

TECHNICAL ASSISTANCE COMPLETION REPORT

Division: SEGF/SERD

TA No. 4523 – PHI: Strengthening SME Credit Management Systems		Amount Approved: \$500,000	
Executing Agency: Department for Trade and Industry (DTI) through Small Business Guarantee and Finance Corporation (SBGFC)	Source of Funding: Japan Special Fund	Amount Undisbursed: \$116,509.30	Amount Utilized: \$383,490.70
TA Approval Date: 23 Dec 2004	TA Signing Date: 16 Jun 2005	Fielding of First Consultant: 20 Aug 2005	TA Completion Date Original: 28 Feb 2006 Actual: 28 Feb 2007 Account Closing Date Original: 28 Feb 2006 Actual: 28 Jun 2007

Description:

The Philippine Government 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 to the 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, a creditline for refinancing SME credits of Small Business Guarantee and Finance Corporation (SBGFC), currently under implementation. This technical assistance (TA) was integral to the strengthening of risk management in SME finance and the promotion of product innovation by SME financial service providers, and therefore extremely important for the success of the above-mentioned project. This TA has been designed with the full cooperation and participation of the Department of Trade and Industry (DTI) and the SBGFC.

Expected Impact, Outcome and Outputs:

The expected impact of the TA was to promote financial deepening by expanding SMEs' access to credit. The expected outcome was to expand the quantity and improve the quality of lending operations of SBGFC, while lowering risk, and mainstreaming market acceptance of nontraditional collateral. Outputs were to include:

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

Delivery of Inputs and Conduct of Activities:

TA4523-PHI was formulated in close cooperation with the implementing agency, SBGFC. The TA budget was adequate to support all field work, workshops and staff training. SBGFC quickly accepted the supporting role of the TA team in coordinating strategic planning, organizational restructuring, and improving the credit management systems. The terms of reference (TOR) for the consultants were clear and 3 international consultants were deployed for 14 person-months between August 2005 and December 2006. During implementation of the TA, the cooperation with the implementing agency became extremely efficient. It was therefore possible to achieve significant savings without compromising the quality of the output. Furthermore, subsequent to internal advice from OGC, it was decided not to field a legal expert in secured transactions. The implementing agency rated the performance of one international consultant as satisfactory and for two other international consultants as excellent.

Evaluation of Outputs and Achievement of Outcome:

The consultants successfully met the terms of reference of the TA and delivered their respective reports on time. Following is a summary of key outputs:

(i) Lending Business - The TA provided international expertise to SBGFC managers and staff in support of building efficient, profitable lending businesses that can achieve substantial outreach. SBGFC needed to strengthen its capacity to evaluate the profitability, credit risk, costs, and efficiency of both its wholesale and emerging retail lending operations. The first key output of the TA was the enhanced capacity to analyze costs, profitability, and credit risk in each of its two main lines of business. As part of this process, the MIS was improved considerably, utilizing its Oracle-based system put into place just before the start of the TA. Another output was a comprehensive reorganization of SBGFC, which established (i) a reorganized financing delivery sector with Luzon wholesale and

Luzon Retail group, Visayas group and Mindanao group; (ii) a product development and management unit, including structured financing, retail and microfinance, wholesale finance, guarantee products, and equity participation; and (iii) a risk management unit comprising risk management policy and credit review.

(ii) Underwriting Process - The second priority was to examine the retail loan underwriting process. SBGFC has a more flexible approach to securing its loans, and accepts a broader range of collateral, than do the larger Philippine commercial banks. The TA provided a specialist in loan product development who worked with SBGFC management to ensure that appropriate non-asset-based lending methodologies are incorporated into their underwriting process. The objective in this effort was to minimize paperwork, processing times, and transaction costs, and to expand lending volumes. During his assignment, the consultant also redesigned the guarantee business and related business processes.

(iii) Credit Scoring Model - Third, the TA assisted SBGFC to develop a proprietary credit scoring model that incorporates SBGFC's own underwriting standards, and draws upon lessons learned from its own lending experience. SBGFC's database of retail customers provided an appropriate starting point for identifying key factors affecting credit quality. Indeed, the available database proved good enough to develop the credit scoring model further into a borrower risk rating (BRR) system that associates different classes of borrowers with different (empirically determined) default probabilities. While the original credit scoring model remains in use for borrowers with a limited history, all standard credit applications now use the BRR as an input for pricing. Since April 2007, the BRR system is also used to determine credit guarantee fees. As a result of these two activities, the review of underwriting policies and procedures and the development of the BRR system, loan products have been streamlined and redesigned so as to be better tailored to SBGFC's clients, and to be more profitable as well. SBGFC is currently starting to disseminate the BRR system to several participating financial institutions (PFIs), associated with the loan.

(iv) Movable Collateral Registry - The TA was to create a blueprint for a movable collateral registry. The component was to include 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. After internal consultation, it was found that the legal and regulatory environment was sufficient for the establishment of a registry for movable collateral. No further analytical work was needed in this respect. In discussions with SBGFC it was agreed that 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. ADB indicated that it will consider supporting the establishment of a private registry for movable collateral, possibly in conjunction with a private credit bureau, or with the existing Registry of Deed system, if SBGFC can reach an agreement with commercial and state-owned banks on establishing such an institution.

Overall Assessment and Rating:

Overall, the TA was successful as it achieved financial deepening in the SME segment of the banking sector. During a review of the associated loan, it was found that by July 2007 a total of 26 PFIs have drawn a total of \$15 million from the loan to SBGFC and provided subloans to 465 SMEs. For at least a quarter of these SMEs, it was their first bank loan. For at least half of the remaining SMEs, it was their first longer term loan. A more thorough analysis will take place after the final disbursement of the loan. The formulation of the TA scope and design was coordinated closely with the implementing agency resulting in a strong partnership. The various training workshops utilized case studies and discussion methods and drew strong participation from the officers and management. As a result, there is now a better understanding of its business inside SBGFC. The expected outcome, to expand the quantity and improve the quality of lending operations of SBGFC has been achieved through reorganization and establishment of a good risk management system. This is reflected in an excellent implementation of the associated project with faster than expected disbursement.

Major Lessons:

The most important factors for the success of this TA were (i) the close cooperation with the implementing agency during the design phase, (ii) the willingness of SBGFC staff to accept change within their organization, and (iii) the resolve of SBGFC management to speedily implement the actions identified by the consultants. Since the end of the TA, SBGFC has continued to improve its systems, moving further up a steep learning curve.

Recommendations and Follow-Up Actions:

The consultants, each for their specific area of expertise, came up with a long list of recommendations, together forming something akin to a roadmap for SBGFC's future involvement in the SME sector of the Philippines. Based on these recommendations, SBGFC formulated a follow-up TA currently under implementation and financed by KfW of Germany. Subsequent to the German TA and final disbursement of ADB's project, ADB will assess the need for (i) further technical assistance, and (ii) an additional loan.