, No. 2 (February 1982).

Table 21
COMPOSITION OF LOANS TO LARGE AND SMALL BUSINESSES
AND SHARE OF VARIOUS FINANCIAL INTERMEDIARIES (1965)
(In Percent)

		Composition of loan			Share of loans in all financial intermediaries loans
		to large business	to small business	Total	
(1)	City banks	76.3	23.7	100.0	35.8
(2)	Local banks	46.7	53.3	100.0	18.0
(3)	Private long-term credit banks	89.3	10.7	100.0	7.4
(4)	Trust banks				
	bank account	87.1	12.9	100.0	1.9
	trade account	94.1	5.9	100.0	7.2
(5)	Mutual financing banks	0.0	100.0	100.0	8.3
(6)	Credit associations	0.0	100.0	100.0	7.9
(7)	Others	63.2	36.8	100.0	13.9
(8)	Total	-	-	-	99.9

Notes: (1) Small (large) businesses are those with less (more) than 50 millions paid-in capital.
(2) Others are composed of governmental financial intermediaries, insurance companies, and credit cooperatives.

Source: Juro Teranishi, "A Model of the Relationship Between Regulated and Unregulated Financial Markets: Credit Rationing in Japanese Context," Hitotsubashi Journal of Economics Vol. 22, No. 2 (February 1982).

to external finance, they pay a higher price for these funds compared to large firms. The price differential has been brought about mainly by the existing financial policy. The various special lending programs for SMEs can then be viewed as a way to neutralize such policy bias. But as shown above, only a small proportion of total SME financing was accommodated by the various government special lending programs. This seems to suggest that the financial instrument has very little impact on the promotion of SMEs in Japan. Other policy instruments such as technical assistance, tax relief, competition-restricting measures, enhancing market opportunities, etc., could have more substantial impact on their profitability so much so that they can well afford the high interest rate on short-term funds. This also implies that the Japanese financial markets are well-functioning to accommodate credit demands from various industries. Thus, there is still no better substitute for having well-developed financial markets when it comes to providing funds for SMEs. Of course, the historically conservative monetary policy pursued by Japan which produced very low inflation rate has tremendously helped her financial system in mobilizing deposits.

Japan is now in the process of developing a venture capital industry to provide more equity investment in emerging, technology-based SMEs. The government led the promotion of venture capital corporations as early as 1963. But the industry suffered a setback during the first oil shock in the early 1970s. It started to recover only in 1982. Accordingly, Japan is currently in the midst of her second venture capital boom (Kotzmetsky *et al.* 1985). Most venture capital enterprises in Japan are subsidiaries of private banks and securities firms. Capital gains to private investors are not taxed in Japan. Thus, private investors have adequate incentive to invest in venture capital enterprises. Financing is not a critical barrier to the development of the Japanese venture capital industry. Rather, the lack of skills to implement U.S. venture capital techniques, cultural barrier to entrepreneurship and scientific research, and the lack of an exit vehicle in the form of either a new issue market or a mergers and acquisitions market have seriously impaired the development of its venture capital industry. MITI is now trying to support the growth of the industry by providing subsidies to research and development up to 50 percent of the company's R&D expenditures and by developing an over-the-counter market as an exit vehicle.

2. The Case of Korea

Korea basically followed the economic philosophy of Japan, that is, heavy government intervention to steer her economy. Right after the Korean war, Korea pursued an import-substitution development strategy. In the 1960s, Korea adopted an outward-looking development strategy. The growth of large scale, export-oriented industries was expedited through government policies (Woo 1985). Like Japan, the policy for SME development pursued by Korea in this period was prompted by the need to neutralize the industrial policy bias against SMEs. Thus, financial institutions like the Small and Medium Industry Bank and the Citizens National Bank were established. Their impact in terms of stimulating growth of SMEs was, however marginal. Thus, SMEs remained a shadow of the rapidly developing large industries. While continuing its export-orientation, focusing on labor-intensive goods, a second import-substitution phase that concentrated on heavy industries was launched in the 1970s. Trade and financial policies were the major instruments used to achieve the objectives of this policy. SMEs were then further starved of the much needed funds. Unlike Japan, her financial markets were less developed. So, SMEs turned to the curb market. It would appear that sufficient funds were made available from the curb market; the progressive narrowing down over the years of the curb market

interest rates and the lending rates of banks would support this view (Ho 1980). Thus, SMEs in Korea survived the policy bias. Then, towards the late 1970s and early 1980s, the Korean government sought to increase the contribution of SMEs to her economy by developing technology-oriented small and medium scale industries. The 10-year Long-Term Promotion Plan which was launched in 1982 intends to increase the value added contribution of SMEs from 35.4 percent in 1982 to 44.8 percent in 1991; and the employment share from 47.7 percent to 54.3 percent. The trade reforms and financial liberalization (particularly interest rate deregulation, reprivatization of national banks, and freer bank entry) initiated by Korea in the early 1980s will further force SMEs to be competitive both in the goods and financial markets.

Unlike in Japan, SMEs in Korea are determined on the basis of the number of employees which varies by industry. In manufacturing, mining, transportation services and other related industries, medium enterprises are those with less than 300 full-time employees, while small enterprises, less than 20 full-time employees; in construction, medium scale enterprises are those with 200 full-time employees or less, while small enterprises, 20 full-time employees or less; and in commerce and services, those with 20 employees or less are considered medium, while those with 5 employees or less are small.

Korea practically followed the approach used by Japan in promoting SMEs. She developed a legal framework for implementing SME development policies. The laws enacted ranged from the creation of specialized financial and non-financial institutions that provide financial and technical assistance to SMEs to regulating transactions between parent and subcontractors to protect the latter from any unfair practices perpetuated by the former (Table 22). She established the Small-and Medium-Industry Promotion Corporation (SMIPC) which is equivalent to the Japan Small Business Corporation. It carries the following programs:

1) The modernization program;
2) The equipment leasing program;
3) The business start-up program;
4) The rural industry development program;
5) Cooperative program;
6) Extension services;
7) Training services;
8) Information services; and
9) International Cooperation program.

The first four programs include the provision of financial assistance to SMEs.

Other financial assistance to SMEs are being offered by several specialized financial institutions and special lending programs. Most prominent among the financial institutions are the Small and Medium Industry Bank and the Citizens National Bank. The features of the lending programs of these two banks are given in Annexes C.1 and C.2. Interestingly, nationwide commercial banks are required to allocate at least 35 percent of their total loanable funds to small enterprises while local banks must lend at least 55 percent of their total loanable funds to SMEs. It is not surprising then that as of 1982, total bank loans (including those of the Small and Medium Industry Bank, Citizens National Bank, commercial banks, and local banks) to SMEs already reached 45 percent of the total loans

Table 22
LEGAL FRAMEWORK FOR PROMOTING SMEs IN KOREA

1. The Small and Medium Industry Basic Law provides for the definition of small business and supports establishment of small businesses. This law also encourages business conversion and pioneers new line of products.

2. The Small and Medium Industry Promotion Law stipulates the establishment of SMPC in order to support modernization and cooperative programmes for the SMI sector.

3. The Small and Medium Industry Cooperatives Association Law prescribes for the establishment of sub-co-operatives and regulates co-operatives operations.

4. The Small and Medium Industry Systematization Promotion Law provides incentives for the development of parts and components industries and encourages subcontracting and sound and fair business practices between large firms and components suppliers.

5. The Small and Medium Industry Business Coordination Law stipulates norms for co-ordination and strengthens small business co-operativesautonomous power to make business co-ordination.

6. The Law on Payments for the Products supplied from Small and Medium Industries regulates unfair practices in subcontracting and stipulates the period of payments and due interests on delayed payment by large firms for supplies from SMIs.

Source: UNIDO, *Small Industry Bulletin for Asia and the Pacific*, UN No. 23, 1988.

for SMEs (Woo 1985). More than half of it were contributed by commercial and local banks. It is not however clear whether all the reported loans really went to the SMEs. Loan diversion was apparently rampant in Korea as in other countries that have similar loan portfolio allocation policy.

There are a number of special credit programs for SMEs in Korea. At least five of them whose features are summarized in Annexes C.3 to C.7 have been identified. It is worthwhile to note that they put emphasis on the provision of long-term funds to SMEs at below market rate using financial institutions as conduits. The performance of these programs is not, however, known. Apart from these lending programs, a guarantee program also provides support to SMEs. It does not distinguish its beneficiaries between export-oriented and domestic-oriented industries. The features of this program are given in Annex C.8.

Korea is now in the process of developing her venture capital industry to provide equity financing to emerging SMEs. But unlike Japan, the major venture capital corporations in Korea were created by the government through special laws. There are four major venture capital corporations in Korea that provide financing to SMEs in the form of venture capital to encourage and nurture R&D-oriented companies. The first is the Korea Technology Advancement Corp. (K-TAC) which is affiliated to and fully funded by the Korea Advanced Institute of Science and Technology (KAIST). It is engaged in commercializing the new technologies developed by KAIST. The second is the Korea Technology Development Corp. (KTDC). It is funded and managed by the private sector with substantial financial support from the Korean government and the World Bank. The third is the Korea Development Investment Corp. (KDIC). Its funds came from seven private financing companies and the IFC. The fourth is the Korea Technology Finance Corp. (KTFC) which was established by the Korea Development Bank (KDB). Unlike in Japan, financing seems to be a critical barrier to the development of the venture capital industry in Korea. This explains the heavy participation of the government and multilateral agencies in the four major venture capital corporations. Table 23 gives a summary of the funding methods of the four venture capital corporations. One key factor that helps sustain the viability of venture capital corporations is greater selectivity of the projects to be funded. For instance, KDIC's acceptance rate is only 12 percent of the total number of applications.

A venture capital corporation is not expected to earn a profit in its initial years of operation because of the long gestation period required of its investments. This seems to be the case of the four Korean major venture capital corporations. They incurred losses in their first few years of operation but later on realized some profits (Table 24).

Support for the development of privately-owned venture capital corporations has recently been intensified with the passage of the Small and Medium-Sized Venture Business Creation Act in 1986. Financial and fiscal incentives are given to venture capital corporations organized under this Act. The response from the private sector has been overwhelming considering the fact that in two years time, 15 corporations have been established under this Act.

Table 23
VENTURE CAPITAL FUNDING METHODS

			financing limit	repayment method, interest rate	objects of funding
KTDC	loans	conventional loans	domestic financing of 500 mil. won (less than 70% of the necessary financing)	repayment of equally divided installments within 10 years (including a grace period of 3 years) 4 times a year in domestic currency, 2 times a year in foreign currency, an annual interest rate of 10 - 11%	companies which develop new technologies, manufacturing of new products, foundation of plants and facilities, technology transfer improvement of productivity and quality
		conventional loans	foreign currency financing of 1.5 mil. $ (about 1 bil. 350 mil.) (100% of the necessary financing)	Pay loyalty at a fixed rate if the venture succeeds. Repay the minimum amount if the venture fails	
	equity investment			allotment of profits, if any	
KTFC	loans	conventional loans	500 mil. won (loans; less than 80% of the necessary financing, investment; less than 50% of the total stocks)	repayment of equally divided quarterly installments within 10 years (including a grace period of one third of the lending period), an annual interest rate of 13-14%	risky high-tech industries with insufficient collateral such as semi-conductors, computers, precise chemistry and ceramics
		conventional loans		Pay royalty if succeeded, Repay the minimum amount if failed	
	equity investment			allotment of profits, if any	
KDIC	equity investment		600 mil. won (less than 50% of the capital)	profit allotment, if any withdrawal of the capital within 5-6 years, the venture, if succeeds	R & D new technology transfer, commercialization of new technology, product diversification, management rationalization and facility expansion
K-TAC	equity investment		500 mil. won (less than 50% of the company's capital)	profit allotment, if any withdrawal of the capital within 5-6 years, if the ventures succeed	commercialization of government research institutes export promotion, foreign technology transfer and commercialization for import substitution

Source: Korea Technology Development Corporation. " A Study on the Effect of KTDC's Financing Activities." February 1986.

Table 24
PROFITS/LOSSES OF VENTURE CAPITAL CORPORATIONS, KOREA

Company	Date Established	Capital (Bil. Won)	Key Personnel	Profits/Losses				
				1981	1982	1983	1984	1985
K-TAC	Sept. 9, 1979	14.84	13	-	-	(67)	321	300
KTDC	April 28, 1981	268.00	47	(31)	(397)	(954)	34	1500
KDIC	Dec. 17, 1982	75.00	7	-	-	(135)	85	195
KTFC	Nov. 8, 1984	150.00	26	-	-	-	-	(23)

Source: Korea Advanced Institute of Science and Technology, A Study on the Effects of KTDC's Financing Activities, 1986.

3. The Case of Taiwan

Taiwan adopted development strategies in the 1950s and 1960s similar to those of Korea. It was import-substitution strategy in the 1950s, then export-oriented strategy in the 1960s. Unlike Korea, however, Taiwan did not go to the second phase of import-substitution in the 1970s. Instead, she continued her outward orientation. In the 1980s, Taiwan started to focus on technology-intensive industries just like Japan and Korea.

Among the three countries, Taiwan has the least interventionist policy towards the promotion of SMEs. There were attempts to organize special credit programs for SMEs, but these were less funded compared to those of Korea. In fact, it was only in 1976 that the government established the Small and Medium Industries Bank. Technical assistance programs for SMEs were likewise less organized compared to that of Korea. The development of SMEs were then left to the mercy of the prevailing macroeconomic policy framework. Despite this, SMEs flourished in Taiwan.

There is a big difference between the industrial structures of Korea and Taiwan. Korea is built on a few, large industries that are geographically concentrated in urban centers whereas Taiwan is built on a great number of small and medium firms that are geographically dispersed. That is, Korea's industrialization has been associated with expansion in the size of relatively small number of firms whereas that of Taiwan's has been associated with a proliferation in the number of small firms (Levy 1987). This is attributed to the role played by traders in the two countries. The growth in the manufacturing sector in Taiwan was accompanied by a parallel growth in the number of traders. This was not the case in Korea which eventually limits the opportunities provided by a few traders to small industries. This may be attributed to divergent incentives offered to individual firms in these two countries. As already mentioned earlier, Korea offered substantial incentives to large firms inducing Korean firms to enter the market at relatively large size. In contrast, Taiwanese firms receiving less incentives than Korean firms start small.

In general, monetary policy in Taiwan was biased against her SMEs. The interest rate control only aggravated SMEs' access to bank credit. But the informal credit markets in Taiwan that served the SMEs were quite large. In fact, the difference between the curb interest rates and the lending rates had narrowed significantly in Taiwan, suggesting that sufficient funds were available from the informal credit markets (van Warmelo 1967). Perhaps, the negative impact of macroeconomic bias against SMEs is less pronounced in Taiwan than in Korea. One of the reasons is that when Taiwan began to industrialize, rural infrastructure was already amply provided, clearly benefiting rural-based industries. This facilitated subcontracting, which is widespread in Taiwan, between parent firms located in urban centers and subcontractors located in rural areas. As pointed out by Levy and Kuo (1987), Taiwanese firms across a wide range of industries enter easily into subcontracting relations with one another. The recent financial liberalization in Taiwan is expected to boost further the growth and development of her technology-intensive SMEs.

B. Lessons from the Experience of Japan, Korea and Taiwan

From the above discussions on the various approaches to promoting SMEs in three Asian countries, Taiwan seems to have the least interventionist approach. Recently, however, she tried to assume a more active role with the purpose of encouraging SMEs to

switch into technology-intensive industries. In contrast, Japan has a long history of substantial government intervention in the promotion of SMEs. Korea seems to follow Japan's approaches but she is grappling with the fact that her industrial structure is built on large firms that had been induced by past industrialization policies. And unlike Japan and Taiwan, she does not yet have a well-developed subcontracting system.

As the monetary policies of the three countries that affect SME development as well as their finance and credit programs were being discussed, one cannot help but notice their familiarity. It is because the Philippines has almost all those policy and programs for SMEs. In fact, some special credit programs for SMEs in the Philippines, e.g.,the IGLF, preceded those of Korea. Nevertheless, there are still a lot of lessons that can be drawn from the experience of Japan, Korea and Taiwan in SME promotion. These are discussed below.

1. It is clear by now that macroeconomic policy affects the development of SMEs. This is reinforced by monetary policy. For instance, the ceilings on interest rate only served the interest of large firms especially in capital-scarce economy. Countervailing measures such as special credit programs that are intended to neutralize the adverse impact of monetary policy on SMEs have very limited impact. For instance, in Japan, government financing in total SME financing has remained small, implying that SMEs rely more on other sources of credit than on government-funded credit programs.

2. When it comes to increasing the flow of credit to SMEs, there is still no substitute to a stable monetary policy. In Japan, inflation rates have historically been very low due to their conservative monetary policy. This induces surplus units to save in financial forms. This could be one of the reasons why Japan has one of the highest saving rates in the world. With adequate mobilized funds, SMEs in Japan have less difficulty in accessing credit from private financial institutions.

3. Lack of credit does not seem to be an insurmountable obstacle to the development of SMEs as long as funds are available from institutional or non-institutional sources even if they are priced at market rates. In Japan, cheap long-term funds were preferentially allocated to large firms. But SMEs turned for their additional financial requirements to the short-term credit markets in which lending rates were not controlled. Short-term funds which were made readily available to borrowers by private financial institutions substituted for the long-term fund requirements of SMEs. In Korea and Japan, SMEs banked on the curb markets for external financing.

4. If the government were serious in promoting SMEs, then it should start with an appropriate legal framework that could be changed from time to time depending on the existing economic environment. This is the experience of Japan that is being emulated by Korea. The legal framework sets the tone for the creation of institutions and programs for SME development. It may include competition-enhancing measures such as regulating activities of associations; measures to protect SMEs against undue advantages of large firms especially in the sub-contracting system; market-expansion measures such as allowing SMEs to obtain purchase orders from government agencies; and tax incentives to encourage SMEs to improve their productivity. The Philippines has yet to devise a legal framework for SMEs so that they can operate in a more favorable environment.

5. SMEs are in need of a champion. Japan and Korea responded by creating an autonomous body which is not charged of recommending policies but rather takes care of providing basic services to SMEs. The Japan Small Business Corporation is more advanced than the Small and Medium-Industry Promotion Corporation of Korea in terms of the variety of services and degree of sophistication of the services provided to SMEs. But the difference merely reflects the degree of sophistication of their economies and their priorities. The provision of low-interest credit is only one of the services offered by these corporations. Technical assistance and training programs appear to be the more important services provided by these corporations.

The Philippines appears to be not too far behind Japan and Korea in terms of the number of special credit programs and institutions providing technical assistance and training programs for SMEs. However, these are small, highly fragmented, uncoordinated and overlapping with each other. There is no real lead agency that SMEs can look up to.

6. No matter how small the impact of special credit programs in relaxing SMEs' access to institutional credit is, they are considered part and parcel of the SME promotion programs of Japan and Korea. There are two important features of their lending programs. One is that these programs focus on the provision of long-term funds to SMEs. It should, however, be noted that this type of lending program will only be sustainable in the long-run if the economy is stable. Otherwise, the program will not be able to regenerate for itself long-term funds that might be lent to other SMEs. The other feature is that access to those funds is not automatic. In the case of Japan, the repayment capacity of borrowers is given emphasis. The same is true of Korea which showed high rejection rates for some programs. Only meritorious projects were being funded. All these show that lending programs should exercise greater selectivity especially since funds are fairly limited. These features are perhaps worth looking into in pushing for special credit programs for SMEs in the Philippines.

7. In view of the limited resources of the government for direct lending programs, a government-sponsored credit guarantee can help expand SMEs' access to institutional credit. Both Japan and Korea have a strong, financially sound credit guarantee program managed by an independent corporation. The program does not discriminate between export- and domestic-oriented industries. In the Philippines, the Philguarantee limits itself to direct exporters while GFSME is increasingly concerned with the agriculture sector. IGLF is not a real guarantee program.

8. A new method of providing long-term funds to emerging SMEs that wish to utilize newly-developed technology has been developed in Japan and Korea in the form of venture capital corporations. This is a way of ensuring that these countries are in the lead pack in this "high-tech age" through the support of firms wishing to push the frontiers of development. In Japan, the government led the promotion of the venture capital industry which is now dominated by the private sector consisting mostly of banks and securities firms. Tax breaks to private investors were adequate incentives for them to place their funds in venture capital corporations. In contrast, Korea opted to establish by law venture capital corporations with funding from the private sector, government and foreign donors. But more recently, Korea is trying to stimulate the development of the private venture capital industry.

In the Philippines, the type of venture capital corporation is similar to that of Japan in that they are adjunct to banks and run by the employees of the parent banks. Bank employees are used to short-term analysis which is different from the real venture capital concept of nurturing a business over a certain number of years. It is not therefore surprising that Philippine venture capital corporations went into traditional lines of business for quick profits. The 40 percent equity participation by government also makes it similar to those of Korea in terms of sources of funds. With the scarcity of funds of the government, what may be attempted by the Philippine government is to develop real privately-funded venture capital corporations by granting private investors tax breaks such as exemption from capital gains tax. Additionally, the Philippine government should seriously consider developing incubators to be based in private or state universities to "assist technically-oriented entrepreneurs in developing their business skills in an environment that simultaneously stimulates technical creativity" (Kotzmetsky *et al.* 1985; p. 54).

IV. ASSESSMENT OF PENDING BILLS IN CONGRESS

So far, Congress has passed one bill which was signed into law by the President (R.A. No. 6810 also known as "Kalakalan 20"), providing some fiscal incentives to micro enterprises and cottage industries in exchange for their staying above ground. It is still too early to measure the success of this legislation since guidelines were only issued this year. However, there are already some skepticisms raised by various quarters about the usefulness of the measures in the bill. In the first place, why should those that are operating in the underground economy register to avail themselves of fiscal incentives that will be withdrawn after five years of registration when they are not paying taxes anyway at the moment? Why should they register if they are going to be subjected to existing labor codes upon registration? Since micro enterprises and cottage industries are not dealing anyway with any government agency, then the reduced bureacratic red tape brought about by the law would not benefit them.

Since there is only one bill passed related to MCSME development, and none of its provisions relate to the financing of MCSME, this chapter will instead make a critical assessment of pending bills in Congress that have some bearing on MCSME. Only those bills that include some provisions related to monetary, banking and credit policies will be analyzed here.

Judging from the number of pending bills in Congress that directly or indirectly affect MCSME development, it can be said that there is a serious effort on the part of legislators to provide a legal framework for policies and programs for MCSME development. To date, at least 16 bills (9 from the House and 7 from the Senate) have been identified as under review by Congress. To facilitate analysis, the key features of the various bills are summarized in Table 25. They may include lending, credit guarantee, and technical assistance programs as well as fiscal incentives for MCSME; propose concessional rate for the loans; recommend the creation of a new agency to implement the provisions of the bill; suggest the appropriate implementing agency; and identify sources of funds. A blank in Table 25 means that the bill concerned is silent on that particular feature. In the discussion below, those that indirectly address the concerns of MCSMEs will be presented first. Then, from among those that directly address the concerns of MCSMEs, those bills

Table 25
CONGRESSIONAL BILLS RELATED TO MCSME DEVELOPMENT

Number	Title	Important Features						
		Lending Guarantee	Concessional Rate	Tax Incentives	Technical Assistance	New Agency	Implementors	Sources of Funds
HOUSE BILLS								
7868	Granting incentives to new, small-scale and necessary home industries by granting them tax exemptions and other assistance, and for other purposes			x			DTI	
16261	An act to assist and develop small and medium enterprises, owned and controlled by citizens of the Philippines, and for other purposes	x	x	x	x	x	DTI (lead)	Existing programs appropriations
17418	An act revising the Rural Banks Act	x						Gov't. subsidy
19510	An act establishing a special fund for the development of small scale industries to be known as the rural investment and development fund	x	x			x	DTI/NEDA	Excise taxes
21608	An act creating the micro, cottage, small and medium enterprises bureau in the Depatrtment of Trade and Industry and providing funds therefor						DTI	Appropriation
22848	An act promoting the development of home and small-scale cottage industries in the Philippines and appropriating funds therefor	x	x		x		DTI	Appropriation

Table 25 (cont'd)

Number	Title	Important Features							
		Lending	Guarantee	Concessional Rate	Tax Incentives	Technical Assistance	New Agency	Implementors	Sources of Funds
HOUSE BILLS									
23514	An act to assist, promote and develop small and medium enterprises owned and controlled by citizens of the Philippines and for other purposes	x	x		x	x	x	New agencies	Existing programs Appropriations
23992	An act creating the national livelihood development authority thereby institutionalizing the livelihood movement of the Philippines	x		x		x	x	New agency	Existing programs PAGCOR
25748	An act to promote, develop and assist small-scale enterprises through the creation of a small and medium enterprises policy (SMEP) council, the conversion of the Bureau of Small and Medium Business Development as the council secretariat thereof and other purposes					x	x	New agency	
SENATE BILLS									
202	An act to provide maximum rates of interest to loans up to the amount of ten thousand pesos			x					
474	An act creating a law on usury by providing for the rates of interest and other charges that may be collected for the loan or forbearance of money, goods, or credits and for other purposes			x					

Table 25 (cont'd)

Number	Title	Important Features							
		Lending	Guarantee	Concessional Rate	Tax Incentives	Technical Assistance	New Agency	Implementors	Sources of Funds
SENATE BILLS									
638	An act fixing the rate of interest upon loans of fifty thousand pesos or less, providing penalty for violation thereof and for other purposes			x					
786	An act to encourage the participation and strengthening the role of non-government organizations in national development, and for other purposes	x		x		x	x*	Implementing agencies	
1189	An act establishing a system of regional universal banking, and for other purposes	x			x		x*	Central Bank	Private sector
1258	An act to rationalize and promote small enterprises, establish a credit and guarantee corporation, provide funds therefor, and for other purposes	x	x	x	x	x	x	New agency	Appro-priations, IGLF
1368	An act establishing alternative credit and loan associations, appropriating funds therefor and for other purposes	x		x			x	DSWD	Appro-priations, member groups

* Private agency/institution

that are less comprehensive will be dealt with first, to be followed by the more comprehensive ones.

There are three bills (i.e., SB 202, 474, and 638) that in effect propose the return of the usury law by putting a cap on the nominal interest rate on institutional and non-institutional loans. Two of the three bills have very limited coverage in that they intend to protect only small borrowers by defining the maximum amount of loans to be covered in the proposed law, while the remaining bill has a comprehensive coverage in that it covers all loan transactions regardless of size and source of funds. If effective, these proposed laws could considerably help MCSMEs. In reality, however, it would be extremely difficult, if not impossible, to administer the provisions of the proposed laws since they involve transactions in the informal credit markets that are significantly numerous. It may well be that the huge additional cost may not justify the activity. In Chapter II, discussed the adverse consequences of interest rate ceilings on the small borrowers' access to credit were discussed. The evidence for the Philippines that was pointed out supported this view. In the three countries reviewed in Chapter III, the pieces of evidence also showed that SMEs are rationed out as a consequence of the low interest rate ceilings on loans. Under high inflationary period, the real lending rate could be negative. This could further constrict the supply of funds available for MCSMEs. In brief, imposing ceilings on interest rate would only end up hurting the supposed beneficiary of the law. If these laws were passed, the Philippines will be the only country that is going back to the era of financial repression. The country's experience as well as those of other countries regarding financial repression proved to be not at all beneficial to small borrowers.

There are two bills that seek to strengthen banking sub-systems especially those that cater to the needs of rural areas. As discussed in the two preceding chapters, a sound banking system serves the interest of MCSMEs since the latter would have greater access to bank credit. Japan's SMEs heavily rely on the private banking system which has ample supply of loanable funds mobilized from surplus households. HB 17418 proposes to revise the Rural Bank Act. There are several laudable features of the bill. One is that it suggests that rural banks be allowed to invest in allied undertakings. This will forge a closer linkage between the rural bank and borrowers since the former can provide other services to the latter. This is one of the best ways for rural banks to gather more information about the creditworthiness of borrowers. It will also reduce transactions cost on both the rural bank and borrowers. Total equity investment in allied activities should however be limited to 25 percent to ensure that rural banks' primary mandate of providing loans be given adequate attention. The other good feature of the bill is that it proposes to allow rural banks to devote a portion of their loanable funds to small business enterprises with capital investment not exceeding P300,000, which is higher than the P100,000 limit provided for in the existing Rural Bank Act. The bill should go further in this area by having a provision that rural banks may lend to any sector provided that the single borrower limit applies. This will allow rural banks to diversify their loan portfolio, thereby reducing risk. There are however several undesirable features in the bill. One of them is the proposed unlimited direct equity participation of the government in rural banks which is inconsistent with the present policy of privatization. The other is the seemingly automatic provision of long-term loans to rural banks by any government-owned bank at very low rate. Exempting rural banks from ownership ceilings which could lead to abuse especially if the bank is controlled by a single family is another undesirable feature of the bill. Moreover, government subsidy

in the form of equity participation in or soft loans to rural banks will be captured by a few families only.

While HB 17418 seeks to amend the Rural Bank Act, SB 1189 proposes to create a new type of banks called Regional Universal Banks (RUBs). RUBs are actually a special type of universal bank since they can do what a universal bank can do except that they are compelled to serve clientele in their chosen region. It is worthwhile to note that the major concerns of the bill are already being addressed by the recent banking reforms such as the liberal bank entry and branching policy, privatization of regional branches of DBP, etc. What is worrisome is that many provisions of the bill run counter to the present banking policies such as less differentiation among different types of banks, uniform incentives given to all types of banks, etc. While the establishment of RUB in a particular region could raise deposits mobilized in the said region, it will not automatically lead to an increase in loans to that region even if RUB is required to lend all its funds to that region. The reason is that a bank will always consider viability of the project and the creditworthiness of the borrower when it decides to lend. RUB might find it unprofitable to continue its operations if it cannot make use more profitably its excess funds elsewhere.

SB 786 is an interesting legislative initiative in that it recognizes the important role played by NGOs in development. As pointed out in Chapter II, the government has increasingly relied on NGOs as credit conduits. There are already financial and technical assistance to NGOs provided by various government bodies. However, these are highly fragmented and uncoordinated. Also, the government's support to NGOs is minimal compared to those provided by domestic and foreign donors. Thus, the bill basically rationalizes and seeks to increase the government's support to NGOs. However, the creation of an Umbrella Non-Governmental Organization through legislation with the intention that all government assistance to individual NGOs will be given only upon the sponsorship of the said umbrella NGO could weaken the effectiveness of existing NGOs, not to mention the political implication of forming such body. Perhaps, it would be better to encourage NGOs to form federations and be incorported with the SEC. Existing laws are already adequate to deal with this situation. Even if in the end, the government has to deal with several federations of NGOs, still there is a need to rationalize and systematize all its support programs to NGOs.

The bills which explicitly and solely identified MCSMEs or sub-groups thereof as beneficiaries are analyzed. HB 7868 proposes to grant fiscal and technical assistance to home industries, i.e.,those that have initial capitalization of P5,000 or less and employ only members of the household. These incentives are already provided for in the "Kalakalan 20." HB 22848 proposes to give DTI a mandate to provide financial and non-financial assistance to small-scale cottage industries. This bill may not be necessary since DTI is already doing those proposed activities through its Bureau of Small and Medium Business Development and Tulong sa Tao Program. HB 21608 recommends the creation of the Micro, Cottage, Small and Medium Enterprises Bureau under DTI (presumably to replace the existing Bureau of Small and Medium Business Development) to oversee the MCSMEs in the country as well as coordinate all government support programs for the MCSMEs. This is an important step towards developing a true champion for MCSMEs. However, the mandate of the proposed Bureau appears to be less clear. Also, being a bureau of a regular line agency could serve as a constraint since it cannot operate flexibly and respond to the ever-growing demands of MCSMEs. HB 19510 proposes to establish a special fund

to be lent exclusively to SMEs at an interest rate of not more than six percent per annum. This just adds to the highly fragmented, special credit programs for SMEs. Also, the interest rate is too low for the program to become sustainable. Considering that part of government revenues will be diverted to this fund, it might be worthwhile to re-examine the merit of this bill.

We now go to the much more elaborate bills. One is HB 23992 which proposes to create the National Livelihood Development Authority (NLDA). To be organized as a non-stock, non-profit corporation, NLDA is given the task to develop, implement, and monitor a comprehensive national livelihood development program. It shall have the following livelihood projects and activities as basic priorities: 1) agricultural crop development; 2) poultry and livestock development; 3) fisheries development; and 4) small-medium scale industries. It shall maintain provincial and municipal offices. All livelihood projects, including the staff and financial resources, of the various government agencies will be merged and consolidated under the NLDA. Aside from initiating and monitoring projects, NLDA also provides marketing, technical, training, information, and financial assistance. This is by far the most interventionist proposal since aside from giving assistance to its clients, NLDA also develops and implements livelihood projects, thus denying the private sector of their primary role in determining for themselves their own livelihood projects. The bill has some inherent contradictions. For instance, it proposes to target the poorest of the poor, yet it provides that only registered corporations, associations, cooperatives duly registered with proper authorities can qualify as beneficiaries of the various programs. Since marginal households and MCSMEs are not usually incorporated nor affiliated to any cooperative or association (Lamberte 1990), they cannot therefore qualify as beneficiaries. Another case in point is its claim that NLDA has a decentralized structure. Yet, projects and credit assistance of between P50,000 and P1 million need approval from the central office in Metro Manila.

NLDA must be well funded since it is going to have a staff in each of the 1,592 cities and towns, not to mention its proposed mandate of granting loans and credit assistance to its clientele. As regards its lending program, it is doubted whether its staff in each city and town have the necessary skills to handle a credit program. Finally, the proposal to peg the nominal lending rate at 8 percent will undermine the sustainability of its credit programs especially since inflation rates in the Philippines have been historically high and the administrative cost of running such program given the mechanisms proposed in the bill is likely going to be very high.

HB 25748 recommends the creation of a Small and Medium Enterprise Council with the Bureau of Small and Medium Business Development of the DTI to be converted into its Secretariat. The Council shall be composed of heads of economic line agencies including the Central Bank and representatives from the private sector. (Surprisingly, the Secretary of the Department of Science and Technology is not included in the council, implying that technological researches for SMEs are not given due importance.) Its tasks are to recommend to the President all policy matters affecting SMEs; formulate comprehensive SME program; coordinate and integrate various government and private sector activities relating to SME development; and provide technical assistance, skills and managerial training programs, marketing assistance, and information services to SMEs. One can immediately observe that the proposed functions of the Council are now being done or can be accommodated by the NEDA Board. Thus, there is no need to pass a law just

to create a council that would duplicate the functions of an exisiting institution. What might be done is to improve the Board's mechanism in developing and implementing SME promotion programs. Even if the Board is not doing nor can accommodate the proposed functions of the Council, the Council will still be a weak institution to carry out its objectives. In the first place, the members of the Council include heads of line agencies who may not have adequate time to work for the Council. The same may be said of the representatives from the private sector. Secondly, the Council has less flexibility compared to an incorporated institution. As mentioned in Chapter III, the lead institution in Japan and Korea that promotes SMEs is incorporated. And thirdly, the track record of the various councils formed by the government in this country in coordinating plans and programs of various agencies is not encouraging at all. There are at least two reasons for this. One is that councils do not have control over resources. The other is that councils have difficulty commanding loyalty from representatives of agencies which are the subject of coordination.

HB 16261 also proposes the creation of a Council with most of the functions similar to that of HB 25748. The Council is also composed of government officials and representatives from the private sector. Under the council is the Small and Medium Enterprises Office which, aside from being the Secretariat of the Council, serves as a "one stop" and information assistance center. Its functions seem to duplicate those of the Bureau of Small and Medium Business Development. But implied in the bill is that the Bureau will remain. One difference between HB 25748 and HB 16261 is that the latter proposes to have under the Council the Small and Medium Enterprise Development Fund. This will be funded by pooling together resources of all existing lending programs for SMEs. This is one big improvement over the existing fragmented system of providing credit to SMEs. It sets a rigorous set of criteria for providing credit assistance to SMEs indicating that access to its lending facility is not automatic. Unlike the previous bills, HB 16261 does not encourage lending at subsidized rates. One drawback in the bill, however, is that the lending program is being managed by the staff of the Council who may not have the necessary expertise to manage and maintain a sound lending program. This may be overcome by using private financial institutions as conduits of the Fund, but it might result in the layering of the cost of funds as what is happening now with the various existing programs. Another difference between HB 25748 and HB 16261 is that the latter grants a considerable amount of fiscal incentives to SMEs. Thus, SMEs will at least be at par with those registered with the Board of Investments.

SB 1258 is the Senate's version of a magna carta for MCSME development. It has several provisions similar to those of HB 16261 especially in the creation of a Council, the composition and functions of the Council, and fiscal incentives given to SMEs. One of the important additional incentives to be given to SMEs is the preferential treatment in seeking order for supply of goods and services from government offices, which is similar to the preferential treatment given by Japan and Korea to their SMEs. One major deviation of SB 1258 from HB 16261 pertains to the set of provisions on credit for small enterprises. In particular, it proposes that all financial institutions set aside 3 percent of their total loan portfolio for credits to small enterprises and that the Council ensure that the interest rates shall be kept at concessional and preferential levels. This is tantamount to forcing financial institutions to subsidize SMEs. As already pointed out in Chapter II, banks would probably respond to this regulation by charging large borrowers a higher rate to recoup their losses due to subsidy given to SMEs. Ultimately, large firms subsidize small firms by paying a

higher interest rate on their loans than the normal rate in the absence of that mandatory requirement. This is certainly an inefficient way of allocating resources. Moreover, the track record of mandatory credit allocation for priority areas here and abroad is not very encouraging. Although on paper, a bank may report full compliance of the regulation, in reality it may not have complied. And monitoring compliance with the regulation imposes high administrative cost. Usually, regulatory avoidance is rampant in tightly controlled markets.

Another important difference between SB 1258 and HB 16261 is that the former proposes to create the Small Enterprise Credit and Guarantee Corporation. In Chapters II and III, it was pointed out that there is a need to have a real guarantee scheme that accommodates both export- and domestically-oriented SMEs. This bill comes close to answering that need. However, there are some questionable provisions of the bill. One is that it proposes to create an entirely new guarantee corporation instead of building up on the existing ones, i.e.,Philguarantee and GFSME. Duplication of functions with the existing ones are likely to occur. Perhaps, what may be needed is the revision of the charter of Philguarantee to expand its mandate and increase its resources. In that case, the available staff and their expertise can be utilized more fully. The other is that it intends to arm the proposed Corporation with a lending facility. Perhaps, GFSME's experience in managing both lending and guarantee programs can throw light to this issue. As already pointed out in Chapter II, GFSME has been gradually phasing out its lending facility and is starting to concentrate instead on its guarantee program.

In summary, there is now a serious effort towards providing a legal framework for MCSME development in the country. The number of bills reviewed above attests to this. This is already a substantial improvement over the past 35 years. However, the bills reviewed above still leave much to be desired considering the requirements of developing MCSMEs in this country.

V. POLICY RECOMMENDATIONS AND LEGISLATIVE AGENDA

This chapter discusses some monetary, banking and credit policies and present legislative agenda for MCSME development in the country.

A. Monetary, Banking and Credit Policies

No matter how monetary policy is made conducive to the development of MCSMEs, it cannot work independently of the rest of macroeconomic policies. The primary task therefore is to finetune macroeconomic policies such that their biases against MCSMEs will be reduced, if not eliminated. For instance, protecting an inefficient steel manufacturing industry would hurt the downstream industries, like the metal working industry, which consists of many small and medium enterprises. Poor rural infrastructure facilities adversely affect MCSMEs which tend to concentrate in rural areas where factor inputs such as labor and raw materials are abundantly available. Taiwan had successfully launched her rural industrialization mainly spurred by SMEs due to the adequacy of infrastructure facilities in rural areas.

As regards monetary policy, a tighter control on the movements of monetary aggregates is desirable to achieve a stable movement of the general price level. This can help business formulate long-term investment plans. An appropriate rediscounting policy and fiscal discipline can help attain this objective.

Banking reforms should continue. Since bank entry and branching is now more liberal than in the past, the focus of reforms should shift towards strengthening bank supervision to reduce bank failure. An ailing banking system will have difficulty mobilizing deposits, hence, there would be less loanable funds for the economy. Credit rationing could take place; and it is known that in any credit rationing system, small borrowers are being rationed out. Thus, upgrading the bank examination capability of the Central Bank is necessary for the strengthening of the banking system. While the bank examination capability of the Central Bank is being strengthened, the legal framework that governs bank examination should also be changed. For example, examiners should be given more authority to look into DOSRI accounts to prevent abuse by bank owners and officers.

There might be a need to review the regulation pertaining to single borrower's limit to determine whether it can be granted liberally to some financial institutions in view of the special character of their business. In particular, finance companies that are engaged in leasing may be allowed to have a higher single borrower's limit due to the indivisibility of the capital goods they lease. Leasing is an important alternative source of financing SMEs which often cannot afford to buy pieces of equipment for their business.

There is a need to review the interest rate policy. As of this moment, interest rate policy is subservient to exchange rate policy. Any pressure on the exchange rate is being moderated by increasing the interest rate. Thus, severely fluctuating interest rates have been experienced by the country. Perhaps, it is about time to let the exchange rate float freely. Of course, the government must initiate the removal of intermediation taxes. This could help bring down the rates. Mandatory credit allocation to priority sectors should be resisted since as argued above, it only results in the raising of the interest rate without accomplishing its objective.

It is about time that the government makes a stand on the proliferation of small, special credit programs for MCSMEs. As pointed out in Chapter II, these are uncoordinated, and many are overlapping with each other. It might be worthwhile to place them in a pool to be used for specific lending programs that would yield much larger incremental benefits to MCSMEs. A related discussion on this issue is presented below.

Under the liberal interest rate policy, borrowers perceived to be riskier are charged higher interest rates by banks. MCSMEs are usually perceived to be riskier borrowers. If they cannot put up the necessary collateral, which is often the case, then banks would not accommodate them. Often, the subjective evaluation of banks on the riskiness of the borrowers diverge from reality. As mentioned in Chapter II, MCSMEs were found to be highly profitable, yet they encounter difficulty in accessing credit from banks. Thus, it would be worthwhile to have a strong guarantee program for MCSMEs that do not discriminate between export- and domestically-oriented enterprises.

B. Legislative Agenda

The first item in the agenda is the creation of the body that will champion the cause of the MCSMEs. It should be pointed out at the outset that there is the need to separate policy formulation from program implementation. It is this author's view that the NEDA Board, with the assistance of NEDA as the Secretariat, is well equipped to handle policy issues related to MCSMEs. What is therefore needed is a body tasked to concretize the announced policies. In this regard, this study views the creation of a Council as a weak institution and proposes instead a corporate body for the promotion of MCSMEs. It can respond more flexibly to the demands of MCSMEs than a Council. It may be called Micro, Cottage, Small and Medium (MCSM) Business Corporation. The tasks of the proposed Council mentioned in different bills above can be incorporated here. Implied here is that existing government institutions performing the same functions as the Corporation are subsumed under it. Organizationally, the Board of Trustees of the Corporation may be composed of representatives from the private sector with only one representative from the government, probably the Finance Secretary. It shall have three departments, with each being assigned to the following individual programs: training and information system programs; research and development; and MCSME financing program. The last will be funded by integrating the existing lending programs for MCSMEs including the six major lending programs of TLRC. This lending program should function like a venture capital entity focusing on the provision of long-term capital to emerging technology-intensive MCSMEs. The Corporation may set up its own research and training institutes or incorporate in it existing research and training institutes. It should be attached to the Department of Science and Technology to emphasize the need to continually upgrade the technology of MCSMEs.

There is a need to establish a real independent Guarantee Corporation. It is proposed here that the charter of Philguarantee be amended to reflect a much broader mandate. Specifically, domestically-oriented industries should be given equal access to the guarantee facility. Its capital should be increased so that it can service a wider array of clientele.

The law governing the creation of venture capital corporations should be amended to develop the venture capital industry funded mainly by the private sector. The law should be more specific about the investment activities of venture capital corporations. For instance, venture capital corporation should invest only in equity and in the start-up operation of small firms wishing to apply and commercialize newly-developed technology. In return, the corporation will be allowed to issue bonds or borrow from more than 19 creditors. To encourage private investors to invest in venture capital corporations, tax breaks such as exemption from capital gains tax should be given to them.

Leasing should be exploited as an alternative method of financing MCSMEs. To stimulate leasing transactions, the application of the VAT should perhaps be reviewed. There might be an alternative arrangement whereby a lessee is allowed to offset the VAT paid by the lessor on the equipment against the lessee's VAT liabilities (Lirio 1987). Additionally, leasing companies my be allowed to borrow from more than 19 creditors so that they can raise more financial resources.

Finally, there should be a law governing subcontracting to protect subcontractors from any unfair practices that may be perpetuated by the parent firm. The proposed MCSM Business Corporation can help in this area by supplying subcontractors with adequate information about prices of products of interest to subcontractors and other possible markets.

Annex A.1
PROGRAM PROFILE

Name of Program	:	Agro-Industrial Technology Transfer Program (AITTP)
Source(s) of Funds	:	Overseas Economic Cooperation Fund (Japan)
Major Objectives	:	To strengthen the agricultural sector by facilitating the transfer of technology for production and processing; developing domestic and export markets; and generating livelihood opportunities for the rural sector.
Date/Year Implemented	:	1984
Area(s) of Implementation	:	Nationwide
Implementing Agencies	:	Technology and Livelihood Resource Center (TLRC)
Trustee Bank (if any)	:	Development Bank of the Philippines
Lending Channels (if any)	:	Direct re-lending of funds by TLRC-AITTP
Lending Terms and Conditions	:	
Loan Purpose	:	Acquisition of fixed assets and provision for working capital.
Eligible Borrowers	:	Producers/processors of agri-or aqua-based projects
Loan Ceiling	:	₱21 Million
Collateral Requirements	:	Land; land improvements; buildings; and chattels
Maturity	:	5 to 15 years inclusive of 1 to 5 years grace period
Interest Rate (per annum)	:	8.75%
Total Funds	:	₱540.917 Million

Program Status (As of September 30, 1989)

Loans Granted	:	₱442.6 Million
Loans Collected	:	₱ 43.7 Million
Loans Outstanding	:	₱398.92 Million
Loans Past Due	:	₱ 23.6 Million
Repayment Rate	:	64.9%
Past Due Ratio	:	6%

Annex A.2
PROGRAM PROFILE

Name of Program	:	Quedan Financing for Food and Agricultural Marketing Enterprises
Source(s) of Funds	:	National Government/Fund Earnings
Major Objectives	:	To provide credit support to small and medium food and agricultural marketing enterprises and thereby encourage production of basic commodities; To support the livelihood program of government and uplift the income level of small and medium food and agricultural business enterprises; To likewise, involve the banking sector in providing more assistance to food and agriculture business undertakings; and To enhance further the price stabilization program of the government.
Date/Year Implemented	:	March 1985
Area(s) of Implementation	:	Nationwide
Implementing Agencies	:	Quedan Guaranteed Fund Board
Trustee Bank (if any)	:	
Lending Channels (if any)	:	Accredited commercial banks, universal banks, thrift, savings and loan banks, specialized government banks, private development banks, rural banks and branches of foreign banks.
Lending Terms and Conditions	:	
Loan Purpose	:	Projects eligible for financing shall be small and medium scale food and agricultural marketing enterprises which are already in actual operations but would otherwise, need additional funding. Preference however, shall be given to home-scale type of enterprises.

Eligible Borrowers	:	Home-scale type proprietors are priority borrowers (business must be existing)
Loan Ceiling	:	Working Capital -₱50,000.00 Fixed Assets - ₱100,000.00
Collateral Requirements	:	Deed of Chattel Mortgage; Deed of Real Estate Mortgage; Deed of Assignment
Maturity	:	6 months - 3 years
Interest Rate (per annum(.)	:	- 12% per annum for weekly amortization - 14% per annum for monthly amortization - 16% per annum for quarterly amortization
Total Funds	:	

Program Status (As of September 30, 1989)

Loans Granted	:	₱ 13.72 Million
Loans Collected	:	₱ 10.66 Million
Loans Outstanding	:	₱ 3.06 Million
Loans Past Due	:	₱ 1.11 Million
Repayment Rate	:	91 %
Past Due Ratio	:	36%

Annex A.3
PROGRAM PROFILE

Name of Program	:	Quedan Financing for Food Market Retailers
Source(s) of Funds	:	On a 50/50 fund sharing between QGFB and accredited lending banks
Major Objectives	:	To stabilize retail prices of basic food commodities by facilitating credit support to food retailers; To develop a strong and ready market for farmers produce specially those of Sariling Sikap and/or KKK projects; and To involve the banking sector in providing more assistance to food-related business undertakings.
Date/Year Implemented	:	April 16, 1984 (Cir. No. 017)
Area(s) of Implementation	:	Nationwide
Implementing Agencies	:	Quedan Guarantee Fund Board
Trustee Bank (if any)	:	
Lending Channels (if any)	:	Accredited commercial banks, universal banks, thrift, savings and loan banks, specialized government banks, private development banks, rural banks and branches of foreign banks.
Lending Terms and Conditions	:	
Loan Purpose	:	The loan shall be used to augment the working capital of food retailers.
Eligible Borrowers	:	Must be a bonafide stallholder in a public market or a bonafide stall lessee in a private market; must possess a current mayor's permit and/or municipal license; must be a food retailer duly registered and/or licensed with NFA if engaged in grains; fish, meat and poultry products; and must have a deposit account with the participating lending banks where he intends to borrow.

Loan Ceiling	:	For a collateralized loan, loanable amound depends on loan values and collateral. For non-collateralized loan, first availment usually less than ₱5,000; loanable amount is up to ₱10,000 on 3rd availment; then on fourth availment, loan ceiling is up to ₱20,000.
Collateral Requirements	:	Deed of Assignment of stocks-in-trade with Trust Receipt Agreement; Jointly and solidarily liable co-makers; Deed of Pledge; Chattel/Real Estate Mortgage; and other collaterals acceptable to the banks.
Maturity	:	30 days to 360 days depending on the borrower's amortization schedule
Interest Rate (per annum)	:	- 10% per annum for daily amortization - 12% per annum for weekly amortization - 14% per annum for monthly amortization - 16% per annum quarterly amortization
Total Funds	:	

Program Status (As of September 30, 1989)

Loans Granted	:	₱343.34 Million
Loans Collected	:	₱292.69 Million
Loans Outstanding	:	₱ 50.65 Million
Loans Past Due	:	₱ 18.14 Million
Repayment Rate	:	94%
Past Due Ratio	:	36%

Annex A.4
PROGRAM PROFILE

Name of Program	:	Quedan Financing for Grains Businessmen
Source(s) of Funds	:	National Government/Fund Earnings
Major Objectives	:	To augment the operating capital of food businessmen and encourage their active participation in the local procurement of milled rice, corngrains, sorghum, soybeans, mongo, peanuts and basic food commodities; To increase the direct involvement of private commercial banks in agricultural credit in compliance with PD 717; To strengthen further the integrity and acceptability of the Quedan as collateral for loan availment; To enhance further the price stabilization program of the government; and To support the food production programs of the government.
Date/Year Implemented	:	May 24, 1978
Area(s) of Implementation	:	Nationwide
Implementing Agencies	:	Quedan Guarantee Fund Board
Trustee Bank (if any)	:	None
Lending Channels (if any)	:	Accredited banks directly lending to trader-millers
Lending Terms and Conditions	:	
Loan Purpose	:	For procuring farmer's produce
Eligible Borrowers	:	Franchised bonded warehousemen
Loan Ceiling	:	Maximum loanable amount is based on loan value of warehousemen's approved capacity.
Collateral Requirements	:	Palay, corn, peanut and milled rice

Maturity	:	3 months - for corn and milled rice 6 months - for palay and peanuts
Interest Rate (per annum)	:	Prevailing bank interest rates
Total Funds	:	

Program Status (As of September 30, 1989)

Loans Granted	:	₱6,743.26 Million
Loans Collected	:	₱6,270.84 Million
Loans Outstanding	:	₱ 472.41 Million
Loans Past Due	:	₱ 89.19 Million
Repayment Rate	:	94 %
Past Due Ratio	:	36 %

Annex A.5
PROGRAM PROFILE

Name of Program	:	Integrated Rural Financing (IRF) Program
Source(s) of Funds	:	Department of Agriculture - Comprehensive Agricultural Loan Fund
Major Objectives	:	To provide comprehensive financing using the area-specific development approach to enhance the production income, and repayment capacity of the small farmer-clientele; To support the thrust towards multiple and diversified farming systems, and integrated farm financing to spread risks in lending; To encourage development of other viable small home or rural industries which are linked to the main livelihood of the community/farm household; To simplify and systematize the loaning process for banks and borrowers which may reduce borrowing and lending costs; and To ensure repayment to fund sources and continued credit access to fund users.
Date/Year Implemented	:	July 1983
Area(s) of Implementation	:	Nationwide
Implementing Agencies	:	Land Bank of the Philippines
Trustee Bank (if any)	:	
Lending Channels (if any)	:	Rural banks, thrift banks and commercial banks
Lending Terms and Conditions	:	
Loan Purpose	:	To finance crop productivity, poultry, fishing and livestock, Quedan financing and commodity loans, and to finance production and manufacturing activities
Eligible Borrowers	:	Farmer Groups/Cooperatives
Loan Ceiling	:	
Collateral Requirements	:	Real estate mortgage, co-maker chattel
Maturity	:	
Interest Rate (per annum)	:	Prevailing market rate
Total Funds	:	₱330.825 Million
Program Status (As of September 30, 1989)		
Loans Granted	:	₱326.02 Million
Loans Collected	:	₱100.48 Million
Loans Outstanding	:	₱223.54 Million
Loans Past Due	:	₱ 4.23 Million
Repayment Rate	:	96 %
Past Due Ratio	:	2 %

Annex A.6
PROGRAM PROFILE

Name of Program	:	Export Industry Modernization Project II
Source(s) of Funds	:	Overseas Economic Cooperation Fund (OECF)
Major Objectives	:	To develop non-traditional export-oriented small and medium scale firms of the Philippines through relending loans to or making equity investments in their modernization projects.
Date/Year Implemented	:	January, 1988
Area(s) of Implementation	:	Nationwide
Implementing Agencies	:	Technology and Livelihood Resource Center (TLRC)
Trustee Bank (if any)	:	
Lending Channels (if any)	:	Direct re-lending of funds by TLRC
Lending Terms and Conditions	:	
Loan Purpose	:	Building, machinery, working capital
Eligible Borrowers	:	New or existing small and medium enterprises
Loan Ceiling	:	₱5 Million
Collateral Requirements	:	100% coverage with hard assets from the projects, such as land, building machines
Maturity	:	
Interest Rate (per annum)	:	10%
Total Funds	:	60 Billion (Yen)

Annex A.7
PROGRAM PROFILE

Name of Program	:	Industrial Guarantee and Loan Fund (IGLF) Program
Source(s) of Funds	:	World Bank
Major Objectives	:	To encourage and promote the setting up and expansion of cottage, small and medium-scale industries.
Date/Year Implemented	:	
Area(s) of Implementation	:	
Implementing Agencies	:	Department of Loans and Credit - Central Bank
Trustee Bank (if any)	:	
Lending Channels (if any)	:	Commercial Banks, Thrift Banks, Rural Banks
Lending Terms and Conditions	:	
Loan Purpose	:	Purchase of factory site for new and expansion of projects; maximum of 25% of amount applied for; construction of factory buildings; purchase of machinery/equipment/fixtures and installation costs; and permanent working capital.
Eligible Borrowers	:	Manufacturing concerns and those service industries supportive of manufacturing activities like warehousing, repair shops,etc.
Loan Ceiling	:	Accredited Scheme - Maximum - Cottage ₱0.4 Million; - Small ₱4.0 Million; - Medium ₱16.0 Million Non-Accredited Scheme -Maximum - Cottage ₱150,000; - Small ₱150,000; - Medium ₱150,000
Collateral Requirements	:	Working capital - maximum of 7 years inclusive of 2 years grace period. Fixed assets - maximum of 12 years inclusive of 3 years grace period.
Maturity	:	Prevailing market rate.
Total Funds	:	———

Annex A.8
PROGRAM PROFILE

Name of Program	:	Tulong sa Tao Program
Source(s) of Funds	:	National Government
Major Objectives	:	To assist micro-business entrepreneurs, including government retirees (civil and military), and ex-detainees who intend to expand their livelihood projects or establish new ones; To provide at least 130 Private Voluntary Organizations (FVOs) with revolving funds for lending to micro-business or livelihood projects; and To develop the capabilities of PVOs in managing a lending program.
Date/Year Implemented	:	1987
Area(s) of Implementation	:	Nationwide
Implementing Agencies	:	Department of Trade and Industry - Bureau of Small and Medium Business Development (DTI-BSMBD)
Trustee Bank (if any)	:	
Lending Channels (if any)	:	Private Voluntary Organizations (PVOs)
Lending Terms and Conditions	:	
Loan Purpose	:	
Eligible Borrowers	:	The ultimate beneficiaries of the program will be qualified individuals with entrepreneurial skills potentials. Specifically these are: micro- entrepreneurs, including government retirees (civil and military) and political ex-detainees.
Loan Ceiling	:	The maximum amount of loan to a qualified PVO should not exceed ₱1,000,000.00. PVO loan beneficiaries shall be up to a maximum of ₱25,000.00

Collateral Requirements	:	
Maturity	:	The term of repayment will be one year (principal and interest). The first quarter release will fall due after one year. The loan will be subject to yearly renewal.
Interest Rate (per annum)	:	The DTI shall charge the PVOs interest of 7% p.a. The PVO shall charge the beneficiaries the prevailing commercial rate.
Total Funds[1]	:	₱60 Million
Total Amount Loaned to PVO, ₱M (as of December 1988)	:	₱31.8 Million
No. of PVOs	:	111
End/Direct Loan Beneficiaries	:	7,401
No. of Jobs Generated	:	11,734

Annex A.9
PROGRAM PROFILE

Name of Program	:	Bagong Kilusang Kabuhayan at Kaunlaran -Expanded Conduited Guaranty and Lending Programs: Kabuhayan sa Nayon
Source(s) of Funds	:	National Livelihood Support Fund (National Government)
Major Objectives	:	To promote livelihood through the establishment of labor-intensive projects and small and micro-scale enterprises; To promote good citizenry by instilling respect for government laws and regulations, social consciousness and the sense of credit responsibility; To provide short and medium term credits to project proponents for the financing kof their livelihood projects; and To establish an appropriate institutional and policy framework that will promote productive employment for the citizenry at the barangay level.
Date/Year Implemented	:	1986
Area(s) of Implementation	:	Nationwide
Implementing Agencies	:	Technology and Livelihood Resource Center (TLRC)
Trustee Bank (if any)	:	Land Bank of the Philippines
Lending Channels (if any)	:	Participating Financial Institutions (PFIs)
Lending Terms and Conditions	:	
Loan Purpose	:	Anchor-Chain Type; Stand Alone Type
Eligible Borrowers	:	Preferable new or existing clients of TLRC; Filipino or 60% or more Filipino-owned corporation; credit-worthy; do not have any outstanding loan in arrears in any BKKK lending

		program. An individual or private entity (whether sole proprietorship, partnership, corporation, cooperative or other organizations) having the legal capacity to borrow and enter into a contract.
Loan Ceiling	:	₱1 Million for Anchor Chain; ₱200 thousand for Stand Alone type
Collateral Requirements	:	Unencumbered project and personal assets such as livestock inventories, standing crops, raw materials and finished goods.
Maturity	:	1 - to 5 years
Interest Rate (per annum)	:	16% (beneficiaries)
Total Funds	:	₱100,000 Million

Program Status (As of September 30, 1989)

Loans Granted	:	₱28.10 Million
Loans Collected	:	₱ 9.51 Million
Loans Outstanding	:	₱ 18.59 Million
Loans Past Due	:	₱ 6.15 Million
Repayment Rate	:	61%
Past Due Ratio	:	33%

Annex A.10
PROGRAM PROFILE

Name of Program	:	The Small and Medium Industry Loan Program: A Land Bank-SSS Partnership (SMILP)
Source(s) of Funds	:	Social Security System (SSS)
Major Objectives	:	To create financing package to fund business expansion at fixed interest rate for long-term loans; and To provide long-term credit for the growth of small and medium-scale industries.
Date/Year Implemented	:	January, 1989
Area(s) of Implementation	:	Nationwide
Implementing Agencies	:	Land Bank of the Philippines
Trustee Bank (if any)	:	
Lending Channels (if any)	:	Land Bank of the Philippines
Lending Terms and Conditions	:	
Loan Purpose	:	Acquisition of project/warehouse sites, machinery, or equipment. Construction of factory building/warehouses, and other civil works.
Eligible Borrowers	:	Sole proprietorships, partnerships, and/or corporations with an acceptable track record, assets and/or sales of at least ₱5 Million, which are involved in the following activities: *Agri-business *Manufacturing *Utilities *Transportation and Communication *Commercial production particularly of food and basic consumer items *Export related businesses
Loan Ceiling	:	₱20.0 Million per project
Collateral Requirements	:	
Maturity	:	
Interest Rate (per annum)	:	Prevailing market rate (beneficiaries)
Total Funds	:	₱500 Million
No. of Projects Approved	:	27
Total Value of Projects Approved	:	₱196 Million

Annex A.11
PROGRAM PROFILE

Name of Program	:	Special-Agriculture, Small and Medium Industries Lending (A-SMILE)
Source(s) of Funds	:	Social Security System (SSS)
Major Objectives	:	To provide financial assistance to socially responsible entrepreneurs as start-up capital or for the expansion of industrial, agro-industrial, and manufacturing concerns and service industries supportive of manufacturing activities.
Date/Year Implemented	:	July 1986
Area(s) of Implementation	:	Nationwide
Implementing Agencies	:	Development Bank of the Philippines
Trustee Bank (if any)	:	
Lending Channels(if any)	:	DBP Branches and Field Offices
Lending Terms and Conditions	:	
Loan Purpose	:	Acquisition of fixed assets and for working capital requirements of projects.
Eligible Borrowers	:	Entrepreneurs engaged in projects such as agriculture, manufacturing, trading and other undertakings.
Loan Ceiling	:	
Collateral Requirements	:	Any or a combination of the following may be accepted: a. First mortgage on real estate b. Chattel mortgage on movable properties c. Assignment of letters of credit or confirmed purchase orders, or sales contracts
Maturity	:	Prevailing market rate (beneficiaries)
Total Funds	:	₱150 Million

Annex A.12
PROGRAM PROFILE

Name of Program	:	National Livelihood Support Fund-Livelihood Development Project
Source(s) of Funds	:	Consolidated Funds of the KKK
Major Objectives	:	Deliver livelihood program packages that would address the needs of the beneficiaries of priority areas that will transform them into bankable/self-reliant entities; To establish a functional network of cooperating SDOs serving the poor; and To mobilize and empower community groups and poverty organizations and to undertake activities that will enbale them to access the basic services needed to uplift their living conditions.
Date/Year Implemented	:	1988
Area(s) of Implementation	:	Nationwide with priority on depressed areas
Implementing Agencies	:	National Livelihood Support Fund/ Office of the President
Trustee Bank (if any)	:	Land Bank of the Philippines
Lending Channels (if any)	:	Non-government organizations
Lending Terms and Conditions	:	
Loan Purpose	:	Livelihood/Income-Generating
Eligible Borrowers	:	NGOs
Loan Ceiling	:	₱300,000/project
Maturity	:	Based on project cash flow but not to exceed 5 years.
Collateral Requirements	:	none
Interest Rate per annum	:	12% (maximum rate to beneficiaries)

Program Status (As of December 31, 1989)

Approved Funding Commitment	:	₱388,779,000
No. of Approved Programs	:	47 programs
Funds Released to SDOs	:	₱62,764,450
No. of SDOs used as Fund Conduits	:	27 SDOs
No. of Projects funded by Programs	:	3,043 projects
No. of Direct Beneficiaries	:	9,729

Annex B.1
SMALL-SCALE ENTERPRISE MUTUAL RELIEF SYSTEM

A. Background to the establishment of the system.

Small-scale enterprises constitute some 80% of the total number of enterprises in Japan, and play an important role in the Japanese economy.

However, since most small-scale enterprises have the strong characteristic of "work for subsistence,"and have weak economic foundations and low profitability, they are always in an unstable condition.

Under these circumstances, this system was formed to attempt to improve and promote the welfare of the small-scale enterprise proprietors in the above-mentioned environments.

B. Setup of the system.

In this system, the small-scale enterprise proprietors make installment payments of premiums in order to qualify for benefits which will be a security to them upon retirement from executive positions or discontinuation of the business,when the "mutual relief money" can be received.

This benefit program acts as an important support for more than one million small-scale enterprise proprietors enrolled in the system to date.

C. Outline of the system.

1. Qualification for entry.
   Small-scale enterprise proprietors and their executives.

2. Installment payments of premium.
   Monthly installment payments of premium can be optionally selected from the range of a minimum Y1,000 to a maximum of Y50,000 provided that the amount is a multiple of Y500.

3. Grounds for payment of the mutual relief money.
   A mutual relief allowance of a specified amount is granted to those who have made monthly installment payments of premiums for more than 6 months and those who fall under any of the following categories:

   a. Termination of private concerns (inclusive of death of owner).

   b. Resignation of executives due to dissolution of the company.

   c. Persons over 65 years of age who have made monthly installment payments of premiums for more than 15 years. (The mutual relief money will be paid upon request even if the grounds mentioned in a -c have not occurred).

4. There are two loan systems for subscribers of the mutual relief system as follows:

   a. A subscriber may immediately receive a loan for business funds appropriate to the total amount of his/her premium installments.

   b. A subscriber may receive a loan from the mutual relief fund in case of illness, injury or accident.

Source: Annual Report of the Japan Small Business Corporation (1989).

Annex B.2
SMALL AND MEDIUM ENTERPRISE MUTUAL RELIEF FOR PREVENTING CHAIN-REACTION BANKRUPTCIES

A. The Background to the establishment of the system.

Since the economic foundation of a small and medium enterprise is weak, they are often susceptible to the impact of the bankruptcy of their clients and consequently, there are many cases of chain-reaction bankruptcies.

This system was established to prevent the chain-reaction bankruptcy of small and medium enterprises as a result of the damage received by unexpected bankruptcy of their clients.

B. Setup of the system.

Under this system, small and medium enterprises make installment payment of premiums into the fund and when the fear of a chain-reaction bankruptcy breaks out due to the difficulty in collection of receivable bills or dishonored receivable drafts by the bankruptcy of a client, they may receive mutual relief loans equal to their damage up to ten times their total amount of installment premium payments.

C. Outline of the system.

1. Qualification entry

Small and medium enterprises in existence for longer than one year, or a cooperative association organized by small and medium enterprises.

2. Installment payments of premiums.

Monthly installment premium payments can be optionally selected from a range of a minimum Y5,000 to maximum of Y80,000 provided that the amount is a multiple of Y5,000. Premium payment can be made up to a total amount of Y3.2 million.

3. Amount of loan of mutual relief money.

Subscribers who are unable to recover accounts and bills receivable due to bankruptcy of a client may receive a mutual relief loan, whose amount is equivalent to either ten times the amount of the installment payments of premium so far accumulated or the amount of total damages, whichever is lower.

The maximum amount of loan is up to Y32 million and is extended without security, guarantor, or interest. This loan is made available beginning 6 months following subscription. The repayment period is 5 years (inclusive of a 6 months period of deferment).

4. Temporary loan.

A temporary loan up to the limits of the total amount of installment premium payment can be received when subscribers face an emergency situation or need temporary business funds.

Source: Annual Report of the Japan Small Business Corporation (1989).

Annex C.1

THE SMALL AND MEDIUM INDUSTRY BANK

	The Small & Medium Industry Bank
Major Functions	Facilities and Operational Loans for Company Formation
Candidates for receiving loans	As a businessman of a small & medium sized company which is to be commercialized for the first time (within a year after the foundation), one should comply with at least one of the following conditions: - one who intends to manufacture products using new technology that is patented or registered in accordance with the Utility Model Law - one who intends to manufacture using technology developed or recommended by public research institutes, or technology developed with the company's own resources - one who intends to manufacture using the new imported technology - one who intends to manufacture newly develped machinery in accordance with the article 12 of the Machine Industry Advancement Act - a company which intends to run systematization approval enterprises or businesses related to small and medium sized firms - a company recommended by the Korea Design Packing Centre for its design packing skills and management training - a company contributing to technology development and quality enhancement through technological tie-ups with foreign companies - one who undertakes technology development projects in accordance with the National Investment Fund Act or manufactures

Source: Korea Advanced Institute of Science and Technology, A Study of the Effect of KTDC's Financing Activities (1986).

Annex C.2
THE CITIZENS NATIONAL BANK

	The Citizens National Bank			
Major Function:	. Financing the commercialization of new technology or new products by small and medium scale firms		. A company intent on locally made machinery/quality improvement . Management/technology training for small and medium scale firms	
	(financing for the company formation of small and medium scale firms) one intent on the company manufacturing business with less than 20 employees/or less than a year after the foundation using the following new technologies: - new technology developed or recommended by public research institutes	(financing for technology development) . a minor entrepreneur with less than 100 employees whose techno-logical capability was examined, recommended, or was approved by the government research institute/and who intends to open a new business of - technology development/ commerciali-zation of imported technology - purchasing of R & D equipment - technology import/improve-ment of imported technology - R & D for energy conservation - exhibition of new products and manufacturing processes	(promotion of venture capital investment) . a small business with less than 100 employees and total assets of no more than 300 million won before the public offering which intends to open a new business of - development of new design - development of antipollution technology - facility expansion of promising small and medium scale businesses - commerciali-zation of new technology or products.	(lending of the national investment funds) . purchasing of locally-made machinery, commerciali-zation of new technology, or quality improvement

	The Citizens National Bank			
Major Function	. Financing the commercialization of new technology or new products by small and medium scale firms		. A company intent on locally made machinery/quality improvement . Management/technology training for small and medium scale firms	
Contents of Loans	. facility fee - loan period: within 8 yrs. (including a grace period) - percentage: within 70% of the necessary financing - limit: 250 million won . operation fee - period: with 5 yrs. - percentage: within 100% of the necessary financing - limit: 100 mil. won	. facility fee - loan period: within 5 yrs. -%: within 100% of the necessary financing - limit: hone . operation fee - period: within 1 yr. (lending by a note) within 3 yrs. (mututal benefit) - % : with 100% of the necessary financing - limit: none	. equity investment - investment within 50% of the paid-in capital - debenture acquisition - loan financing if additional necessary financing needed . investment limit - within 300 mil. won per a company, (combination of equity and debenture)	.limit: no limit in financing amount, within 80% of the necessary financing (70% for technology development, quality improvement, 100% for facilities for energy saving) . method and period: lending by a certificate within 10 yrs. (technology development, quality improvement - within 8 yrs.
collateral	real estate, provisional certificate fidelity guarantees	"	equity investment: without collateral debenture acquisition with collateral	real estate provision certificates fidelity guarantees

Source: Korea Advanced Institute of Science and Technology, A Study of the Effect of KTDC's Financing Activities (1986).

Annex C.3
FINANCING FOR SMALL AND MEDIUM SIZED BUSINESSES

Financing Scale		No Limit
Candidates		minor entrepreneurs .R & D for new products, new manufacturing process or product improvement .commercialization manufacturing of new development of technology or imported technology .purchasing of R & D facilities & equipment .import of technology & improvement of imported technology
terms of lending	banks	all the financial institutions (excluding the Industrial, Bank Import/Export Bank and the Long-Term Credit Bank, and branch offices of foreign banks)
	period	within 5 yrs. (including a grace period of 2 yrs.)
	interest rate	annual interest rate of 10.0 - 11.5% (10.0 - 13.5% for 'facility funds for more than 1 year')
	others	should be examined or recommended for the technological validity by the government research institute

Source: Korea Advanced Institute of Science and Technology, A Study of the Effect of KTDC's Financing Activities (1986).

Annex C.4

THE MACHINE INDUSTRY ADVANCEMENT FUND

Financing Scale		8.4 Bil. Won ('85)
Candidates		As a small and medium sized machine industry registered in accordance with article 6 of the machine Industry Advancement Act, it should comply with one of the following conditions: . a company be recommended as a promissing small and medium sized business . a company awarded for developing high quality machinery . a prize winner in the precision contest . a joint-venture in accordance with the Article 6 of the Small & Medium Sized Business Systematization Promotion Art * Sectors with priority . development cost for the items requested by the Demand & Supply Corp. Association and exhibited in the Components Exhibition organized by the Korea Machinery Industry Promotion Association . development cost for the items (including parts) with highprospects for export and with manufacturing request from overseas . development cost for the items (including parts) considered by the Minister of Commerce and Industry to be essential for import substitution, increase of exports and technology development.
banks		The Small & Medium Industry Bank
terms	%	. will provide up to 90% of the necessary financing
	limit	. 200 mil. won
	period	. within 5 yrs. (including a grace period of 2 yrs.)
	interest rate	annual interest rate of 6.0
	method	. lending by certificate
Others		. lending request: the Korea Machine Industry Advancement Association

Source: Korea Advanced Institute of Science and Technology, A Study of the Effect of KTDC's Financing Activities (1986).

Annex C.5

THE ELECTRONIC INDUSTRY ADVANCEMENT FUND

Scale		4 Bil 227 Mil. ('85)
Candidates		Small and medium scale companies selected by the Electronic Industry Advancement Funds through the consideration of the operation 4 management committee of the Funds
banks		The Small & Medium Industry Bank
terms	financing amount	limit set by the Electronic Industry Advancement Funds
	period	within 5 years (repayment of 3 years' equally divided installment with a grace period of 2 years
	interest rate	annual 6.0 %
Others		. lending request: the Korea Society for the Advancement of Machine Industry

Source: Korea Advanced Institute of Science and Technology, A Study of the Effect of KTDC's Financing Activities (1986).

Annex C.6

THE TEXTILE INDUSTRY MODERNIZATION FUND

Scale			3 Bil ('85)
Candidates			one who intends to run a fibre industry in accordance with the Fibre Industry Modernization Act
banks			The Cho-Heung Bank Ltd, The Commercial Bank of Korea Ltd. Korea First Bank Korea Exchange Bank The Small & Medium Industry Bank
terms	percent		within 90% of the purchasing cost of machinery
	limit		300 mil won
	period		repayment of equally divided installment within 5 years with a grace period of 3 years
	interest rate		annual 6.0 %
Others			. lending request: the Korea Fiber Industry Association

Source: Korea Advanced Institute of Science and Technology, A Study of the Effect of KTDC's Financing Activities (1986).

Annex C.7

THE SMALL & MEDIUM SIZED BUSINESS ADVANCEMENT FUND

Scale	55 Bil 500 Mil ('85) (won)
	modernization: 22.4 bil . cooperation: 21.4 bil . traditional arts and crafts: 1.1 bil . company formation: 3 bil . industries in farming and fishing area: 7.8 bil
Candidates	. modernization the modernization project must be approved by the representative of the Small & Medium sized Business Advancement Corp. (SMBA) . business conversion the business conversion project must be approved by the SMBA . company formation the company formation project must be approved by the SMBA . cooperation the cooperation must be approved by SMBA . recommended companies one recommended by SMBA for their financing needs according to the training results by the Small & Medium Sized Business Advancement Corp. . local small & medium sized businesses one recognized by the representative of the Small & Medium Sized Business Advancement Corp.

Scale	55 Bil 500 Mil ('85) (won)		
	. traditional arts and crafts Industry selected from the candidates for traditional arts and crafts industrial promotion designated to produce traditional arts and crafts or a prize winner in traditional arts and crafts contest . one approved of the project for developing rural income sources		
banks	The Small & Medium Industry Bank The Citizens National Bank		
financing purpose		facility fund	operation fund
	. modernization	facilities for modernization projects	operation fund for approved modernization projects,
	. business conversion	business conversion projects	conversion projects, and company formation process
	. comapny formation	company formation process (including facility investment overseas purchasing cost	
	. cooperation	- financing for the purchasing of the site or building - construction fund of the site	- the necessary financing for cooperation projects
		- construction fund/financing for the backup facilities such as electricity/ others	- machine installation/antipollution equipments/other common facilities/ including common sector, a separated plant site

Scale	55 Bil 500 Mil ('85) (won)		
	. recommended companies	the financing the purchase of facilities approved by a representative of the Small & Medium Sized Business Advancement Corp.	the necessary operation fund approved by the SMSA
	. the traditional arts and crafts industry	. the purchasing of facilities for the development & production of the traditional arts and crafts	the necessary operation fund for the development and production
	. industries in farming & fishing villages	- construction fund and additional facility financing - the purchasing of machinery - other common facility	the necessary operation fund for the development of income sources in rural areas

	percent	Purpose by sector		
leading		. modernization business . conversion company . formation recommended . local small & medium sized firms	. within 300 mil. (within 90% of the necessary facility fund)	. within 100 mil. (with 50% of the necessary operation fund at a time)
		. cooperation projects	. within 70% of the necessary facility fund (within 90% of the common antipollution facility fund)	. within 50% of the necessary operation fund at a time

Scale		55 Bil 500 Mil ('85)	(won)	
terms		. traditional arts and crafts	. within 50 mil. (with 90% of the necessary facility fund)	. within 50 mil. (within 90% of the necessary operation fund at a time)
		. industries infarming & fishing villages	. within 300 mil. (with 70% of the necessary facility fund)	. within 100 mil. (within 70% of the necessary operation fund at a time)
	period	. facility financing:	within 8 yrs. (including a grace period of 3 yrs.)	
		. operation financing:	within 3 yrs. (including a grace period of 1 yr.)	
	interest rate	. facility financing:	annual 9% (5% for joint purchasing of antipollution facility)	
		. operation financing:	annual 9%	
	repayment method	repayment of equally-divided-semi-aanual-installment after the grace period		
	limit	. 400 mil (300 mil in facility financing, 100 mil in operation financing), no limit for financing for the site, building/common facility		
Others		. selection of candidates/decision of the lending amount: the Small & Medium sized Business Advancement Corp.		
		. the period of application for the loan/within 90 days after the notice for lending		

Source: Korea Advanced Institute of Science and Technology, A Study of the Effect of KTDC's Financing Activities (1986).

Annex C.8
THE TRUST GUARANTEE FUND

eligible industries	. mining industry . manufacturing . electricity and gas . construction . wholesale . transportation and safety deposit . technology services . architecture and design . surveying . the medical and public health industry . repair industry . overseas resources development
types of trust guarantee	. loan guarantee . the second financial guarantee . provision guarantee . tax-payment guarantee . debenture guarantee . bill guarantee . facility-lending guarantee . undertaking guarantee
by type of funds	. operation fund: within 300% of one's own capital, within the operation cost at a time $\times \frac{\text{average score of the achievement test}}{70}$ only, set the operation financing at 1/3 of annual sales amount or at the sales amount during the last 4 months regardless of the business classification, in case of the following: (1) export financing (2) guarantee for companies approved for joint business projects for small and medium sized business systemization in accordance with the Small & Medium sized Business Systematization Act (3) the demand & supply of small & medium sized business trust-guaranted by the mother company of the systemized company

	* the operation fund by type of business (1) Mining, Manufacturing, Electric, Gas, Rail Industry: 1/4 of the annual sales amount, or the sales amount during the last 3 months (2) Construction, wholesale & retail trade, transportation, safety deposit, travel agency, the medical & public health, technology service industry: 1/6 of the annual sales amount, or the sales amount for the last 2 months (3) Others: 1/12 of the annual sales amount or the sales amount for the last month facility fund: within (one's own capital + fixed debts + loan requested - fixed asset) only, in case that a guaranteed facility is obtained as a collateral immediately after its completion and appropriated for the guarantee termination, the requested amount is set at the assessed amount within the necessary cost
guarantee limit	1 bil. won
commission	annual 1.0% (1.5% for large companies) only, repayment in installments is allowed in case the guarantee exceeds 1 bil. won
procedure	requesting companies - counselling - registration credit investigation - examination - decision - notice - contract - certificate issuing - execution
required papers	. an application (with certain format) . basic reference to the business achievements . a written confirmation of the financial transactions . a copy of the business registration card or financial records (of the last 3 quarters) . a registered copy of the residential address of the representative

	. the articles of a company, a registered copy of a corporation, a list of shareholders (applied only to a corporation)
	. others
the small sum-guarantee system	"provisional evaluation standard" is applied in case of a small & medium sized business trust guarantee worth no more than 50 mil.
commissioned guarantee	a small sum of guarantee worth no more than 50 mil is dealt in the pertinent banks
guarantee ratio for small & medium sized business	no less than 40% of the total guarantee * Since 1984, new guarantees are continued to small & medium sized businesses in observance of the operation plan of the Trust Guarantee Funds

Source: Korea Advanced Institute of Science and Technology, A Study of the Effect of KTDC's Financing Activities (1986).

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