

**ASIAN DEVELOPMENT BANK**

**TAR:PHI 37764**

**TECHNICAL ASSISTANCE**  
(Financed by the Japan Special Fund)

**TO THE**

**REPUBLIC OF THE PHILIPPINES**

**FOR**

**STRENGTHENING SME CREDIT**

**MANAGEMENT SYSTEMS**

**December 2004**

## CURRENCY EQUIVALENTS

(as of 10 December 2004)

Currency Unit	–	peso (P)
P1.00	=	\$0.0178
\$1.00	=	P56.27

## ABBREVIATIONS

ADB	–	Asian Development Bank
DTI	–	Department of Trade and Industry
GFI	–	government-owned financial institution
RA	–	Republic Act
SB Corp	–	Small Business Guarantee and Finance Corporation
SME	–	small and medium enterprise
TA	–	technical assistance

## TECHNICAL ASSISTANCE CLASSIFICATION

<b>Targeting Classification</b>	–	General intervention
<b>Sector</b>	–	Industry and trade
<b>Subsector</b>	–	Small and medium-scale enterprises
<b>Themes</b>	–	Sustainable economic growth; private sector development
<b>Subthemes</b>	–	Promoting economic efficiency and enabling markets; private sector investment

## NOTES

- (i) The fiscal year (FY) of the Government ends on 31 December.
- (ii) In this report, "\$" refers to US dollars.

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## I. INTRODUCTION

1. The Philippine Government has requested the Asian Development Bank (ADB) to provide support for the promotion of small and medium enterprises (SMEs), in conjunction with the implementation of the SME Development Plan 2004—2010. The Government considers development of SMEs as central to employment and income generation and further promotion of a sound and broad-based private sector. ADB's involvement in SME sector policy dialogue has been extensive since 1999 which has facilitated the design of the Philippine Small and Medium-Sized Enterprise Development Support Project, currently under processing. This technical assistance (TA) is integral to the strengthening of risk management in SME finance and the promotion of product innovation by SME financial service providers. This TA has been designed with the full cooperation and participation of the Department of Trade and Industry (DTI) and the Small Business Guarantee and Finance Corporation (SB Corp).<sup>1</sup> Agreement has been reached on the objectives, scope, cost estimates and financing and implementation arrangements, and terms of reference for consulting services under the TA. The project framework is presented in Appendix 1.

## II. ISSUES

2. SMEs represent a vital subsector of the Philippine economy. In 2002, SMEs contributed 32% of value added, and accounted for 8% of business establishments<sup>2</sup> and 31% of total employment. Shares of value added and sales by SMEs have been increasing to 30% and 31%, respectively, in 1998, from 21% and 22% in 1983, and both from 28%, in 1993. The SME sector's direct contribution to manufacturing exports was approximately 24%, but their indirect contribution as suppliers to large exporters is likely much higher.

3. Small enterprises are defined as those with assets valued from P3,000,001 to P15,000,000, while medium enterprises have assets from P15,000,001 to P100,000,000. Using an alternative definition based on number of employees, a small enterprise is one that employs 10 to 99 people, while a medium enterprise employs 100—199 people.<sup>3</sup> SMEs are found in practically all subsectors, though more than 78% are concentrated within a range of traditional product groups: food processing, garments, gifts/toys/handicrafts, metal working, footwear and leather goods, wood and bamboo products, and building materials. There is a high concentration in the National Capital Region, which accounts for more than 24% of all establishments and 40% of all employees.

4. The importance of SMEs to the Philippine economy is reflected in the so-called Magna Carta for SMEs, or Republic Act 6977 (RA) enacted in 1991.<sup>4</sup> The RA lays out broad policy goals related to the SME sector, which include improvement in productivity, upgrading of existing—and introduction of new—technologies, lower costs of doing business, and better access to financing. The RA also launched three major initiatives. First, the SME Development Council was created as the primary body for development of the country's SME sector through policy formulation, interdepartmental coordination, and promotion of programs for SME development. Second, the Magna Carta specified mandatory credit allocations for all banks to SMEs, 6% and 2% of lending to SMEs, respectively. Third, the government-owned financial

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<sup>1</sup> The TA first appeared in *ADB Business Opportunities* (Internet edition) on 17 December 2003.

<sup>2</sup> There were 825,000 registered businesses in the Philippines in 2001, of which 62,000 are considered small and 2,900 medium. Of the remaining 92% of registered businesses, practically all are microenterprises.

<sup>3</sup> SME Development Council Resolution 1, 16 January 2003, and Bangko Sentral ng Pilipinas Circular 376, 20 March 2003.

<sup>4</sup> RA 6977 was enacted in 1991 and amended in 1997 by RA 8289.

institution (GFI), SB Corp, was created to provide SME finance nationwide at better terms than banks could offer, i.e., by offering loans in smaller amounts, often with longer maturities, and based on more flexible collateral requirements.

5. In July 2004, President Arroyo announced a 10-point agenda of reforms for her 6-year term. The first item is the creation of at least 6 million jobs in 6 years through supporting SME development by tripling of credit available to SMEs, developing land for agricultural business, and stimulating entrepreneurship. The Government also presented the SME Development Plan 2004—2010, a comprehensive sector development plan to be implemented by concerned Government agencies in partnership with the private sector and external funding agencies. The SME plan is the result of numerous inputs from DTI, SME Development Council, and industry associations in the Philippines as well as external agency-funded studies and TA.<sup>5</sup> With the implementation of this plan the Government projects that SMEs' gross value added will increase to 48% of the total, and that SME exports will grow by 16% annually.

6. While the Philippine financial sector weathered the Asian financial crisis comparatively well, SMEs suffered significant adverse effects in terms of availability of and access to finance. Despite relatively high levels of liquidity, rising levels of non-performing loans and a deteriorating business environment have led to a reduction in lending by Philippine banks. Domestic credit to the private sector as a share of gross domestic product decreased from 62% in 1997 to 34% in 2003. Of total bank lending in 2003, 10.8% was channeled to the SME sector, a decline from 13% in 2002.<sup>6</sup> SME lending has accounted for at least 11.8% of annual gross lending since 1998. In 2003, loans to small and to medium enterprises accounted for 5.6% and 5.2% of gross loans, respectively. This is lower than in comparable countries in the region such as Indonesia, where lending to small enterprise (with 5 to 20 employees ) was 17% of gross loans in both 2002 and 2003. Alternative formal sources of funding are limited for SMEs. The equity and bond markets are small in relation to the economy<sup>7</sup> and SMEs cannot meet the requirements for tapping these markets. Venture capital and lease financing are also limited. Small enterprises in particular tend to rely more on informal sources of finance, which can be more costly and far less stable than a bank credit line, regarding interest and repayment terms.

7. In response to the dramatic reduction in credit available to SMEs, the Government, in 1999, authorized two GFIs, SB Corp and Trade and Investment Development Corporation of the Philippines (PhilEXIM), to lend directly (retail) to SMEs. Until then, SB Corp had offered guarantees and loans to SMEs on a wholesale basis via accredited financial institutions. SB Corp's current mandate is to support viable SMEs that cannot access bank finance due to banks' stringent requirements, including those for collateral. Using its own offices as well as the DTI's regional offices and bureaus to disseminate information on both its retail and wholesale lending operations and guarantee programs, SB Corp aims to reach SMEs nationwide.

8. SB Corp has become a major innovator in the field of SME finance. It plays mainly a catalytic role by promoting SME lending through wholesale operations with commercial and thrift banks, on the one hand, while also experimenting with retail lending, on the other. SB Corp is

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<sup>5</sup> ADB. 1999. *Strengthening Export Competitiveness*. Manila (TA 3345 for \$1 million); and ADB. 2002. *Program to Accelerate Small and Medium Enterprise Financing*. Manila (TA 4070 for \$400,000). The Japan International Cooperation Agency provided advisory TA to draft the SME Development Plan.

<sup>6</sup> The upward adjustment of the asset-size ceiling of medium enterprises in 2001 from P60 million to P100 million made it easier for the commercial banks to directly comply with SME credit allocation.

<sup>7</sup> The total market capitalization of the Philippine Stock Exchange was 23.6% of GDP in 2003.

well capitalized and profitable. Its nonperforming loans,<sup>8</sup> at present amount to slightly more than 10% of its overall portfolio, a level that is substantially below the average for commercial banks. SB Corp has an opportunity, if it can both substantially increase its lending activities and improve the efficiency of its operations, to provide a powerful demonstration to the market about the profitability of SME lending. Most of the clients served through both its wholesale and retail operations represent smaller, but still viable SMEs that cannot otherwise access commercial sources of funding due to the combination of the failure of commercial banks to serve the market, and the difficulty in providing sufficient collateral that may be legally pledged.

9. SB Corp is a pioneer in using nontraditional collateral as security for SME loans, accepting as collateral a broader range of assets and at higher values than do banks. Collateral is taken as a sign of seriousness by both borrower and lender, mirroring standard microlending underwriting techniques. Legal enforcement is not an option, and the collateral must be surrendered voluntarily. Philippine banks rarely accept as collateral anything other than titled prime real estate. Collateral, therefore, is a key constraint to greater access by SMEs to bank financing. It is necessary to create a solid legal foundation under nontraditional collateral so that commercial banks, seeing a demonstrable profit opportunity, will serve the SME market on a secured basis. Nontraditional collateral essentially means movable property. At present, there is no way to perfect legally a security interest in movable property, and there is no movable collateral registry. This represents a significant legal gap in the secured transactions framework, and one that impacts SMEs disproportionately.

10. SB Corp's management has discovered (as have many other lenders in many places) that there is no clear correlation between the kind and quality of collateral offered to a lender and loan default. That means that loan underwriting techniques that do not rely on traditional collateral are highly relevant in the Philippines context. Micro and small enterprise (MSE) lending based upon evaluations of borrower character and capacity is an example of a successful "nontraditional" lending technique, though often, microfinance institutions (MFIs) do require MSE borrowers to provide collateral, despite the fact that the legal basis for securing or seizing collateral may be weak. Experiments in other countries have shown that MSE lending techniques, appropriately modified, can be applied prudently in small business lending as well.

11. In general, SMEs find it difficult to submit proper (let alone) audited financial statements, or to prepare business plans with sales and revenue projections that meet banks' requirements. Newer SMEs tend to rely on own funds, relatives, or expensive informal finance providers due to the difficulties of accessing formal finance. DTI has recognized this situation and offers counseling and some assistance through its SME Centers. In addition, a number of donors, including Deutsche Gesellschaft fur Technische Zusammenarbeit (German Agency for Technical Cooperation), and the Canadian International Development Agency are active in providing business development services to SMEs throughout the country. On the financing side, both Kreditanstalt fur Wiederaufbau and the International Fund for Agriculture and Development are considering lending to SB Corp.

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<sup>8</sup> Actual nonperforming loans, as of year-end 2003, amounted to 10.3% of total wholesale and retail lending. SB Corp's allowances for loan losses are presently 202% of these nonperforming loans, meaning there is more than adequate coverage of the potential losses from SB Corp's lending activities.

### **III. THE TECHNICAL ASSISTANCE**

#### **A. Purpose and Output**

12. The goal of the TA is to promote financial deepening by expanding SMEs' access to credit. The purpose is to expand and improve the quality of lending operations of SB Corp, while lowering risk, and mainstreaming market acceptance of nontraditional collateral. Outputs will include:

- (i) Enhanced management information system (MIS) and analysis of lending operations at SB Corp, based on line of business reporting;
- (ii) Updated/redesigned SME loan products incorporating cash flow, character, and nontraditional collateral into underwriting;
- (iii) Credit scoring model for SB Corp's retail lending; and
- (iv) Blueprint for movables collateral registry.

#### **B. Methodology and Key Activities**

13. The TA aims to expand SB Corp's outreach and improve its financial performance, providing a powerful demonstration effect in the loan market, while at the same time expanding the scope for secured transactions in such a way that more SMEs can access commercial sources of credit. The outputs will be achieved through the provision of consulting services, focused on activities in two key areas.

##### **1. Institutional Capacity Building at Small Business Guarantee and Finance Corporation**

14. The TA will provide international expertise to SB Corp managers and staff in support of building efficient, profitable lending businesses that can achieve substantial outreach. SB Corp needs to strengthen its capacity to evaluate the profitability, credit risk, costs, and efficiency of both its wholesale and retail lending operations. The first key output of the TA will be the enhanced capacity to analyze costs, profitability, and credit risk in each of its two main lines of business. MIS will be improved as part of this process, utilizing its Oracle-based system recently put into place.

15. The second priority is to examine the retail loan underwriting process. SB Corp currently has a more flexible approach to securing its loans, and accepts a broader range of collateral, than do Philippine commercial banks. The TA will provide a specialist in loan product development to work with SB Corp management to ensure that appropriate non-asset-based lending methodologies are incorporated into their underwriting process. To the extent practicable, those underwriting techniques should allow pledged items that could be secured via a registry of movable property to be accepted as collateral. The objective in this effort is to minimize paperwork, processing times, and transaction costs, and to expand lending volumes.

16. Third, the TA will assist SB Corp to develop a proprietary credit scoring model that will incorporate SB Corp's own underwriting standards, and draw upon lessons learned from its own lending experience. A credit scoring model is a powerful way in which financial institutions can streamline the processing of loans, and thereby increase the volume of their business. It is also the purpose of the credit scoring model to select out borrowers with poor risk profiles by evaluating key factors impacting payment performance. SB Corp's database of retail customers

provides an appropriate starting point for identifying key factors affecting credit quality, and this direct customer experience is necessary to incorporate into a credit scoring model that fits SB Corp. As a result of these two activities, reviewing underwriting policies and procedures and developing a credit scoring model, loan products may be streamlined or redesigned so as to be better tailored to SB Corp's clients, and be more profitable as well.

## **2. Enhancing Legal Environment for Secured Transactions**

17. The TA will create the blueprint for a movable collateral registry. The blueprint encompasses a review of existing laws and recommendations related to potential amendments and/or new legislation that might be required to expand the framework for secured transactions to encompass movable property. In addition, it will be necessary to outline a strategy for bringing the collateral registry into being, which will involve identifying and working with the key stakeholders, from both the public and private sectors, who will oversee the creation of the registry, maintain it, and use it. The output will be a time-bound action plan for creating the movable collateral registry.

### **C. Cost and Financing**

18. The estimated cost of the TA is \$718,500, comprising \$410,000 in foreign exchange and \$308,500 equivalent in local currency. The Government has requested ADB to provide \$500,000 equivalent to finance the entire foreign exchange cost and \$90,000 in local currency costs. The TA will be financed on a grant basis by the Japan Special Fund, funded by the Government of Japan. The Philippine Government will provide the remaining \$218,500 equivalent in kind in the form of office accommodation, counterpart staff, transportation expenses, and training. Detailed cost estimates and a financing plan are in Appendix 2.

### **D. Implementation Arrangements**

19. DTI will be the Executing Agency for the TA. SB Corp will be the implementing agency for activities related to its own institutional capacity building. Individual consultants will be recruited by ADB in accordance with its *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB for the engagement of domestic consultants. The TA consultants working at SB Corp will report directly to the implementing agency project manager designated for the specific consulting assignment, as well as to the ADB project officer.

20. Three international consultants will serve for a total of 14 person-months. They will include a bank financial management expert (2 person-months), a loan product development specialist (4 person-months), and a credit scoring expert (8 person-months). One domestic consultant, a secured transaction legal expert, will serve for 10 months. Appendix 3 presents the outline terms of reference for the consultants. The TA is expected to begin in March 2005 and to be completed by February 2006.

## **IV. THE PRESIDENT'S DECISION**

21. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$500,000 on a grant basis to the Government of the Philippines for Strengthening SME Credit Management Systems, and hereby reports this action to the Board.

## TECHNICAL ASSISTANCE FRAMEWORK

Design Summary	Performance Indicators and Targets	Monitoring Mechanisms	Assumptions and Risks
<p><b>Goal</b></p> <ul style="list-style-type: none"> <li>Promote financial deepening by expanding SMEs' access to credit</li> </ul>	<ul style="list-style-type: none"> <li>Increased lending to SMEs, in terms of both overall volume of loans, and numbers of SMEs serviced. Key indicators:</li> <li>250% increase in numbers of SMEs receiving loans through combined wholesale and retail operations of SB Corp by year end 2009.</li> </ul>	<ul style="list-style-type: none"> <li>SB Corp reports</li> <li>BSP reports</li> </ul>	
<p><b>Purpose</b></p> <ul style="list-style-type: none"> <li>Expand lending operations of SB Corp, while lowering risk, and mainstreaming market acceptance of nontraditional collateral</li> </ul>	<ul style="list-style-type: none"> <li>Performance and output indicators to include:</li> <li>ROA of no less than 2.5% for SB Corp overall, and also for individual retail and wholesale lines of business from FY 2005 through 2009;</li> <li>NPLs as % of total lending not to exceed 8% by end FY 2009, and ratio of NPLs to Provisions not to exceed 135% over the period of 2005-2009, and not exceed 100% by FYE 2009;</li> <li>Wholesale lending portfolio to increase by not less than 300% over the period FY 2005 to 2009;</li> </ul>	<ul style="list-style-type: none"> <li>SB Corp reports</li> </ul>	<p><b>Assumptions</b></p> <ul style="list-style-type: none"> <li>SB maintains focus on SME lending</li> <li>Continued high demand for credit by SMEs who do not have traditional collateral to offer</li> </ul> <p><b>Risk</b></p> <ul style="list-style-type: none"> <li>Major financial crisis impacts demand for credit</li> <li>Loan is delayed or cancelled.</li> </ul>

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Design Summary	Performance Indicators and Targets	Monitoring Mechanisms	Assumptions and Risks
	<ul style="list-style-type: none"> <li>• Retail lending portfolio to increase by not less than 250% over the period FY 2005-2009;</li> <li>• Capital Adequacy Ratio not less than 10% from 2005 through FYE 2009</li> <li>• Data providing loan classification by collateral type</li> </ul>		
<p><b>Outputs</b></p> <ul style="list-style-type: none"> <li>• Enhanced MIS and analysis of lending operations at SB Corp, based on line of business reporting</li> <li>• Updated/redesigned SME loan products incorporating cash flow, character, and nontraditional collateral into underwriting</li> <li>• Credit scoring model for SB Corp's retail lending</li> <li>• Blueprint for movables collateral registry</li> </ul>	<ul style="list-style-type: none"> <li>• MIS system produces financial reports by business (wholesale, retail, guarantee operations), showing revenue, costs, and profitability by line of business; SB Corp managers trained in financial/business analysis</li> <li>• New products successfully introduced to the market, complementing existing products</li> <li>• Retail loans approved based upon scoring model (judgmental), and staff trained to continuously monitor and enhance model</li> <li>• Key stakeholders reach consensus on necessary steps</li> </ul>	<ul style="list-style-type: none"> <li>• SB Corp reports</li> <li>• TA reports</li> <li>• SB Corp reports</li> <li>• SB Corp reports</li> <li>• Consultants' reports</li> <li>• TA review missions</li> </ul>	<p><b>Assumptions</b></p> <ul style="list-style-type: none"> <li>• Continued management and staff buy-in to overall purpose</li> <li>• Oracle system can accommodate new reporting requirements</li> <li>• Key stakeholders can be assembled to determine next steps for developing movable collateral registry</li> <li>• Consultant TORs are appropriate, consultants are effective, ADB staff has capacity to provide leadership</li> </ul> <p><b>Risks</b></p> <ul style="list-style-type: none"> <li>• Inadequate staff training in support of new product initiatives and credit scoring model</li> <li>• Lack of consensus on how to proceed with movables collateral registry and/or outright opposition to the effort</li> </ul>

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Design Summary	Performance Indicators and Targets	Monitoring Mechanisms	Assumptions and Risks
	for implementing movable collateral registry	<ul style="list-style-type: none"> <li>• Ongoing consultations</li> </ul>	
<b>Activities</b> <ul style="list-style-type: none"> <li>• Consulting services provide analysis, recommendations, ongoing consultation, and on-the-job training</li> </ul>	<ul style="list-style-type: none"> <li>• Terms of Reference met and TA funds fully disbursed</li> </ul>	<ul style="list-style-type: none"> <li>• Ongoing consultation with SB Corp</li> <li>• Consultants' reports</li> <li>• ADB TA review missions</li> </ul>	<b>Assumptions</b> <ul style="list-style-type: none"> <li>• Appropriate consultants can be identified and recruited</li> <li>• TA financial resources are adequate</li> </ul>
<b>Inputs</b> <ul style="list-style-type: none"> <li>• Estimated cost of the TA is \$718,500, comprising \$470,000 in foreign exchange and \$248,500 equivalent in local currency</li> </ul>			

ADB = Asian Development Bank, BSP = Bangko Sentral ng Pilipinas, FY = fiscal year, FYE = fiscal year end, MIS = management information system, SB Corp = SB Corporation, SME = small and medium enterprise, TA = technical assistance, TOR = terms of reference.

**Table A2.1: COST ESTIMATES AND FINANCING PLAN**  
(\$)

<b>Item</b>	<b>Foreign Exchange</b>	<b>Local Currency</b>	<b>Total Cost</b>
<b>A. Asian Development Bank Financing<sup>a</sup></b>			
1. International Consultants			
a. Remuneration and Per Diem	360,000		360,000
b. International Travel	20,000		20,000
2. Local Consultants		30,000	30,000
3. Miscellaneous Administrative and Support Costs <sup>b</sup>	25,000		25,000
4. Contingencies	65,000		65,000
<b>Subtotal (A)</b>	<b>470,000</b>	<b>30,000</b>	<b>500,000</b>
<b>B. Government Financing</b>			
1. Office Accommodation and Transport		5,000	5,000
2. Remuneration and Per Diem of Counterpart Staff		50,000	50,000
3. Transportation		5,000	5,000
4. Staff Training <sup>c</sup>		130,000	130,000
5. Contingencies		28,500	28,500
<b>Subtotal (B)</b>		<b>218,500</b>	<b>218,500</b>
<b>Total</b>	<b>470,000</b>	<b>248,500</b>	<b>718,500</b>

<sup>a</sup> Funded by Japan Special Fund, funded by the Government of Japan.

<sup>b</sup> Items such as local transportation, communications, equipment, etc. will not be funded by ADB.

<sup>c</sup> Funded by SB Corp.

Source: Asian Development Bank staff estimates.

## **OUTLINE TERMS OF REFERENCE FOR CONSULTANTS**

1. A team of three international experts will be recruited to assist Small Business Guarantee and Finance Corporation (SB Corp) to further develop and refine their wholesale and retail lending business models, and to improve technical skill levels of their staff. The international experts will provide consulting services for 14 person-months. One domestic expert will provide assistance to the Department of Trade and Industry, working in consultation with the Ministry of Justice, to develop the blueprint for a movable collateral registry, for 10 person-months. There will be no team leader, per se, and each of the specialists will report directly to the Asian Development Bank (ADB) project officer, as well as to their designated implementing agency counterpart.

### **A. International Experts**

#### **1. Bank Financial Management Expert (2 person-months)**

2. The expert will have at least 15 years experience as a bank manager, with particular expertise in the management of lending operations, and have had significant “bottom line” responsibility. In addition she or he will have a strong background in accounting and finance. Experience in strategic planning is highly desirable, and the expert will be able to demonstrate how to allocate specific costs and revenue streams to products, and/or lines of business, and determine profitability on product and departmental bases. Specifically, the bank financial management expert will:

- (i) review SB Corp’s lending operations, and provide their management with a detailed financial analysis, including profitability analysis, of the wholesale and retail lending businesses. In addition, she or he will provide financial comparisons to institutions operating in comparable markets (e.g., Indonesia, Thailand) that might serve as appropriate benchmarks for SB Corp’s small and medium enterprise (SME) lending operations;
- (ii) assist SB Corp to develop line of business reporting structures so that revenues, costs, and profits can be appropriately allocated and evaluated on both product and departmental (or divisional) bases; and
- (iii) advise management on best practices in evaluating product profitability based upon return on capital parameters, and, together with SB Corp management, develop analytical tools for determining minimum loan pricing levels and projecting loan profitability to be used during initial loan underwriting (pre-disbursement).

#### **2. Loan Product Development Specialist (4 person-months)**

3. The specialist will have at least 10 years experience in SME/retail lending, with substantial banking operations experience, and have proven ability in the design of loan products for SMEs. Product design is understood to encompass underwriting policies and procedures, determination of appropriate marketing/delivery channel(s), and costing and pricing. The loan product development specialist will:

- (i) review SB Corp's retail lending operations, including loan products; underwriting parameters, policies and procedures; organizational structure; staff skill levels; and experience in retail SME and micro and small enterprise (MSE) lending;
- (ii) identify areas in which underwriting processes, policies, procedures, and loan products can be streamlined or improved so as to lower risk while increasing lending volumes, based upon best practices developed in other markets, including MSE lending markets, that are appropriate to SB Corp. It may be useful and character, and thus providing SMEs with an opportunity to develop a positive credit history. The use of microfinance underwriting techniques modified for the SME market might allow many SMEs to overcome the lack of the kind of collateral that Philippine bankers traditionally demand, and that effectively excludes the majority of small firms from bank financing;
- (iii) assist SB Corp management, wherever appropriate and practicable, to redesign, streamline, or otherwise improve its loan product offerings in order to ensure that there is a clear match between each loan products' features with the needs of the SME client, in other words, that the loan products are fully responsive to SME needs and conditions. The Loan Product Development Specialist may be required to assist in the pilot testing of new lending products. All of these efforts may require that the Loan Product Development Specialist also provide assistance and advice in improving and/or simplifying loan applications, as well as in loan underwriting and processing procedures;
- (iv) organize workshops and presentations to discuss and disseminate findings and recommendations, and prepare a brief report that analyzes SB Corp's lending products and/or lending policies and procedures; and
- (v) evaluate the present staff skill levels and recommend specific areas in which additional staff training is needed, particularly in the areas of underwriting, credit analysis, product delivery, and product design.

### **3. Credit Scoring Expert (8 person-months)**

4. The Credit Scoring Expert will have at least 15 years' experience in banking, have advanced training in statistics and statistical analysis, and have built and tested credit scoring systems for commercial banking or other commercial lending operations. The specialist will be called upon to create a credit scoring model that will be fully proprietary to SB Corp and ADB. The credit scoring expert will:

- (i) determine a strategy for the development of a credit scoring model (either statistical or judgmental) in consultation with management of SB Corp, then prepare a detailed, time-bound action plan, including all human resource requirements, for developing, testing, and introducing a credit scoring model. As the model is likely to have product-specific features, the process of creating the scoring model should build upon and be coordinated with the work of the loan product development specialist;
- (ii) working with SB Corp's own computer and lending specialists, create a robust and user-friendly credit scoring model that will enable SB Corp to increase lending volumes while at the same time minimizing client selection risk. To the

extent possible, use existing software platforms already licensed to SB Corp, and consider closely the requirements and limitations of the end-users, namely, account officers of SB Corp who will not have specialized computer training;

- (iii) advise on proper methods for maintaining model integrity and carrying out periodic analysis of model results, and ensure that SB Corp has sufficient staff trained to support, diagnose, and enhance the credit scoring model, including recommending specialized training for key SB Corp staff;
- (iv) prepare a full set of documentation (user's manual) for the credit scoring model, and provide copies of all necessary computer files, software programs, etc. to make the model operable; and
- (v) prepare a brief final report for SB Corp and ADB summarizing the activities undertaken to create the credit scoring model, and recommending how the model should be used, and potentially enhanced and adapted to other products.

**B. Domestic Expert: Legal Expert in Secured Transactions (10 person-months)**

5. The Legal Expert in Secured Transactions will be a lawyer with at least 15 years' experience working in close proximity to the financial services industry in the Philippines, and possess a thorough knowledge of banking practices and banking law. She or he will have an intimate knowledge of the legal environment as it relates to secured transactions and a deep understanding of the legislative process. The expert will ideally have experience in drafting legislation related to banking and/or the financial sector. International experience working in the area of secured transactions would be very advantageous. The legal expert will:

- (i) undertake a review of the environment for secured transactions in the Philippines, and prepare a detailed analysis of the legal issues related to existing legislation that impacts secured transactions and indicate legal gaps to the creation of a movable collateral registry that must be filled by new legislation;
- (ii) determine a strategy for the development of enabling legislation for a movable collateral registry; define the path that such legislation would have to take to passage, indicating significant obstacles, legal and otherwise, that would have to be overcome; and identify key agencies and stakeholders that would have to be involved in the creation of a movable collateral registry;
- (iii) manage a dialogue with key stakeholders, including the Department of Trade and Industry, Ministry of Justice, and ADB, on issues related to the creation of a movable collateral registry, and to the extent possible, forge a broad consensus among these stakeholders around a time-bound action plan for creating the registry.