

A Finance Model For Small Entrepreneurs: The Planters Bank Experience

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1. Introduction

Planters Development Bank, or Plantersbank (PDB), has been deeply involved with small and medium-sized enterprises (SMEs) for four decades. As in most other countries, SMEs make up an important sector of the Philippine economy: they account for about 90 percent of business firms in the country, they contribute about 25 percent of the Philippines' gross national product, and they provide jobs for about half the labor force.

SMEs are regarded as a lead sector in stimulating economic development, particularly in the countryside, and as a poverty alleviation tool. Yet, although SMEs are important, banks avoid lending to them because they are viewed as risky, costly, and difficult.

Plantersbank has a long history of promoting SMEs, and the bank's experience in this field provides a useful model for other institutions that are seeking a successful formula for SME financing. The bank has overcome many inherent limitations by learning to improvise and develop practical solutions that have effectively surmounted the difficulties inherent in SME financing.

During the past 40 years, the bank has successfully financed more than 15,000 small- and medium-scale projects. This experience has shown that, if handled properly, lending to SMEs can be a rewarding and profitable undertaking. While lending to SMEs, the bank's returns on equity and assets have consistently been better than the average for commercial banks during the two decades prior to the onset of the Asian financial crisis in the late 1990s.

The institution's successful lending to SMEs has gained recognition from various institutions worldwide, and has paved the way for three foreign financial institutions—the Asian Development Bank (ADB), the Nederlandse Financierings-Maatschappij Voor Ontwikkelingslanden N.V. (FMO) or Netherlands Development Finance Company, and most recently, the World Bank through the International Finance Corporation (IFC)—to make investments in the bank. Today, these three institutional partners own up to 40 percent of Plantersbank, and the partnerships with them have brought Plantersbank into close cooperation with national and international government agencies involved in assisting SMEs. The Dutch Government has joined hands with Plantersbank in the establish-

ment of the PDB-FMO Development Center. This company has been responsible for helping set up an SME lending desk in North Yemen and Pakistan, as well as the establishment of a Bankers Training Center in Viet Nam. This same company has been involved in training bankers and investment advisors from Africa, Asia, the Middle East, the Mekong Region, and the Pacific islands. These training programs cover the various aspects of lending to SMEs, from project development to project evaluation, project supervision, and remedial management.

2. The Ingredients of Success

What are the ingredients for the success of Plantersbank in the SME field? First and most important, the bank is primarily committed to providing finance for SMEs. Whereas most banks have an SME lending desk, at Plantersbank the entire organization is focused on SMEs. This allows the bank to understand the unique features, needs, and practices of SMEs. Consequently, Plantersbank has been able to adapt its organization, processes, products, and services to the dynamics of the SME market. Adaptability gives the bank the necessary agility to react rapidly to threats and opportunities, to make fast decisions, and to move cohesively.

Second, the bank is profit driven. During its early years, it took advantage of government subsidies and incentives available to private development banks, such as tax exemptions and lower reserve requirements. While it regards lending to SMEs as a business opportunity, the bank never loses sight of its need to make a profit in order to stay in business. This bottom-line orientation forces the bank to be flexible, adaptable, and able to improvise. It charges interest rates high enough to cover the higher overhead and supervisory cost of lending to smaller accounts, and the higher rates are accepted by the market because of the value-added services the bank provides in addition to financing. The bank makes extensive use of rediscounting facilities and inexpensive funds from government and multilateral funding agencies to keep its interest rates on loans at competitive levels while meeting the long-term financial needs of SME clients.

Third, the bank manages its credit risk using innovative methods. Lending officers have learned to use surrogate indicators of credit risk whenever the borrower's accounting records prove tedious or difficult to reconstruct, or the information needed to evaluate a project too costly to acquire. The bank has a diversified loan portfolio, with loans to SMEs in various industries, including larger accounts and short-term credit. Risk is also reduced by continued bank lending to service the financial needs of SME clients that have matured and grown and could easily avail themselves of the credit facilities of bigger commercial banks. The bank counters the inherent weaknesses of the SME sector by requiring guarantees and collateral to cover its credit exposure. Such guarantees and collateral also serve as a mechanism to instill financial discipline by establishing adequate disincentives for loan defaults.

Fourth, the bank maintains a long-term orientation and developmental perspective. It views its relationship with clients as a long-term partnership and focuses on elements that

build value for clients as well as for bank shareholders. In addition to financial assistance, Plantersbank provides nonfinancial services such as management counseling and bringing clients together with prospective markets and suitable business partners. It is not uncommon for a bank officer to be regarded as a financial advisor by a client, and bank officers sometimes assist in the reconstruction of the client's records, preparation of project feasibility studies, and evaluation of investment options.

Finally, Plantersbank capitalizes on its identified strengths by keeping its operations simple and focused on what it does best. The bank has a customer-oriented culture and organizes its functions in a way that fosters responsiveness and effectiveness in catering to the needs of the SME market. It encourages its employees to know their clients well, and to interact and develop good working relations with them. Although this approach invariably entails additional costs for the bank, the familiarity with prospective projects and borrowers themselves is advantageous over time, because it reduces the cost of monitoring and supervision in the long run.

3. A Formula for 40 Years of Small Enterprise Financing

Plantersbank's formula can thus be summed up as follows: commitment and focus to its defined market, which is the SMEs; profit consciousness to ensure sustainability in its operations; innovative approaches in credit risk management; a long-term developmental orientation; and simplification of operations, while remaining focused on what it does best.

Forty years of successful experience in SME finance has made Plantersbank a recognized leader in this field. In addition, a new venture makes use of the Internet in its efforts to assist SME financing. In June 2000, Plantersbank launched PDB SME Solutions Inc., a joint venture with IFC and Silicon Valley-based e-Vicor, to provide SMEs with web-based business solutions that help them manage their services better, expand their markets, and compete globally. The bank will continue its pioneering approach in building the institutional capabilities of its e-commerce company, to help SMEs develop and grow in the 21st century, and to realize its vision of becoming one of the best-managed banks in the Philippines.