The guidelines formally adopted by the Independent Evaluation Department on avoiding conflict of interest in its independent evaluations were observed in the preparation of this report. To the knowledge of the management of Independent Evaluation Department, there were no conflicts of interest of the persons preparing, reviewing, or approving this report.

In preparing any evaluation report, or by making any designation of or reference to a particular territory or geographic area in this document, the Independent Evaluation Department does not intend to make any judgment as to the legal or other status of any territory or area.
Abbreviations

ADB – Asian Development Bank
BSP – Bangko Sentral ng Pilipinas
CIB – credit information bureau
CIC – Credit Information Corporation
DSLC – domestic standby letter of credit
MCO – Moody’s Corporation
PCG – partial credit guarantee
PFI – participating financial institution
PSOD – Private Sector Operations Department
RRP – report and recommendation of the President
SBC – Security Bank Corporation
SMEs – small and medium-sized enterprises
URC – Universal Robina Corporation

Currency Equivalents

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Acknowledgments

A team from the Independent Evaluation Department contributed to this study, including analysis, desk reviews, interviews, and research. The core team included Nathan Subramaniam (team leader), Noel Gamo, Irene Garganta and Royston Brockman (consultant).

The report benefited from the guidance of Vinod Thomas, Director General, Independent Evaluation Department and Bob Finlayson, Director, Independent Evaluation Division 2.

The team would like to thank ADB staff and Security Bank Corporation who were interviewed for their time and inputs.
Basic Data

Small and Medium Enterprise Development Support Project (GU7218)

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<th>Key Project Data</th>
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<td>Allocated to SBC b</td>
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<td>Loan to SB Corporation c</td>
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<tr>
<td>Equity investment in the CIB</td>
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a Converted using the foreign exchange rate of P47.43 on the signing date (26 April 2007) of the Guarantee Facility Deed with SBC.

b 50% of the approved PCG facility was allocated for the SME financing operations of SBC: P500 million out of the P1 billion facility.

c The loan to SB Corporation was disbursed as a complementary facility under ADB’s public sector lending operations and supported by a guarantee from the Republic of the Philippines. The loan to SB Corporation is not reviewed in this report.

Key Dates

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<td>Loan agreement</td>
<td>26 April 2007</td>
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<td>PCG effective date</td>
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<tr>
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<td>Extended annual review report</td>
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PCG = partial credit guarantee, PFI = participating financial institution, SBC = Security Bank Corporation.

Project Administration and Monitoring

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N/A = not available.
Executive Summary

In August 2005, the Asian Development Bank (ADB) Board of Directors approved a partial credit guarantee (PCG) facility of P1 billion, a $25 million equivalent loan guaranteed by the Republic of the Philippines to the Small Business Guarantee and Finance Corporation, and an equity investment of up to $1 million in a proposed credit information bureau (CIB) that was to be established by the government. These facilities were part of ADB’s Small and Medium Enterprise Development Support Project.

This project performance evaluation report reviews the nonsovereign components of the above project involving the provision of a PCG to one financial institution to support its lending to small and medium-sized enterprises (SMEs) and a proposed equity investment in a CIB. The rationale and objectives of both components were to improve the enabling environment for SMEs and their ability to access finance.

The PCG facility was a revolving local currency, credit-enhancement facility designed to support participating financial institutions (PFIs) lending to SMEs. The facility was set up to guarantee agreed credit risk amounts associated with PFIs’ portfolios of loans and other credit exposure to their SME borrowers. In September 2006, ADB approved Security Bank Corporation (SBC) as the first and only PFI under the PCG facility, with ADB and SBC operating on a 50–50 loss-sharing basis. The SBC facility was for P500 million (50% of the total PCG amount), of which P100 million was allocated to Universal Robina Corporation (URC). All transactions for URC distributors were structured as domestic standby letters of credit. The first transaction to URC was made in January 2008. The maximum utilization of P98.8 million was achieved in February 2010, and the last transaction matured in February 2011. No default or invocation of ADB’s guarantee has been recorded.

In February 2011, ADB cancelled the unallocated balance of the P500 million PCG facility and the proposed $1 million equity investment in the CIB. The PCG facility was terminated in April 2012 at the end of the availability period due to the low level of utilization. The equity transaction was cancelled because the established corporation deviated from the ownership structure and oversight arrangements originally approved by ADB’s Board. At the time of ADB Board approval, it had been envisaged the equity investment would be made to a nonsovereign entity, but the credit bureau was established by the government as a majority state-owned enterprise, and was ineligible for ADB’s nonsovereign funding.

The project is rated unsuccessful overall, based on unsatisfactory ratings for its development impact and outcome and ADB work quality, and a less than satisfactory rating for ADB investment profitability and ADB additionality.

The development impact and outcome of the project is rated unsatisfactory based on component ratings for private sector development; business success;
contribution to economic development; and environmental, social health, and safety performance. The facility's overall effect on private sector development is rated unsatisfactory since the expectation that it would be utilized by a number of PFIs, cover a range of SMEs across sectors, and support different financial instruments was not realized. Only half of the facility (P500 million) was allocated to only one intermediary (SBC), which financed smaller distributors of one food manufacturer for up to P100 million. The investment in the CIB never took place. The project's business success is rated less than satisfactory since less than 10% of the allotted funds were utilized. The PCG facility impacted a select few SMEs, which is a positive accomplishment. However, given the small size of the facility relative to SBC and its limited utilization by SBC, its impact on SMEs by improving access to finance was minimal. Economic sustainability is rated unsatisfactory for the same reasons. Although it is possible, the intervention could have generated some new jobs, its limited scale made a minimal contribution to the local economy. On environmental, social, health, and safety performance, ADB's investment is rated satisfactory given SBC's compliance with environmental standards, practices and procedures, involuntary resettlement, and indigenous peoples' safeguards.

Although there were no defaults or invocation of ADB’s guarantee, the investment profitability based on average utilization and relative to capital allocation requirements is rated less than satisfactory.

ADB's work quality is rated unsatisfactory based on component ratings for screening, appraisal, and structuring of the project, monitoring and supervision, and ADB's role and contribution. ADB's performance in screening, appraisal, and structuring is rated unsatisfactory because of the low utilization (only one intermediary participated in the project) and the fact that ADB did not implement the first loss provision in the guarantee agreement. The shortfalls in monitoring and supervision of the facility are illustrated by the lack of new PFIs being selected and its low utilization. There was considerable delay in following up the request of SBC to increase its allocation to URC, which contributed to underutilization. The constant changing of ADB staff contacts meant there was no real continuity of supervision. Since overall monitoring and supervision was not proactive in detecting problems or issues, it is rated unsatisfactory. ADB’s role and contribution is rated less than satisfactory. Efforts to raise awareness and use of the facility by other Philippine banks and other clients of SBC were below expectations. No additional intermediaries were identified prior to approval, leading to considerable underutilization of the project.

ADB's additionality is rated less than satisfactory. This rating would have been higher if the facility had been adopted by at least a few PFIs or benefited a wider set of SME clients of SBC.

The assessment offers these lessons:

(i) More work should have been undertaken to establish an adequate pipeline of PFIs at the outset.

(ii) Pricing needs to be market related and fully reflect project risks. Where market comparators do not exist, more exhaustive studies and analyses of the effective demand for guarantees should have taken place.
The impact of ADB staff changes on the monitoring process was underestimated. Although the need for effective monitoring was stressed in the report and recommendation of the President (RRP), its outcome was far from satisfactory.

Better due diligence of the financial intermediary for the PCG should have taken place as ADB neither fully considered SBC’s risk rating process nor understood its processes and procedures.

Better due diligence should have been undertaken for the proposed equity investment in the CIB, and the risks of the government establishing a state-owned corporation, rather than a private corporation adequately flagged in the RRP, to avoid unnecessarily locking up ADB headroom.

Recommended actions for future projects:

(i) ADB should improve its due diligence and screening, and identify, select, and sign up a number of PFIs before approval.

(ii) ADB transactions should be made more replicable, and ADB should grant more autonomy in decision making to the PFIs, establish there is sufficient demand for the proposed project, adopt more rigorous market-based pricing, and encourage its wider use to cover guarantees for term lending by SMEs as well as for covering domestic standby letters of credit.

(iii) ADB needs to improve its monitoring of project implementation and be more flexible in responding to changes needed during project implementation.
A. Project Background

1. In August 2005, the Asian Development Bank (ADB) Board of Directors approved a partial credit guarantee (PCG) facility of P1 billion, a JPY2.75 billion ($25 million equivalent) loan guaranteed by the Republic of the Philippines to the Small Business Guarantee and Finance Corporation, and an equity investment of up to $1 million in a proposed credit information bureau (CIB). These facilities were part of ADB’s Small and Medium Enterprise Development Support Project, which responded to a request from the Government of the Philippines for assistance in implementing its small and medium-sized enterprise (SME) development plan, 2004–2010.1

2. Prior to this approval, ADB had financed a project preparatory technical assistance in 2003 to assess the status of SMEs in the Philippines, which included an analysis of the government’s development policies and actions, and the issues and constraints facing the SME sector. The study found that despite SMEs’ vital contributions to the economy, their effective operations and growth were constrained by poor access to finance.2

3. This project performance evaluation report is concerned with the private sector component of the Small and Medium Enterprise Development Support Project, which involved providing PCGs for one financial institution to support its lending to SMEs and the proposed equity investment in a CIB, which was cancelled in February 2011. Appendix 1 contains the project highlights and additional details on its implementation.

B. Key Project Features

4. The PCG facility was a revolving local currency, credit-enhancement arrangement designed to support participating financial institutions (PFIs) in the Philippines. The facility was set up to guarantee agreed credit risk amounts associated with PFIs’ portfolios of loans and other credit exposure to their SME borrowers, who were selected according to specified criteria.

5. The PCG facility was an innovative instrument that was designed to enhance the capacity of ADB’s private sector loan and credit facilities and to provide innovative

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risk transfer arrangements for SMEs in the Philippine banking system. The PCG facility was based on the concept of ADB risk participation with PFIs to stimulate lending to SMEs. ADB and PFI recourse was limited to the underlying guaranteed portfolio of SME loans, and not to the PFIs’ balance sheets. Under the facility, ADB set a limit of P1 billion to be allocated among selected PFIs, two to five were originally targeted. The financial structure was based on a 50–50 risk-sharing arrangement between ADB and the selected PFIs, who were required to cover the remaining risk of up to P1 billion. Other features of the facility are contained in Appendix 1.

C. Progress Highlights

6. In September 2006, ADB’s guarantee committee approved the inclusion of Security Bank Corporation (SBC) as its first PFI under the PCG facility, with ADB and SBC operating on a 50–50 loss-sharing basis. The guarantee agreement between ADB and SBC was signed in April 2007, 1 year after Board approval of the project. The PCG facility for SBC was approved for a maximum amount of P500 million (50% of the total PCG amount), of which P100 million was allocated to Universal Robina Corporation (URC) as the principal for its distributors. Participants were URC’s branded distributors, which were locally incorporated SMEs with sales turnover not exceeding P1 billion per year.

7. ADB and SBC completed all documentation and compliance requirements in the second half of 2007. The first transaction under the facility took place in January 2008, and utilization increased to its maximum level of P98.8 million (of a P100.0 million limit) in February 2010. Thereafter, no new clients were added, and utilization dropped with the maturity or expiry of underlying exposures. The last transaction matured in February 2011. Under the P100 million limit for URC distributors, 16 qualifying SME URC wholesalers received credit. As of the termination date of the facility on 26 April 2012, 65 qualifying instruments—domestic standby letters of credit (DSLCs) amounting to P430 million—had been issued by SBC, with 50% of the credit exposure guaranteed by ADB. No default or invocation of ADB’s guarantee was recorded. In February 2011, nearly 3 years after the first transaction with SBC, the Private Sector Operations Department (PSOD) cancelled the unallocated balance of P500 million. The PCG facility was terminated in April 2012 at the end of the availability period.

8. The proposed $1 million equity investment in the CIB was also cancelled in February 2011 because the corporation established by the government was a majority

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3 URC is a major food manufacturer in the Philippines and has a key market position in the domestic snack and beverage business. URC has an extensive network of wholesale distributors, which are usually accredited after a rigorous assessment as exclusive agents for warehousing and distributing URC products in specified geographical areas. These distributors supply retail outlets.
The Project

state-owned enterprise, which deviated from the structure originally approved in the report and recommendation of the President (RRP).4

9. The extended annual review prepared by the PSOD in April 2012 assessed impact of the PCG facility to be less than satisfactory.5 This result was based on less than satisfactory ratings for development impact, ADB investment profitability, and ADB work quality. ADB’s additionality assessment was rated satisfactory. With regard to development impact assessment, private sector development and business success was rated less than satisfactory, economic sustainability was rated unsatisfactory, and compliance with environmental, social, health, and safety performance was rated satisfactory. Monitoring and supervision within work quality assessment was rated unsatisfactory. Key lessons learnt were that the PCG facility, with minor adjustments and realignment, could be adopted and rolled out in most ADB developing member countries, and that it would be necessary to (i) monitor the utilization of approved limits; (ii) restructure, realign, and modify them when required, and (iii) cancel allocations not using ADB capital efficiently.

4 The CIB was renamed the Credit Information Corporation (CIC), which was established under Republic Act 9510 (the Credit Information System Act) in 2008. The CIC is 60% owned by the national government and 40% by qualified investors defined as industry association of banks, quasi-banks and other credit-related associations, namely the Bankers Association of the Philippines, the Philippine Cooperative Center, the Credit Card Association of the Philippines, the Chamber of Thrift Banks, the Rural Bankers Association of the Philippines, and the Philippine Credit Reporting Alliance. Under the law, the government has 5 years from the start of operations to dispose of at least 20% of CIC’s shares to investors. Guardianship of the CIC is under the Philippines Securities and Exchange Commission and not the Bangko Sentral ng Pilipinas (BSP) as originally proposed. The Securities and Exchange Commission submitted the proposed rules and guidelines for the establishment of the CIC to the Congressional Oversight Committee for review in May 2009, and they were approved in January 2010. The chairman of the Securities and Exchange Commission is the CIC’s chairman of the board. The CIC, which is expected to be fully operational by December 2014, is currently receiving advisory services financed by the International Finance Corporation to support the establishment of a credit information system in line with international best practice standards.

CHAPTER 2

Evaluation

A. Overview

10. The project is evaluated using the criteria defined in ADB’s guidelines. The project rationale and objectives set out in section B of this chapter outline those envisaged during the approval of the project. The investment is evaluated according to (i) development outcomes and impact, (ii) ADB investment profitability, (iii) ADB work quality, and (iv) ADB additionality.

B. Project Rationale and Objectives

11. The rationale and objectives of the PCG facility were to improve the enabling environment for SMEs and facilitate their increased access to finance. This facility supported the Government of the Philippines’ policies and plans to create at least 6 million jobs in 6 years by promoting SMEs, tripling financing available, and developing land for agribusiness. The facility was designed to support the needs of SMEs, and it focused on enhancing access to long-term capital by PFIs and SMEs. The facility was designed to encourage PFIs to allocate credit to SMEs through the use of innovative risk-sharing arrangements.

12. The PCG facility was intended to encourage banks to change the basis of their lending to SME borrowers from securing loans according to the value and quality of collateral based on fixed and movable assets, to collateral based on SME cash flows. This arrangement would have addressed the problem of limited access to finance resulting from banks’ more conventional collateral-based lending approach based on fixed and movable assets.

13. PCG-guaranteed exposures carry a zero risk weight in computing regulatory capital requirements on banks. PFIs were expected to increase their lending capacity without needing more capital, exceeding exposure limits, or breaching prudent underwriting criteria. The PCG facility was envisioned by ADB to help banks improve their capital efficiency and loan portfolio diversity. These developments were expected to make commercial banks more willing and able to lend to SMEs.

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7 The credit risk weights, for each asset class under BSP’s implementation of the Basel II capital adequacy framework, have been defined in BSP's new risk-based capital adequacy framework. Under this arrangement, when a bank’s exposure is guaranteed by a qualified guarantor—in this case ADB, which has an AAA external credit rating—the bank is allowed to apply the risk weight of the guarantor to the guaranteed portion of the credit exposure throughout the term of the guarantee. This reduces the capital requirements for the facility.
14. The proposed equity investment in the CIB was a complementary facility that was intended to improve the enabling environment for SMEs. The investment had been targeted for the end of 2005, when legislation was expected to have been passed and investments finalized by all sponsors. The main product of the CIB was to have been consolidated credit information that would have allowed the CIB to improve the sharing and dissemination of information through a credit information system that was intended to: (i) improve the ability of lenders to identify good borrowers; (ii) create a better risk management process; (iii) increase lending; (iv) extend credit to underserviced sectors of micro, small, and medium-sized enterprises; and (v) strengthen credit discipline, leading to the lowering of defaults.

C. Development Impact and Outcomes

1. Overview

15. The overall development impact and outcome is rated unsatisfactory based on component ratings of unsatisfactory for private sector development, less than satisfactory for business success, unsatisfactory for contribution to economic development, and satisfactory for environmental, social, health, and safety performance.

2. Private Sector Development

16. Private sector development is assessed under two categories (i) beyond company impacts and (ii) direct company impacts. Based on component ratings of unsatisfactory for both of these categories, private sector development is rated unsatisfactory. Appendix 2 summarizes the private sector development indicators and ratings.

a. Beyond Company Impacts

17. The beyond company impacts of the project are discussed according to: (i) enhanced lending to SMEs, (ii) demonstration or catalytic impact, and (iii) establishment of and support for the CIB.

i. Enhanced Lending to SMEs

18. The PCG facility, which was part of the broader intervention for SME development as envisaged in the RRP, had ambitious objectives to (i) improve access by SMEs to financing to promote their operations, profitability, and competitiveness and (ii) contribute to private sector development and sustainable economic and employment growth in the Philippines. The project's intended outcomes were to increase PFI lending to SMEs (in terms of borrowers and lending volume) and introduce new and innovative products in the Philippine banking system to improve SME access to finance. The project had a tenor of 5 years, and the maximum tenor of the guarantees was 3 years. The facility therefore had the potential to create a significant development impact on SMEs. The ADB Board observed that finding new SMEs and developing their institutional capacity was more important to the success of the project than increasing the size of the credit line being offered to SMEs.
19. SBC was the only participating banking institution, DSLCs were the only guaranteed financial instrument, and URC wholesale distributors were the only types of SMEs supported under the project. Facility utilization peaked at nearly P100 million in February 2010, which represented only about 10% of the approved limit. This amount was well below ADB’s expectations, considering the facility had an availability period of 5 years. The lack of demand for the product could be attributed to various reasons, including: (i) ADB’s lack of success in identifying more financial institutions that could have benefited from such a facility, (ii) ADB delays in responding to SBC’s requests for an increase in the limit for URC distributors when the P100 million limit was reached, and (iii) SBC’s lack of understanding that the facility could have been used for guaranteeing SME term lending facilities as well as DSLCs. Also, even though SBC tried to get its other distributor clients to use the remaining P400 million of the facility, many of the distributors did not bank with SBC and were unwilling to change their banking arrangements. SBC issued 65 DSLCs amounting to P430 million, but this only amounted to about 0.1% of the estimated SME lending of all commercial banks in the Philippines, which had outstanding balances of P408 billion at the end of 2011.

ii. Demonstration or Catalytic Impact

20. The PCG facility was expected to have a catalytic effect based on its uptake by various PFIs to service a variety of SMEs and satisfy a number of financing requirements. However, utilization was very low and of limited extent and scope. SBC was the only PFI that participated in the project, and only one of its clients (URC’s branded distributors) participated in the project, accounting for less than 10% utilization of the entire approved limit. Once the P100 million limit was reached, SBC stopped using the facility for URC distributors because of slow response times on requests made to ADB to increase the limit allocated for URC from P100 million to P250 million. Another reason for the low utilization was the reorganization of URC’s distribution network, which reduced the number of distributors and encouraged exclusive arrangements with larger distributors. Demand for the facility from SBC and URC fell, leading to limited demonstration impacts. The approach of guaranteeing DSLCs has been continued by SBC using its own resources after closure of the ADB transaction.

iii. Establishment and Support for the Credit Information Bureau

21. The proposed equity investment in the CIB was cancelled in February 2011 because the ownership structure deviated from the originally approved structure in the RRP. The Credit Information Corporation (CIC) was established in 2008 as a government-owned and controlled corporation with 60% of its shares owned by the public sector. In the RRP it was envisaged that the CIC would be established as a majority privately owned corporation. The actual CIC ownership structure reflected the wishes of the government to have a majority (60%) ownership initially, but to gradually reduce its share by 20% over 5 years. It is not clear why this risk was not picked up during the initial due diligence, as it meant that the CIC would not be eligible for nonsovereign equity funding. At approval, the target date for the ADB investment was the end of 2005, as soon as legislation had been passed and investments finalized by all sponsors.

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8 P98.4 million was utilized out of the of the approved ADB limit of P1 billion for allocation among selected PFIs.
Guardianship of the CIC is assigned to the Philippines Securities and Exchange Commission and not the Bangko Sentral ng Pilipinas (BSP) as originally proposed in the RRP. Legislation was passed in 2008, and the Securities and Exchange Commission submitted the proposed rules and guidelines for the establishment of the CIC to the Congressional Oversight Committee for review in May 2009. The CIC regulations were approved in January 2010, and the board of CIC was set up in 2010 with the chair of the Securities and Exchange Commission as its head. In November 2012, the International Finance Corporation and CIC signed an agreement for the provision of advisory services to support the establishment of a credit information system in line with international best practice standards. The assistance is scheduled for completion by December 2014, at which time the CIC is expected to be fully operational. As the investment never happened, the proposed equity investment by ADB in the CIC did not contribute to improving the enabling environment for SMEs.

22. In the absence of the PCG’s greater utilization and wider adoption through the inclusion of other PFIs and different instruments under the amount allocated to SBC, the facility’s impact on private sector development was limited and well below expectations. Furthermore, the investment in the CIB never happened (para. 21). Hence, the beyond company impact is rated unsatisfactory.

b. Direct Company Impacts

23. SBC was the only one bank that participated in the project. The expected direct company impacts of the PCG facility on SBC were an increase in its lending to SMEs and an improvement in its operating standards. These impacts should be assessed within the context of the size of the PCG facility, which was underutilized, and the lack of PFIs participating in the project.

24. From 2006 to 2011,\(^9\) the outstanding balances of SBC’s loans to micro, small, and medium-sized enterprises were fairly constant at about 12% of its customer loans. Outstanding balances increased from P4 billion to P11 billion, a compound annual growth rate of 23%. For micro and small enterprises, however, outstanding balances decreased from P2.3 million at the end of 2006 to P2.0 billion at the end of 2011.\(^{10}\) Growth was clearly occurring within the medium-sized enterprise sector, and the PCF facility was designed to support this growth. However, the amount guaranteed under the project was small relative to the scale of lending, and it was restricted to one kind of SME: the URC distributors. SBC was unaware that the facility could also be used to guarantee other SME term loans.

25. ADB’s PCG had limited impact on SBC operations and its corporate governance for three reasons. (i) ADB imposed a P100 million limit on guarantees for the loans initiated by the primary borrower (URC) since it was an unknown entity at the time of approval. The limit was reached in 2010, and it took ADB about 15 months to respond to requests by SBC for an increase, at which time internal financing had been provided to continue the loan program for URC. The PCG facility was set up to cover PFIs’ selected SME exposures, with recourse to the underlying SME assets and not the PFIs’ assets. However, during the course of the project, there was a change in PSOD

\(^{9}\) Data for 2011 was the latest available. A number of requests were made to SBC for later figures, but they were not provided.

\(^{10}\) See footnote number 9.
management preference in taking financial intermediary risk rather than risk associated with SMEs (ii) Newly formed Office of Risk Management requested SBC to share its risk rating model, but because of confidentiality issues, some of the required data was not shared by SBC with ADB. This lack of disclosure might have contributed to underutilization of the facility and resulted in ADB not aggressively pursuing new opportunities and (iii) SBC did not fully understand the potential of the project and only used the facility to provide guarantees for DSLCs. SBC never realized it could also use ADB’s PCG to guarantee general SME term lending, and this also limited the use of the facility.

26. Before the project, many of the SME distributors benefiting from the PCG facility had not previously borrowed from SBC. Although SBC indicated it may have financed the distributors even without the ADB facility, it became more comfortable with these SMEs and extended other credit facilities to them. The PCG facility improved SME access to finance (e.g., general lines of credit, bill purchase limits, and short-term receivables financing), which supported the growth of the distributors’ businesses. In some cases, credit was given to other businesses of the borrowers’ sponsor. ADB had no appreciable impact on SBC’s risk systems or corporate governance because of its limited interaction with SBC as a result of frequent staff changes within ADB and the very low utilization of the facility.

27. Since exposure under the PCG facility carries zero risk weight in computing regulatory capital requirements, SBC increased its lending capacity under the PCG without the need for additional capital. This effect was minimal, however, given the small size and limited utilization of the facility, and the fact that SBC had acceptable capital adequacy ratios well above BSP requirements and those adopted under Basel II.

28. Transfer of skills to SBC personnel was minimal. While SBC staff learned about ADB procedures and processes, frequently changing project contacts within ADB and delays in responding resulted in limited skills transfer for SBC staff.

29. A select few SMEs benefited from the project (with most securing their first loans through PCG cover), but SBC was unable to utilize the full allotted facility limit and could not leverage its experience with URC to develop a wider client base to use the facility. Due to the relatively small size of the project, it did not have any effect on SBC’s capital efficiency. The direct impact on SBC is therefore rated unsatisfactory.

c. Overall Assessment of Private Sector Development

30. ADB’s PCG facility was designed to enhance the financing capacity of SMEs, but it was restricted to one bank (SBC) and one instrument (DSLCs). The P1 billion allocated for the facility was small compared to the needs of the sector. ADB’s expectation that the facility would be utilized by a number of PFIs and cover a range of SMEs across sectors was not realized.

31. Only half of the facility (P500 million) was disbursed, and this disbursement was only allocated to one PFI (SBC). Of this, only P100 million was utilized (10% of the total facility) by URC distributors. This limited set of borrowers significantly reduced the facility’s demonstration or multiplier potential. Involving other PFIs and encouraging SBC to link the facility with other similar financing arrangements would have raised
awareness, encouraged utilization, and allowed faster recycling of ADB’s committed capital over the life of the PCG facility. In the absence of these measures, the facility’s overall effect on private sector development is rated *unsatisfactory*.

3. **Business Success**

32. The profitability of SBC and the impact that the PCG facility made on a few SMEs are positive accomplishments. There were no defaults or invocation of ADB’s guarantee. Nevertheless, its business success is rated *less than satisfactory* because of the small size of the investment and SBC’s limited use of the facility. The PCG facility is therefore unlikely to have made any significant impact on SBC’s profitability.

33. The PCG facility’s financial performance and return on invested capital for SBC has been reviewed in the context of the facility’s impact on the intermediary PFI and the SMEs that benefited from enhanced access to credit. However, this assessment is constrained by the small size of the facility, its low utilization relative to other operations of SBC, and the lack of financial information available on the beneficiary SMEs.

34. Since SBC’s exposure to the SME market is limited (about 12% of its customer loans outstanding on average) and because the PCG facility made only a small contribution to its earnings, it is inappropriate to assess the impact of the PCG facility on SBC’s profitability. In terms of the impact on SME beneficiaries, information from SBC has shown the facility helped some to increase their sales turnover and profits. Many small distributors at the outset became much larger over time, and a number merged or grew into regional wholesale distributors.

35. In terms of SBC’s return on investment capital and financial performance, a separate assessment is impractical given the small size of the facility. As a proxy, SBC’s profitability, which has been consistently above average among banks in Philippines, is used to estimate the return on invested capital. Average annual return on assets for SBC was 2.8% from 2006 to 2012, while the average annual return on shareholder equity was 22.9% over the same period.

4. **Contribution to Economic Development**

36. Economic sustainability is rated *unsatisfactory*. The PCG facility would have generated new jobs, but because of its limited scale, this impact remained significantly below expectations and contributed minimally to the development of the local economy. The PCG facility was used by only one bank, benefited only one set of SMEs, and achieved only about 10% utilization. While the PCG structure supported local currency lending to SMEs, it has not been replicated since. The PCG’s contribution to economic development has been marginal.

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11 Higher sales turnover and profits can be inferred from the changes in URC’s policy toward its distributors, which included phasing out smaller distributors and consolidating business with fewer distributors with regional coverage. This suggests higher volumes of URC business for these entities. The extent to which this was directly linked with the impacts of the PCG facility cannot be determined.

12 In its full rating report for SBC in October 2011, Fitch Ratings mentioned that SBC’s profitability, measured as return on assets, has historically averaged above 2.5%, or more than double the 1.1% of local peer banks. In 2012, SBC was the top private domestic universal bank in terms of its return on shareholders’ equity (22%) and its return on assets (3.3%). Security Bank 2012 Annual Report.
5. Environment, Social, Health, and Safety

37. The ADB PCG facility for SBC was categorized as a financial intermediary under ADB’s Environment Policy (2002). As a result, subprojects would likely not have had significant impacts on the environment, involuntary resettlement, or indigenous peoples. The classification is generally based on what business beneficiaries pursue, and the SMEs supported by the PCG were mainly engaged in trading activities. The Supplemental Deed (No.1) to the Guarantee Facility Deed indicated that each qualifying SME had to be in full compliance with applicable environmental and social safeguard laws and regulations and not engaged in any activities or businesses prohibited in ADB’s exclusion list. No violation of Philippine environment laws or ADB’s list of prohibited investments was reported.

38. SBC has its own environmental policy that requires an environmental clearance certificate on projects where necessary under government regulations. Given SBC’s compliance with environmental standards, practices and procedures, involuntary resettlement, and indigenous peoples’ safeguards, ADB’s investment is rated satisfactory.

D. ADB Investment Profitability

39. ADB investment profitability on guarantees is evaluated by comparing the pricing of the guarantee to other ADB portfolio guarantees with similar project and country risk profiles at approval. For this project, however, there were no other approvals with similar project and country risk profiles. The pricing of the guarantees was negotiated with SBC at the time of documentation, and it was supposed to have been based on the prevailing risks identified during due diligence and comparable fees derived elsewhere. There were no defaults or invocation of ADB’s guarantee. The facility was grossly underutilized. ADB investment profitability is rated less than satisfactory.

E. ADB Work Quality

40. ADB’s work quality is rated unsatisfactory in terms of its screening, appraisal, and structuring of the project as well as its monitoring and supervision. For ADB’s role and contribution, the rating is less than satisfactory.

1. Screening, Appraisal, and Structuring of the Project

41. Due diligence was weak. Only one bank was advanced for participation at the time of appraisal, and since time was limited, a decision was made to defer selection of other PFIs until after approval. There was a failure of ADB to sell the concept to other banks. ADB had initial meetings with several banks, including SBC, prior to Board approval, but these discussions were not advanced, although ADB shared the project term sheet with them. The private sector loan was processed alongside other public sector components as part of a larger assistance program prepared by ADB. Time constraints during approval meant that ADB decided to identify other PFIs after project approval.

13 Citibank, Standard Chartered, Unionbank, Planters Bank, and Banco De Oro.
constraints during approval meant that ADB decided to identify other PFIs after project approval. Unfortunately, there was not much follow-up by ADB afterwards. The first loss provision included in the RRP was never implemented as the guarantee agreement between SBC and ADB was silent on the issue. SBC considered the first loss provision to be unworkable and requested ADB to drop the provision in the guarantee agreement. A first loss provision would have been more appropriate for SBC’s term loans rather than the domestic letters of credit guarantees under the project. The guarantee agreement was eventually signed 1 year after Board approval, and it did not include the first loss provision. Much of the delay occurred because of SBC’s unfamiliarity with ADB procedures and operations and the inadequate follow-up by ADB.

42. The concept of the PCG facility was aligned with government and ADB objectives for encouraging SME sector development. The decision to select SBC as the first bank under the facility in 2006 was made on the basis of limited screening. Although SBC had an acceptable credit profile, was profitable, and had an adequate capital structure, its SME financing had been relatively small. At appraisal, SBC was the 15th largest bank in Philippines, but it did not have an extensive retail branch network, and it lacked established relationships with SMEs. It was expected that SBC would expand its SME business and widen its associated services. However, in the absence of businesses similar to URC that were willing to participate in the use of the PCG, growth in SME lending by SBC was below expectations. Furthermore, the misunderstanding between SBC and ADB on the wider use of the guarantee, especially for term lending, also contributed to the low utilization of the facility.

43. Because of the low utilization, the participation of only one bank, inadequate pricing at the outset, and the fact that ADB did not apply the first loss provision that was included in the RRP approval in the guarantee agreement, ADB's performance in screening, appraisal, and structuring is rated unsatisfactory.

2. Monitoring and Supervision

44. The shortfalls in monitoring and supervision of the PCG facility are illustrated by the lack of new PFIs being selected and its low utilization. Not enough was done to identify and select other PFIs, while the considerable delay in following up on the request of SBC to increase its allocation to URC contributed to the poor performance of the facility. The constant changing of ADB staff contacts meant there was no continuity of supervision. Had there been better monitoring and supervision, the lack of progress would have been identified earlier. Since monitoring and supervision was not proactive in identifying problems or issues, it is rated unsatisfactory.

3. ADB’s Role and Contribution

45. The PCG facility was structured and operated in line with ADB’s operating strategies and policies. However, efforts to raise awareness and encourage use of the facility by other Philippine banks and other clients of SBC were below expectations.

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14 At the time there was a rushed schedule for approval, since the PSOD was part of a larger project championed by the Southeast Asia Regional Department that was ready and included a public sector component that had been prepared earlier.

15 In 2005, SBC did not have a well-defined SME portfolio and only had limited coverage. Its SME exposure, at $20 million, was less than 1% of its total customer loan portfolio.
46. Delays in the approval of SBC’s request to increase the allocation limits for URC were largely due to insufficient staff resources within ADB to process the extensive number of documents required to enroll each new SME. When the P100 million limit was reached, URC stopped enrolling new distributors and ADB did not intervene to create additional capacity. Also, as part of its approval process, the newly formed Office of Risk Management requested that SBC share its risk rating model, but some of the required data was not provided. This might have contributed to ADB’s slow response. Nevertheless, ADB should have undertaken better due diligence at appraisal, which might have enabled it to delegate authority to SBC to enroll each new distributor.

47. PSOD was not keen to take direct SME risk, preferring financial intermediary risk. This might have ultimately contributed to underutilization of the facility, as new opportunities were not aggressively pursued. Since ADB could have done more and been better organized, its role and contribution is rated less than satisfactory.

F. ADB Additionality

48. The concept was innovative and had the potential to leverage ADB funds for SMEs if it had been implemented more effectively. The weak monitoring by ADB, its requirements for data that proved impossible for SBC to provide on grounds of confidentiality, the changes of staff and policies within the PSOD, and the failure to identify new PFIs all point to less than satisfactory performance.

49. ADB has not applied the PCG to other projects in the Philippines or elsewhere.

50. ADB took the initiative in designing and structuring the facility and undertook all screening and appraisal. ADB’s additionality would have been rated higher if the facility had been adopted by at least a few more PFIs or benefited a wider set of SME clients of SBC. Additionality is rated less than satisfactory.

G. Overall Evaluation

51. Table 1 shows that the overall performance of the PCG facility has been rated unsuccessful.

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<td>B. ADB Investment Profitability</td>
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ADB’s additionality would have been rated higher if the facility had been adopted by at least a few more PFIs or benefited a wider set of SME clients of SBC.
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ADB = Asian Development Bank.
Source: Independent Evaluation Department.
CHAPTER 3

Issues, Lessons, and Recommendations

A. Issues and Lessons

52. This review offers the following lessons.

53. Carefully assess effective demand for new instruments. For projects where similar models do not exist in the local market, more exhaustive studies and analyses of the demand and willingness to pay for guarantees covering SME exposure should take place.

54. An adequate pipeline is needed. More care is needed in establishing a pipeline of PFIs. Due diligence was weak, preventing the participation of more banks before approval or immediately afterwards. Given more participants, the volume of guarantees would have increased and a wider variety of SMEs could have taken part. More exhaustive due diligence is needed in the future, especially in identifying and assessing PFIs. Poor monitoring and supervision of the project by ADB contributed to the low utilization of the facility. ADB should have been able to identify the issues, problems, and lack of progress more effectively, and it should have been more flexible in changing the project during implementation.

55. Pricing needs to reflect market demand. The formal price change from ADB came too late to make a difference, since by then the price waivers had been granted. Likewise the first loss provision outlined in the RRP was dropped from the guarantee agreement between ADB and SBC.

56. Lack of replicability. There has neither been a follow-up project in the Philippines, nor has ADB financed a similar project elsewhere in the Asia Pacific region. The issue of taking on SME risk against that of the financial intermediary needs resolution before its further application. The PCG facility could potentially be adopted in a number of ADB’s developing member countries, but further work is required to adequately measure and assess the risk-return benefits of the instrument for stakeholders. Many variations are possible, such as different stop-loss levels; differentiated risk sharing; financial instruments for different uses (e.g., trade financing, equipment purchases, and other capital investment); and working capital. Some of these adjustments can be explored to assess whether the PCG can be made more flexible and better tailored to local conditions.
57. **Underestimating the impact of staff changes.** PSOD preferred to assume financial intermediary risk rather than risk associated with SMEs, which contributed to the delay in raising the credit limit to URC and the selection of new PFIs. ADB staff changes at the project officer level confused SBC and contributed to the lack of continuity and consistency of efforts by ADB.

58. **Better due diligence of financial intermediaries is required.** ADB did not adequately assess the risk rating process of SBC or do enough work to understand its processes and procedures. A better understanding of SBC would have enabled ADB to assume more decision-making responsibility on the implementation of the facility. In addition, ADB should have undertaken due diligence of other potential PFIs at appraisal. Leaving the decision to SBC about which SMEs could participate would not have required extensive ADB staff involvement after PFI selection and might have encouraged other banks to participate.

59. **Need to proactively monitor facility utilization.** The need for effective monitoring was stressed in the RRP, but it was not carried out satisfactorily. Monitoring facility utilization was necessary to guide restructuring, realignment, and modifications, and, where required, to cancel allocations so ADB capital could be deployed more efficiently. ADB originally expected that over time, the PCG facility would allow PFIs to become familiar with SME risks and provide guarantees for a wider range of instruments, which would have prompted more PFIs to participate. This outcome would have required better and more proactive monitoring of the utilization of the facility, which would have prompted the inclusion of new PFIs and allowed for a wider set of clients and instruments to be tested. Although the PCG facility was approved and made available to partner banks for 8 years, ineffective monitoring led to cancellations rather than the reallocation of guarantees, availability periods, and tenors.

**B. Recommended Follow-up Actions**

60. Three actions are recommended for future projects.

61. **Improve due diligence and screening.** ADB should identify, select, and sign up a number of PFIs before approval of future projects. Appropriate screening and rigorous due diligence of their lending processes and practices, risk management systems, collateral requirements, debt recovery procedures, financial performance, and SME market profiles would enable future participants to assume more autonomy in decision making and reduce the burden on ADB back office support. A pipeline of PFIs and potential SME clients and a pricing structure for the PCG facility that reflects prevailing market conditions and practices should be determined and agreed before the approval of future projects.

62. **Make the transaction more replicable.** The implementation of the PCG facility was an innovative approach that could be modified to better reflect stakeholder (SMEs, financial institutions, and ADB) requirements. These modifications could include granting more autonomy in decision making to the PFIs, offering better market-based pricing for the facility, and promoting its wider use to cover guarantees for term lending to SMEs as well as covering DSLCs. These changes could help make the transaction more replicable.
63. **Improve monitoring capacity.** ADB needs to improve its monitoring of project progress and be more flexible in responding to changes needed during implementation. More effective follow-up and interaction with PFIs by ADB staff is essential to identify problems and issues before they become serious and delay implementation. More back office staff time should be allocated in future projects.
Appendixes
APPENDIX 1: PROJECT HIGHLIGHTS AND IMPLEMENTATION

A. Project Highlights

1. Background

The Small and Medium Enterprise Development Support Project was the Asian Development Bank (ADB) response to a request from the Government of the Philippines to support small and medium-sized enterprise (SME) development as part of the government’s effort to reduce poverty through private sector development and employment generation. The project’s impact was to improve SME contributions to economic growth and employment, and its outcome was to improve the enabling environment for SMEs and facilitate greater access to finance. This aligned with the 10-point agenda of the government’s Medium-Term Philippine Development Plan 2004–2010, which targeted creating at least 6 million jobs in 6 years.¹

2. A project preparatory technical assistance analyzed the status of SMEs in the Philippines, including the government’s development policies and actions, and the issues and constraints facing the sector.² The study found that SMEs contributed 32% to value addition and accounted for 31% of employment. Despite the sector’s significant contributions, SME operation has been constrained by poor access to finance as a result of (i) banks’ reluctance to expand their SME lending following the Asian financial crisis because of a perceived higher cost and risk, and (ii) the difficulties SMEs face in preparing and presenting credible business plans and realistic cash flow estimates, and in providing acceptable collateral. Commercial banks generally secure SME lending on formal collateral (e.g., hard assets and chattel mortgages) rather than on project cash flows or future revenues.

3. The project was designed to support the findings of the project preparatory technical assistance and was consistent with ADB’s country strategy and program update, 2004–2006 for the Philippines,³ which focused on public–private partnerships for sustainable SME development. The project was designed to support SME development through (i) a credit line of $25 million to the Small Business Guarantee and Finance Corporation for relending to SMEs, (ii) a partial credit guarantee (PCG) of P1 billion to other commercial banks to expand their SME portfolios, and (iii) an equity investment of $1 million in a proposed credit information bureau (CIB). The credit line was to be backed by a guarantee from the Republic of the Philippines as the public component of ADB’s intervention. The PCG facility and the equity investment were structured as a private transaction and are the subject of this evaluation.

2. Key Features

4. The PCG facility was structured as a revolving local currency credit enhancement instrument in favor of local participating financial institutions (PFIs) that guaranteed agreed risks associated with their portfolios of loans or other credit exposure, including guarantees or letters of credit extended to SME borrowers selected according to specified criteria. The PCG facility aimed to encourage PFIs to assume exposure to medium-sized enterprises, while the $25 million public sector loan to the Small Business Guarantee and Finance Corporation focused on microenterprises and other small enterprises. This split was undertaken to widen the reach of ADB’s SME development program.

5. This PCG was structured to encourage the participation of PFIs by limiting their risk with recourse limited only to the underlying guaranteed portfolio and not to the PFIs’ balance sheet. While a

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PFI faced operating and indirect credit risk, this risk was reduced by the PFI’s specifying portfolio exposure and selection criteria for the SMEs for which ADB would assume risk, and selection and monitoring. The facility was intended for primarily top-tier domestic banks and finance institutions in the Philippines with some experience in SME lending and well-established underwriting procedures. Some of them were accredited in ADB’s Trade Finance Facilitation Program.

6. Under the facility, ADB set a limit of P1 billion to be allocated among selected PFIs, with 50–50 risk-sharing agreement requiring PFIs to guarantee P1 billion. The limit for each PFI was set at P500 million. ADB intended to negotiate a provision of first loss assumed entirely by the PFI. The amount of first loss cover was to be based on the loss experience of each PFI over the preceding 3 years. The underlying rationale for proposing a first loss provision was to better ensure complete alliance of interest.

7. A maximum exposure per borrower was set at P25.0 million, translating to a maximum ADB guarantee of P12.5 million per borrower. The selection criteria for SME borrowers were defined by the PFI and ADB. The SME had to be a branded distributor of Universal Robina Corporation (URC), have a sales turnover not exceeding P1 billion, and be locally incorporated. URC was tasked to undertake due diligence through an independent valuation of each distributor. Each distributor should have had at least 2 years of trading history with URC or been in the distributor business servicing its current geographic area for at least 2 years. In addition, each distributor should have been profitable for the preceding 2 years and must be in full compliance with relevant environmental and social safeguard laws and regulations and not engage in any business on the Exclusion List. These arrangements were critical since, unlike other credit facilities, the PCG exposed ADB to the credit risk of the portfolio of SMEs selected through the normal underwriting practices of the PFI. There was a maximum loss limit under the facility, which was to function as a trigger and allow ADB to review the continuation of the facility if losses or claims under the guarantee exceeded anticipated amounts.

8. The PCG facility was available for 5 years, with the maximum loan tenor capped at 3 years, effectively making the facility available for 8 years. Pricing was to be determined for each transaction based on ADB’s share of exposure booked under the facility, which was capped at 50% of the nominal amount. The pricing of the project was negotiated with Security Bank Corporation (SBC) at the time of documentation based on the prevailing risks identified during due diligence.

B. Implementation

9. ADB had initial meetings with a number of banks, including SBC, prior to Board approval, but these discussions were not advanced, although ADB shared the project term sheet with them. Since the public sector component was ready for appraisal and the private sector one was only added later, time constraints meant that ADB decided to identify other PFIs after project approval. Unfortunately, there was limited follow-up by ADB after loan approval, largely because of limited back office staff resources.

10. Board approval of the project was in September 2005. The selection of SBC as the first PFI was endorsed by the guarantee committee in September 2006. The Guarantee Facility Deed was signed with SBC for a maximum amount of P500 million in April 2007.

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4 In an indirect manner, insolvency or a material weakening in the credit standing of a PFI would weaken its ability to monitor the portfolio of guaranteed exposures and maintain specified portfolio parameters, thereby increasing the default risk of the portfolio and ADB’s risk as a partial guarantor.


6 First loss is computed as a percentage of the guaranteed loan portfolio, and on such amount under the guarantee, the reserve on the first claim would be made. Amounts in excess of first loss cover were to be shared between the PFI and ADB.

7 Section 4, Supplemental Deed (No. 1) to the Guarantee Facility Deed between ADB and Security Bank Corporation (SBC). 26 April 2007.

8 Citibank, Standard Chartered, Unionbank, Planters Bank, and Banco De Oro.
11. SBC allocated the PCG facility for utilization by SMEs comprising URC distributors. Under the PCG, ADB provided a 50% guarantee on the DSLCs issued by SBC on behalf of these SMEs in favor of URC.9 URC required these qualifying instruments (the DSLCs) under the facility agreement to extend trade credit to the SMEs.10 Distributors were selected according to a prescribed set of credit policies and procedures adopted by SBC in consultation with ADB. SBC directly assumed 50% of the DSLC amount.

12. Documentation between ADB and SBC (the supplemental deed of the guarantee) outlined a number of eligibility requirements for URC distributors’ inclusion in the facility to (i) ensure that SBC used the facility solely for lending to SMEs—setting a sales turnover threshold of P1 billion per annum—and (ii) mitigate the credit risk to ADB—all short-listed distributors were to have at least 2 years of either dealing with URC or related business experience in their current geographical areas, and have been operating profitably for the past 2 years with positive retained earnings. In addition, SBC subjected every transaction to independent due diligence before recommending it to ADB for approval.

13. As facility utilization rose almost to the approved limit, SBC requested in November 2009 an increase in the amount allocated to URC distributors from P100 million to P250 million, which was within SBC’s P500 million approved limit. However, the Private Sector Operations Department (PSOD) did not respond until 15 months later. By that time there had been a steady drop in utilization because SBC had stopped enrolling new distributors into the project on the advice of ADB, which had recommended postponing new enrollments of instruments to stay within the prescribed amount.

14. In January 2011, ADB indicated to SBC that it could resume access to the P100 million limit since utilization had fallen below the limit since February 2010. However, SBC still failed to use the allocated amount, and no new transactions were booked by SBC for URC dealers. Although it tried with other entities, SBC did not formally propose any new participants to use the remaining P400 million. SBC failed to introduce new participants because the pricing of the guarantee was considered to be too expensive, and many of the distributors did not bank with SBC and were unwilling to change their banking arrangements. Also, SBC mistakenly thought the facility could only be used for DSLCs.

15. Another reason for the lower utilization in 2011 was the reorganization of URC’s distribution network, which reduced the number of distributors and encouraged exclusive arrangements with larger distributors. Although the volume of business handled by URC distributors increased, this reorganization reduced the number of distributors eligible for ADB’s agreed guarantee coverage (based on turnover), although current participants remained eligible even if their turnover was greater than the limit. However, URC’s demand for the facility fell with no new enrollments.

17. Under the P100 million limit for URC distributors, 16 qualifying SME wholesalers received credit support under the PCG facility after it became effective in 2007. By April 2012, SBC had issued 65 DSLCs to the 16 distributors amounting to P430 million, 50% of which was guaranteed by ADB. No default or invocation of ADB’s guarantee has been recorded.11

18. In February 2011, the PSOD cancelled the remaining unallocated balance of P500 million. The cancellation note observed that no other suitable banks had been selected as a facility PFI because of

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9 These SMEs were branded customer food and beverage group distributors of URC incorporated in the Philippines and with annual sales turnover not exceeding P1 billion.

10 In more conventional terms, this is a typical channel financing arrangement, wherein a relatively strong and well-established entity supports the financing of its distribution or channel partners by entering into a distribution or dealership arrangement with them. This strengthens the distributors’ business and financial profiles and provides a more secure basis for a bank to extend credit.

creditworthiness concerns or a lack of interest on the part of potential banks. There was no further justification for these statements, which are inconsistent with the following factors: (i) SBC is a bank with moderate creditworthiness, and several banks, including those participating in ADB’s Trade Finance Facilitation Program, are equally or more creditworthy;\(^12\) (ii) SME lending is and has been a primary focus of the Government of the Philippines, and new regulatory requirements on minimum lending to the SME sector; and (iii) SBC utilized almost all its approved facility limit for URC, and it requested increases to the limit for URC distributors.

19. The proposed equity investment in the CIB was cancelled in February 2011 because (i) the ownership structure deviated from that originally approved in the report and recommendation of the President (RRP) and (ii) another board approval would have been necessary if the investment had been pursued further. In 2008, the Credit Information Corporation (CIC) was established, but its ownership structure changed from that originally envisaged. Instead of a private company, CIC was set up as a government-owned and controlled corporation, with 60% of its shares owned by the public sector. At approval, the target date for the ADB investment was the end of 2005, as soon as legislation had been passed and investments finalized by all sponsors. It was envisaged that the CIB would be established as a corporate entity under the Corporation Code, with Bangko Sentral ng Pilipinas owning 49% of the company and the balance by private sector institutions, related industry associations, strategic partners, and ADB. Guardianship of CIC is under the Philippines Securities and Exchange Commission and not Bangko Sentral ng Pilipinas, as originally proposed. Legislation was only passed in 2008, and the Securities and Exchange Commission submitted the proposed rules and guidelines for the establishment of CIC to the Congressional Oversight Committee for review in May 2009. These ruled and guidelines were approved in January 2010, and the board of CIC was set up in 2010 with the chair of the Securities and Exchange Commission as its head. CIC is expected be fully operational by December 2014. CIC is currently receiving advisory services financed by the International Finance Corporation to support the establishment of a credit information system in line with international best practice standards.

20. The initial price, which was evidently included in the facility documents, was based on a sample price range. It was never actually applied to any transaction under the PCG facility, which was determined on a case-by-case basis. Pricing included the arrangement for compensating the PFI for administrative costs incurred implementing the facility.

21. In February 2011, nearly 3 years after the first transaction with SBC, the PSOD cancelled the unallocated balance of P500 million. The proposed $1 million equity investment in the CIB was also cancelled in February 2011 because the corporation established by the government (CIC) deviated from the structure originally approved in the RRP. The last qualifying instrument under SBC’s URC program expired in February 2011, and there were no new enrollments afterwards. The Guarantee Facility Deed officially reached its end of availability period without any outstanding qualifying instrument on 26 April 2012, and the PCG facility was terminated on the same day.

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<td>1.1 Private sector expansion and institutional impact:</td>
<td>Unsatisfactory</td>
<td>The project was largely a failure since only one bank participated, less than 10% of the allotted funds were utilized, and the investment in the CIB never took place. However, the profitability of SBC and the impact that the PCG facility made on a few SMEs are positive accomplishments. Although five or six banks were identified as possible partners, SBC was the only one that participated. The PCG facility for SBC was approved for P500 million, of which P100 million was allocated to URC as the principal for its distributors comprising locally incorporated SMEs with sales turnover not exceeding P1 billion per year. The first transaction under the facility was booked in January 2008, and utilization peaked at P98.8 million in February 2010. The last transaction matured in February 2011. Only 16 SME URC wholesalers received credit under the facility. Some 65 DSLCs amounting to P430 million were issued by SBC, 50% of which were guaranteed by ADB. SBC never used the remaining balance of P400 million since it was unaware that the facility could be used to guarantee other SME term lending, as well as the DSLCs for URC distributors. In February 2011, ADB cancelled the unallocated balance of the P500 million. Because of its small size and the fact that there was only one PFI, the facility had limited impact outside and inside SBC. The proposed $1 million equity investment in the CIB was cancelled in February 2011 since the agency deviated from the structure approved in the RRP. The project had very little impact on improving the enabling environment for lending to SMEs.</td>
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<tr>
<td>1.1.1 Contribution to increased private sector share and role of commercial banks in SME lending</td>
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<td>1.1.2 Contribution to institutional development by improving the enabling environment and improving risk management for lending to SMEs</td>
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<tr>
<td>1.2 <strong>Competition</strong>: Contribution to competition in the commercial banks’ SME banking business among local banks</td>
<td>Less than satisfactory</td>
<td>The small size of the credit guarantee facility limited its impact on competition. However, its concept of providing guarantees to SMEs was good, and more competition would have been encouraged if more banks had participated in the project. Since only SBC participated, the rating is less than satisfactory.</td>
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<tr>
<td>1.3 <strong>Innovation</strong>: Contribution to new ways of offering effective banking services to SMEs in ways that are replicated by other banks</td>
<td>Less than satisfactory</td>
<td>At inception of the project, the credit guarantee facility filled a gap in the market for SME lending. SBC was skeptical of URC at first, and the project may have helped them get comfortable with URC. Although the approach of guaranteeing DSLCs has been continued by SBC using its own resources after the completion of</td>
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<tr>
<td>Indicators</td>
<td>Ratings</td>
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<tr>
<td>1.4 <strong>Linkages</strong>: Contribution to increasing the size of SME portfolios, and contribution to major upstream or downstream effects to borrowers’ businesses in their industries or the economy</td>
<td>Less than satisfactory</td>
<td></td>
</tr>
<tr>
<td>1.5 <strong>Catalytic element</strong>: Contribution to the mobilization of other international or local financing, and contribution to a positive demonstration to market providers of guarantees for loans to SMEs</td>
<td>Unsatisfactory</td>
<td></td>
</tr>
<tr>
<td>1.6 <strong>Affected laws frameworks, regulation</strong>: Contribution to improved laws, regulation, and inspection affecting commercial banks, and contribution to the provision of banking services to SMEs in the local financial system</td>
<td>Unsatisfactory</td>
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the project, it was never replicated by other banks. More PFIs participating in the project could have benefited more SMEs.

The project was limited to providing guarantees for the credit lines of URC’s distributors, some of whom benefited a lot. At the start of the project, most were small, but some grew substantially during the implementation period. Others, however, declined, resulting in larger but more efficient regional distributors. Since the project was limited to URC distributors, there were no major external upstream or downstream effects, as SBC was the only participating bank.

The approach was supposed to be a model for others to follow. However, it was not adopted by any bank except SBC. Even within SBC there was a misunderstanding, and only one model—that of guaranteeing DSLCs—was adopted. The concept was not really understood by SBC, which thought the facility could only apply to credit lines and/or letters of credit, and not other SME loans. These misunderstandings limited the project’s contribution to banking services to SMEs in the local financial system. Also, the approach of guaranteeing individual SME loans fell out of favor within ADB when changes within the PSOD took place, which might have also slowed new approvals under the project. ADB was more comfortable taking financial intermediary risk than direct SME company risk. The catalytic element was therefore minimal.

The project had limited effect since only one bank participated and the project investment was small. The equity investment in the proposed CIB never materialized. The bureau was set up as the CIC in 2008, but its ownership structure changed from the envisaged structure of Bangko Sentral ng Pilipinas having 49% ownership, with the remaining 51% ownership divided between industry associations, international financial institutions (including ADB), and other investors. Instead, CIC was set up as a government-owned and controlled corporation, with 60% of its shares owned by the national government and 40% by qualified investors defined as industry associations of banks, quasi-banks, and other credit related associations. Guardianship of CIC is under the Philippines Securities and Exchange Commission and not the Bangko Sentral ng Pilipinas as originally proposed. CIC has begun to operate, and it will be fully functioning by the end of 2014. ADB had no influence on the establishment of the CIC, which is currently
<table>
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<th>Indicators</th>
<th>Ratings a</th>
<th>Justifications/Annotations</th>
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<tr>
<td>1.7 <strong>Wider demonstration of new standards</strong>: Contribution to raised standards in the commercial banking sector in corporate governance, risk management, transparency, and stakeholder relations, environmental health and safety, and energy conservation</td>
<td>Less than satisfactory</td>
<td>receiving advisory services financed by the International Finance Corporation to support the establishment of a credit information system in line with international best practice standards. There was very little wider demonstration of new standards, since SBC was the only participant and only used the facility for a limited time. SBC never fully understood the potential of the project and limited its application to DSLCs for URC distributors. ADB also became uncertain of the concept due to personnel changes. Also, PSOD preferred to provide guarantees to a bank rather than assume risks with actual SMEs because the latter would have overwhelmed ADB’s available back office resources. SBC ultimately became comfortable with URC and did not require ADB to share risk. The project had no direct impact on SBC’s corporate governance activities.</td>
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<td><strong>2. Security Bank Corporation Impacts</strong></td>
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<tr>
<td>2.1 <strong>Skills and wider impact potential</strong>:</td>
<td>Less than satisfactory</td>
<td>SBC staff acquired new skills and learned lessons about working with international lending agencies as a result of the new concept. However, SBC never fully understood the full potential of the project and thought the guarantees under the PCG facility could only apply to credit lines and/or letters of credit and not to other SME term loans.</td>
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<tr>
<td>2.1.1 Contribution to improved managerial, strategic, and operational skills in the participant bank in ways that can be replicated by other commercial banks.</td>
<td></td>
<td>The project was small and was not designed to have a major impact. Low utilization (only 10% of the facility was accessed) further limited its impact. It had no observable impact on the business of SBC. SBC’s skills upgrading was limited. Had there been more than one PFI, the impact would have been greater and could have offered more variety in the lending instruments supported.</td>
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<td>2.1.2 Contribution to expanding lending to SMEs within the participant bank</td>
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<td><strong>2.2 Demonstration of new standard-setting potential</strong>:</td>
<td>Unsatisfactory</td>
<td></td>
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<tr>
<td>2.2.1 As evident in new ways of operating the business and competing, and in performance against industry benchmarks and standards</td>
<td></td>
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<tr>
<td>2.2.2 As evident in standards for corporate governance, stakeholders’ relations, environmental health and safety, and energy conservation</td>
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<tr>
<td><strong>Overall Private Sector Development Rating</strong></td>
<td>Unsatisfactory</td>
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</table>

ADB = Asian Development Bank, CIB = credit information bureau, CIC = Credit Information Corporation, DSLC = domestic standby letter of credit, PCG = partial credit guarantee, PSOD = Private Sector Operations Department, RRP = report and recommendation of the President, SBC = Security Bank Corporation, SMEs = small and medium-sized enterprises.

a Ratings scale: excellent, satisfactory, partly satisfactory, and unsatisfactory. The rating is not an arithmetic mean of the individual indicator ratings, and these have no fixed weights. It considers actual impact (positive or negative) and potential further impacts as well as risk to its realization.