UNIVERSITY OF THE PHILIPPINES
CENTER FOR INTEGRATIVE AND DEVELOPMENT STUDIES
POLITICAL ECONOMY PROGRAM

UP CIDS DISCUSSION PAPER • 2021-01

Micro, small, and medium enterprise (MSME) sector financing
Issues and challenges

Ma. Victoria R. Raquiza

ISSN 2619-7448 (PRINT)
ISSN 2619-7456 (ONLINE)

UNIVERSITY OF THE PHILIPPINES
CENTER FOR INTEGRATIVE AND DEVELOPMENT STUDIES
POLITICAL ECONOMY PROGRAM

UP CIDS DISCUSSION PAPER • 2021-01

Micro, small, and medium enterprise (MSME) sector financing

Issues and challenges

Ma. Victoria R. Raquiza

Micro, small, and medium enterprise (MSME) sector financing
Issues and challenges

Ma. Victoria R. Raquiza[1]

ABSTRACT

A vibrant and strong micro, small, and medium enterprise (MSME) sector can reduce poverty and inequality in the country. In spite of the plethora of Philippine policies and programs for MSMEs, however, the sector continues to suffer from low productivity, slow growth, and little stability. A key element missing is the adequate public financing for MSME development programs. Although financing for MSMEs have increased in the context of the pandemic, much more are needed. But for this to happen, a policy rethink is required that allows government to play a more active and direct role in MSME development.

KEYWORDS

MSMEs, productivity, innovation, financing, economic governance, development

There is widespread recognition of the importance of micro, small, and medium enterprises (MSMEs) in promoting broad-based development. Such appreciation of this sector is based on two grounds. One, in both developed and developing countries, MSMEs comprise the majority of businesses, and employ the bulk of the workforce—a situation that

1 Associate Professor, National College of Public Administration and Governance, University of the Philippines Diliman • Email address: mrraquiza@up.edu.ph

has led to the sector being referred to as the backbone of development. Two, MSMEs, especially those in manufacturing, have high labor productivity potential that, when realized, could provide workers better wages and greater access to social security.

In light of its potential to create jobs, uplift the general standard of living, and reduce inequality in their countries, governments have thus sought to develop a strong and dynamic sector. For instance, with the region's small and medium enterprises (SMEs) contributing 50 to 95 percent of all employment, 30 to 53 percent to gross domestic product (GDP), and 19 to 31 percent to exports (Maehara 2012, 48), the Association of Southeast Asian Nations (ASEAN) has prioritized the sector's development. It formulated the SME Strategic Action Plan (2010–2015), and, in 2018, produced the ASEAN SME Policy Index (OECD and ERIA 2018).

The Philippines more or less follows this regional pattern. What is noteworthy, however, is that while the MSMEs comprise more than 99 percent of all businesses in the country, the sector's contribution to the GDP was the smallest among that of its neighbors. In 2008, for instance, the MSMEs contributed 32 percent, while those in other ASEAN countries were as follows: Indonesia, 57 percent; Malaysia and Thailand, 47 percent; Vietnam, 42 percent; and Singapore, 35 percent (Habito 2014). The relatively low output of the sector in the country suggests that, despite recent efforts to promote MSMEs in line with ASEAN's agenda, the sector remains mired in structural difficulties.

This paper provides an overview of the state of registered MSMEs in the Philippines and focuses on access to credit of those in the formal economy as a key factor to the sector's slow growth.

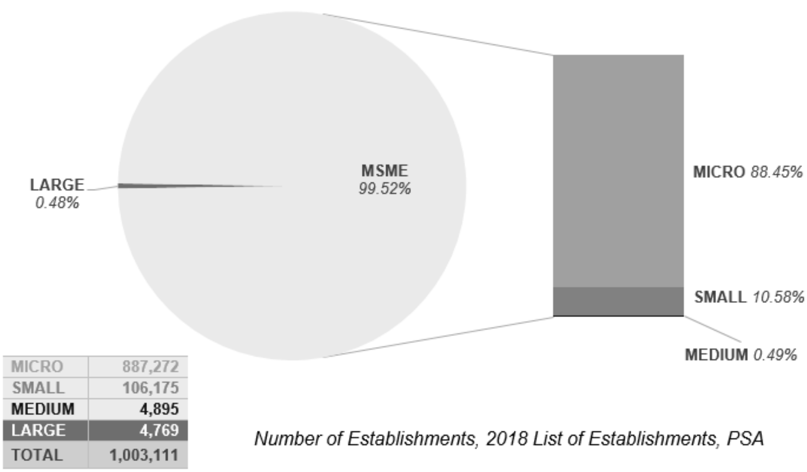
Profile of the Philippine MSME sector

The Department of Trade and Industry (DTI) categorizes businesses as MSMEs based on their asset size and by the number of their employees. In terms of asset size, enterprises are grouped under micro if they have Php 3,000,000 or less in assets, small if they have Php 3,000,001 to Php 15,000,000; and medium, Php 15,000,001 to Php 100,000,000. An enterprise is also considered a micro enterprise if it has one to nine employees, small if it has 10 to 99 employees, and medium if its employees number anywhere from 100 to 199. Businesses with bigger asset size and more number of employees fall under the large enterprise (LE) category.

In 2018, the country had over one million registered firms and of these, 99.5 percent come from the MSME sector. Micro enterprises made up 88.45 percent (or 887,272 establishments) of the sector. Those categorized as "small" constituted 10.58 percent (or 106,175 establishments), while medium and large enterprises constituted a mere 0.49 percent (4,895) and 0.48 percent (4,769) of total number of country's firms, respectively (see Figure 1 below).

The low number of small enterprises and the almost negligible number of medium enterprises highlight the "missing or hollowed middle" phenomenon in the Philippine MSME structure, observed as early as 2012 (Aldaba 2012b, 151). The "missing middle" refers to the miniscule number of small- and medium-sized enterprises as compared to the overwhelming preponderance of micro enterprises. The figures suggest that the number of medium-sized firms have

Figure 1
Number and percentage of enterprises by size, 2018



Source: *PSA 2018 List of Establishments*, cited in DTI n.d.

stayed stagnant despite the robust growth of the country's economy in recent years. Furthermore, the dynamism of SMEs that one finds in countries like Taiwan does not exist in the Philippines, suggesting the "unintegrated" nature of the country's industrial sector (Balisacan and Hill 2003, 239).

This distribution of the country's registered enterprises is also reflected in the deployment of the workforce. Of the 9,043,063 workers employed in registered establishments in 2018, 63.19 percent were from MSMEs; the remaining 36.81 were employed in large establishments (PSA 2018). A breakdown of the workers by industry shows that the biggest category of workers in the sector—representing 25 percent—came from two combined groups, namely wholesale and retail trade, and repair of motor vehicles and motorcycles, while workers in manufacturing and administrative and support services sectors made up 17.80 percent and 14.94 percent, respectively. Noteworthy, even though manufacturing only comprised about 12 percent of firms in the sector, it employed almost 18 percent of MSME workers—suggesting higher labor absorption than that of the trade and vehicle repairs subsectors. Trade and vehicle repairs combined made up 46 percent of firms but employed only 25 percent of the workers in the sector (for the breakdown, see Table 1 on next page).

MSME performance

If high inequality is a stark and sobering reality in the Philippines, nowhere is this more evident than in the private sector. It was noted that many of the offices in skyscrapers that bedazzle the skyline of Metro Manila and other urban centers represent less than one percent of all businesses in the Philippines yet contribute 68 percent of total economic output and incomes. On the other hand, MSMEs make up more than 99 percent but contribute only 32 percent to the country's GDP (Habito 2014). Compared to those in other ASEAN countries, Philippine MSMEs also employ fewer workers—only about 63 percent of the working population as compared to Cambodia's 73 percent, Thailand's 77 percent, Laos' 81 percent, and Indonesia's 97 percent (Habito 2015).

Table 1
Number and percentage of MSMEs and employment, 2018

Category	Number of establishments	% of total*	Number of workers	% of total*
Wholesale/retail trade; repair of motor vehicles & motorcycles	462,349	46.09%	2,264,918	25.05%
Manufacturing	117,468	11.71%	1,609,781	17.80%
Administrative & support services	18,713	1.87%	1,350,697	14.94%
Accommodation & food services	144,640	14.42%	921,292	10.19%
Financial & insurance activities	46,216	4.61%	480,352	5.31%
Education	18,079	1.80%	412,301	4.56%
Agriculture, forestry, & fishing	8,679	0.87%	188,004	2.08%
Information & communication	29,687	2.96%	233,255	2.58%
Other services	66,173	6.60%	232,934	2.58%
Construction	4,507	0.45%	289,151	3.20%
Transport & storage	11,200	1.12%	259,109	2.87%
Professional, scientific, & technical activities	15,974	1.59%	178,095	1.97%
Arts, entertainment, & recreation	15,393	1.53%	105,130	1.16%
Real estate	11,595	1.16%	112,645	1.25%
Electricity, gas, steam, & air conditioning supply	1,298	0.13%	68,015	0.75%

Table 1
Number and percentage of MSMEs and employment, 2018 (continued)

Category	Number of establishments	% of total*	Number of workers	% of total*
Mining & quarrying	850	0.08%	39,092	0.43%
Water supply, sewerage waste management, & remediation activities	1,466	0.15%	40,873	0.45%
Human health and social work activities	28,824	2.87%	257,419	2.85%
Total	**1,003,111**	**100%**	**9,043,063**	**100%**

Source: *PSA 2018 List of Establishments*, cited in DTI n.d.

Furthermore, while MSMEs accounted for more than 60 percent of total jobs, they contributed only 35.7 percent of total sales in manufacturing and value-added (Espenilla 2013). Recent data also shows that while SMEs represent 60 percent of all domestic exporters, they account for only 25 percent of the country's total exports revenue (2018 MSME Statistics; OECD and ERIA 2018). This underscores that export products from this sector are generally of very low value or of low volume.

These figures in the sector's output, revenue, and labor productivity suggest the need to upgrade, diversify, and increase the competitiveness of the country's SMEs if the sector is to make a substantial contribution to the country's pursuit of sustainable and inclusive growth. The next section outlines the main government programs geared toward supporting MSMEs.

Philippine policies and programs for MSMEs

The potential role that MSMEs can play in boosting the Philippine economy is not lost on policymakers. House Representative Rufus

Rodriguez (2014), for instance, noted that "because the sector is generally dispersed nationwide, it has a relatively wide reach and provides an entry point to the economy for entrepreneurs as well as those who are traditionally excluded from the labor force like undergraduates, out-of-school youth, housewives, and persons with disabilities." More, he pointed out that MSMEs also serve as suppliers, subcontractors, and logistic service providers to large enterprises, including exporters (ibid.). This observation is shared by the country's central bank, the Bangko Sentral ng Pilipinas (BSP), stating that despite the limiting enclave character of some in the subsectors, MSMEs are "strategically positioned to effectively create backward and forward linkages" (*GMA News Online* 2010).

Such public recognition of SMEs' potentials is consolidated in and institutionalized with the enactment of the landmark legislation called the Magna Carta for Small Enterprises (Republic Act No. (RA) 6977) in 1991; amended to include medium enterprises (RA 8289) in 1997 and micro enterprises (RA 9501) in 2008). One of the most important provisions of the Act is the creation of the Micro, Small and Medium Enterprise Development (MSMED) Council, the government body primarily "responsible for the promotion, growth, and development of [SMEs]" (Section 6). Its roles include making policy recommendations to the President and Congress on SME-related matters; coordinating and integrating various government and private sector activities; working with local government units; and working with the National Economic and Development Authority (NEDA) and the Coordinating Council for the Philippine Assistance Program in tapping local and foreign funding—all to support the many facets of SME development. In order to accomplish its many roles, Section 9 of the Magna Carta stipulates that the Council would get from the national government budget a separate annual appropriation, while also allowing to receive private sector contributions.

As conceived, the MSMED Council is a body attached to the Department of Trade and Industry with the DTI Bureau of Micro, Small, and Medium Enterprise Development (BMSME) serving as the Council Secretariat and acts as a "one-stop shop" to guide SMEs to specialized support agencies. The BMSME recommends annual and medium-term SME development plans for the Council's approval and prepares position and background papers and yearly reports on the status of SMEs for the Council. It also assists in monitoring and coordinating all SME activities of the government.[2]

Another key provision of the Magna Carta is its Section 15, which requires all lending institutions, whether public or private, to set aside 10 percent of their total loan portfolio for MSMEs (eight percent for micro and small, and at least two percent for medium enterprises) for a ten-year period starting in 2008. In the spirit of "affirmative action," the provision seeks to address the financing gap for MSMEs and to facilitate their entry into the formal lending system. Furthermore, the Magna Carta stipulates that banks that do not comply with this mandatory allocation provision (Section 15) will be penalized with a fine of not less than Php 500,000 (Section 19).

Besides the Magna Carta, other government financing initiatives include the People's Credit and Finance Corporation (PCFC), founded in 1995 to provide loans to microfinance institutions like rural banks, cooperatives, and non-government organizations. In 2002, the Barangay Micro Business Enterprises (BMBE) Law (RA 9178) was enacted in order to "encourag[e] the formation and growth of barangay micro business enterprises" and "integrat[e] those in the informal economy with the mainstream economy" through interventions at the local level and various incentives and benefits for employment generation and poverty alleviation (Section 2). In 2003, the SME Unified Lending Opportunities for National Growth (SULONG) was set up by various government financial institutions (GFIs) to extend credit at concessional interest rates and funds for export financing

2 The DTI has, in fact, 14 offices and 20 line bureaus mandated to support SMEs and SME exporters. As stated in the Magna Carta for MSMEs, the MSMED Council takes charge of formulating SME policies and provides overall guidance and direction in implementing SME programs.

and temporary working and permanent capital and equipment, lot purchase, and building/warehouse construction.[3]

Other legislative measures to improve MSMEs' access to funds are the Agri-Agra Reform Credit Act of 2009 (RA 10000) and the Credit Surety Fund (CSF) Cooperative Act of 2015 (RA 10744).

More recently, the MSME sector gained a boost with the passage of Republic Act No. 10644 (An Act Promoting Job Generation and Inclusive Growth through the Development of Micro, Small, and Medium Enterprises) or the "Go Negosyo Act." Passed in 2014, the Act sought to further boost MSME development by establishing Negosyo Centers in all provinces, cities, and municipalities. The centers sought to promote ease of doing business by providing business registration assistance, business advisory services, business information and advocacy, and monitoring and evaluation (DTI 2015). The Act also aimed to establish a start-up fund for MSMEs and to provide technology transfer, production and management training, marketing assistance for SMEs, and a unified and simplified business registration process through automatic approval of business permits and licenses that are not approved for any reason within 15 days (ibid.).

The Go Negosyo Act expanded the functions of the MSMED Council to include coordinating and acting as an oversight body for Negosyo Centers, drawing up compliance guidelines for rules concerning MSMEs, promoting women entrepreneurship, and developing entrepreneurial education and trainings in coordination with relevant government agencies. The Act also reconstituted the MSMED Council. Today, it is chaired by the DTI Secretary and has the Secretaries of the Department of Agriculture (DA) and Department of the Interior and Local Government (DILG) and the Chair of the Small Business Corporation (SBCorp) as members.[4]

3 SULONG involved various GFIs like the Land Bank of the Philippines, the Development Bank of the Philippines, the SB Corporation, the Quedan and Rural Credit Guarantee Corporation, the Philippine Export-Import Credit Agency, and the National Livelihood Support Fund.

4 The Departments of Labor of Employment and Environment and Natural Resources were no longer included as members of the MSMED Council.

The council now also includes three representatives from the MSME sector to represent Luzon, Visayas, and Mindanao, with at least one representative from the microenterprise sector; a representative from the women's sector designated by the Philippine Commission on Women; and one representative from the youth sector designated by the National Youth Commission.

The Act likewise created an Advisory Council to the MSMED Council composed of the following: the Secretary of the Department of Science and Technology (DOST); the BSP Governor; the Presidents of the Land Bank of the Philippines, Development Bank of the Philippines, and Credit Information Corporation; the Director General of the NEDA; and a representative from the labor sector; and representatives from the private banking sector (to alternate from among the Chamber of Thrift Banks, Rural Bankers Association of the Philippines, and the Bankers' Association of the Philippines), microfinance nongovernment organizations (NGOs), and the University of the Philippines Institute for Small Scale Industries (UP ISSI).

The inclusion of the BSP in the Advisory Council is particularly critical in MSME development especially since it is in charge of promoting the commercial banks' and MSMEs' participation in the different credit programs. It is not only in charge of implementing Section 15 of the Magna Carta for MSMEs. It also issues policies intended to clear regulations that work against MSME lending and promotes incentives, such as Circular 389 that exempts registered SMES from the standard documentary requirements, and Circular 482 that reduced thrift banks and rural banks' reserve requirements if they lend to SMEs (Fonacier 2012). The central bank also conducts on-site examinations of banks engaged in MSME lending to determine their financial conditions while assessing MSMEs' use of loans.[5]

Overall, the efforts of government are reflected in the succeeding Medium-Term Philippine Development Plans. In the 2004–2010

5 Interview with a state bank official, April 1, 2014.

Plan, a One Town, One Product (OTOP) Program was envisioned to support entrepreneurial activities in every municipality or city by developing a product with comparative advantage. In the 2011–2016 Plan, specific constraints to MSME development were identified (i.e., "poor business conditions and access to finance, inability to penetrate export markets, and low level of productivity") (see Sidebar on page 12) and steps were outlined to overcome these (Aldaba 2012b, 147–48). The current Medium-Term Philippine Development Plan 2017–2022 envisions the country's MSMEs to become globally competitive.

Challenge to MSME development: Funding

As the previous section illustrates, the country has a plethora of policies and programs to promote and develop MSMEs. Yet, the sector continues to suffer from low productivity and growth. Thus, while the Philippines was the first country in the ASEAN to formulate a Magna Carta for MSMEs and to establish a MSMED Council in the region, it is now the laggard in terms of MSME performance.[6] What would account for the apparent disconnect? While recognizing other hurdles confronting MSMEs,[7] this section will focus on funding, both in terms of budgetary support for MSME programs and accessible and affordable credit for MSMEs.

MSME development budget

The idea that there is a variety of government programs supporting MSMEs needs to be tempered by the reality that many of these suffer from neglect and low funding. Noteworthy, from 1991 to 2013, the MSMED Council did not receive any budget from the General Appropriations Act (GAA), despite this being stipulated in Section 20 of the Magna Carta for MSMEs. It was only in 2013, due

6 Interview with a government official working with MSMEs, August 26, 2015.

7 Hurdles confronting MSMEs are formidable and spread out across many domains, including the business environment, access to markets, and productivity and efficiency (Clavesillas 2013).

SIDEBAR

Binding constraints to MSME development and government response

The Micro, Small, and Medium Enterprises (MSME) Development Plan identifies challenges confronting the sector and the steps taken by the government to address these. Besides credit, the Plan also focuses on the following areas: business environment, access to markets, and productivity and efficiency.*

Focus areas	Challenges	Responses
Business environment	• High cost of doing business (e.g., taxes, fees, etc.) • Tedious, lengthy, and complicated registration and licensing procedures • Lack of coordination and harmonization in concerned agencies' efforts to develop a conducive business environment for MSMEs • Inadequate enforcement of laws and policies supporting MSME development • Lack of or failure to implement investment codes in several regions	• Passage of the Ease of Doing Business and Efficient Government Service Delivery Act (RA 11032) in 2018 in order to streamline government procedures and systems, especially to ensure prompt action on business applications and all sorts of citizens' inquiries and concerns • Establishment of the Anti-Red Tape Authority (ARTA) under the Office of the President

* This brief overview is based on the MSME Development Plan 2011–2016 and the MSME Development Plan 2017–2022.

Focus areas	Challenges	Responses
	• Lack of infrastructure and utilities needed to promote business and investments in several regions • Some regions inordinately prone to more risks • Enablers' lack of capacity to support and promote the MSME sector	
Market access	• Stiff competition from unregistered enterprises and cheap imports • Limited access to organized marketing networks of independent consolidators • Uncoordinated marketing support for MSMEs • Poorly packaged and labeled products • Limited capacity for product development and design • Lack of certification and accreditation needed to penetrate new markets • Lack of access to market information	• Enhanced support for trade fairs and exhibitions, product development, and design services • Export Pathways Program–Regional Interactive Platform for Philippine Exports (RIPPLES) • OTOP (One Town-One Product) • Tindahang Pinoy (Filipino Store) • Information sessions on free trade agreements (FTAs)
Productivity and efficiency	• Unsteady supply and high cost of water and electricity, which	• Industrious, Systematic, Time-conscious, Innovative,

Focus areas	Challenges	Responses
	• adversely impact MSME productivity • Lack of information and education on productivity • Reduced level of productivity due to poor working conditions arising from non-compliance with labor laws • Production systems that are not environmentally friendly • Lack of knowledge on and capacity to comply with international quality standards • Piracy of highly skilled workers • Vocational and technical schools not offering learning programs that are responsive to MSME needs • Low investment in productivity-enhancing technologies • Expensive services of government-subsidized technology/ packaging centers • Inability to access productivity programs due to high costs	and Strong Values (ISTIV)–Productivity Awareness Program • Small Enterprise Technology Upgrading Program (SET-UP) • Shared Service Facilities (SSF) integrating the various interventions by the various providers, with DTI identifying potential participants, training needs, and trainers

to the advocacy efforts of the MSMED Council, that the Department of Budget and Management (DBM) began to channel a significant percentage of the penalties that arose from banks' non-compliance with the mandatory allocation provision to the MSMED Council. In 2015, 90 percent of the Council budget for its operations came from the penalties collected by the BSP (DBM 2014).

That the budget for the MSMED Council was largely based on the private banks' acts of omission raises questions on the seriousness of the government's pursuit of MSME development. On the one hand, the amounts generated from the penalties fall short in meeting the MSMED Council's needs. In 2014, for instance, fines collected totaled a mere Php 16 million so that the regions only each got Php 1 million for MSME promotion.[8] On the other hand, relying on private banks' negative behavior for funding means that the more banks fail to comply with the mandatory allocation provision, the more funds the Council will have for its operations. As such, the Council's source of funding works against it being able to fulfill its role, which includes improving MSMEs' access to credit.

The woeful lack of budgetary support for the MSMED Council has also constrained it from realizing its full potential as a policymaking body. According to a government official involved in the sector, largely due to the lack of resources, the Council's role has been reduced to simply consolidating the different government agencies' lists of MSME programs and initiatives and packaging these as the country's MSME national plan.

Some relief may come from the enactment of Executive Order 50 approving the MSMED Council's 2017–2022 Development Plan. It stipulated that the Council's budget will be sourced from the "applicable budgets of concerned agencies" and other sources to be identified by the DBM and the MSMED Council Fund, depending on approval and availability of funds. There is logic here given that many of the MSME programs and projects listed in the MSMED

8 Interview with government official working with MSMEs, August 26, 2015.

Council Development Plan are those budgeted and implemented by other agencies such as the DOST and the DA.

However, it is noteworthy that the DTI, which is the agency primarily responsible for MSME development and the operations of the MSMED Council, has one of the smallest budgets among Philippine departments. While its budget has steadily increased from Php 4.67 billion in 2017 to Php 7.9 billion in 2020, the DTI has never broken into the ranks of the top ten government agencies with the highest budget allocations since 1987. Its limited budget has greatly constrained services it provides to help MSME operations. The budget of its Shared Service Facilities (SSF) project, aimed at boosting the productivity of MSMEs by providing machines and equipment for common use, was only Php 574 million in 2020.

By comparison, for instance, the budget of the Department of Social Welfare and Development (DSWD) in 2020 stood at Php 162.09 billion in 2020. The agency's biggest budget item was the Pantawid Pamilyang Pilipino Program (4Ps), a conditional cash transfer program aimed at boosting the health and education status of poor families. The 2020 4Ps budget alone stood at a whopping Php 108.765 billion or 67 percent of the entire DSWD budget.

Undoubtedly, providing social protection for economically disadvantaged and socially excluded groups is necessary especially for developing countries like the Philippines with significantly high levels of poverty. Yet the colossal disparity in the budgets of DSWD and DTI in general, and the specific budgets of the SSF and the 4Ps in particular, needs to be addressed. When asked to explain this puzzle, a former NEDA official stated, "The small budget of DTI comes from a market philosophy that the government should not be in business itself or be a practitioner. According to this view, there is no justification for a large budget because it is not expected to make catalytic investments. There is an economic theory behind it which is neoliberal."[9]

9 Interview with former NEDA official, April 14, 2014.

Such a policy perspective would suggest the need for a fundamental policy rethink on the government development priorities. There is an abundance of empirical evidence from other countries' experiences, where governments infused significantly higher amounts of funding to increase the productivity and innovation capacity of MSMEs under its policy direction, which in turn helped them to reduce levels of poverty and inequality and to uplift the people's standard of living.

Commercial banks' participation in MSME lending

Despite the Magna Carta's mandatory allocation provision and other financing facilities for MSMEs that have been set up since the 1990s, access to credit continues to be among the most binding constraint to MSME development. Studies found that capital raised by SMEs from the banking sector, ranged from a low 11 percent[10] (Nangia and Valliancourt 2006; cited in Aldaba 2012b, 154) to 21 to 28 percent (Espenilla 2013)—lower than the 30 percent international benchmark (ibid.). This indicates that the rest of their financing needs come from other sources, such as their own personal resources, family/clan members, friends, and informal lenders (Aldaba 2012a, 14).

Recent data shows that while MSME lending by commercial banks has increased, it still fell short of the 10 percent of banks' portfolio that was previously required up until 2018. Concretely, in 2019, MSME lending totaled Php 579.13 billion, broken down as follows: big banks lent Php 473 billion; thrift banks, Php 73.5 billion; and rural and cooperative banks, Php 42.09 billion (Caraballo 2020). Nevertheless, this amount was equivalent to only about seven percent, rather than 10 percent, of the total loan bank portfolio that was expected to be allocated for MSME financing, as required by the Magna Carta for MSMEs. Ten percent of total loan portfolio for 2019 was estimated at Php 8.14 trillion.

10 This figure is based on the International Finance Corporation–Private Enterprise Partnership (IFC–PEP) SME Finance Survey 2007.

Another study revealed that in 2019, Philippine banks lent USD 11.6 billion to small and medium enterprises—an amount that pales in comparison with counterparts in other Southeast Asian countries (ADB 2020). As of mid-2020, banks in Thailand lent USD 218.2 billion, USD 79.9 billion in Indonesia, USD 68.1 billion in Malaysia, and USD 56.85 billion in Singapore. This gap underscores the reality that MSME lending by Philippine banks remains the laggard among peer nations (Cuaresma 2020).

In fact, there are studies of foreign and domestic banks resorting to dubious practices in an apparent attempt to avoid allocating 10 percent of their loans to MSMEs, as provided by Section 15 of the Magna Carta.[11] Studies note instances of private banks (1) giving the bulk of funds charged against SME financing to large firms that hide their true worth in order to qualify as medium enterprises, (2) depositing the required amount to the BSP rather than seek out SME borrowers, and, more telling, (3) preferring to pay fines rather than "set aside non-income generating funds for lending to medium enterprises" (Aldaba 2012a, 17). One instance had a commercial bank acquiring a small bank that would provide loans to MSMEs, and using the latter's record as proof of its compliance with the law.[12] Other banks resort to alternative compliance methods such as buying preferred stocks issued by the SBC with the money generated used for MSMEs.[13] Many commercial banks also provide aggregate figures in their reports to the BSP without any breakdown, and then cite the Bank Secrecy Law to justify this.[14]

Notably, such practices have not been challenged in court in order to ascertain their compliance with the law. One GFI official[15] observed

11 The discussion on problems with the implementation of the Magna Carta for MSME is largely based on interviews with government officials and MSME representatives conducted in early 2014.

12 Interview with a state bank officer who works with MSMEs, April 1, 2014.

13 Ibid.

14 Interview with an officer of a national business organization, March 10, 2014.

15 The data and quotation in this paragraph was taken from an interview with a GFI official on June 10, 2014.

that there seems to be a significant degree of ambivalence about the previous mandatory provisions on the part of the private sector and even policymakers. He states that, "On the one hand, we say it is just that the government promote SME lending by private enterprises and banks (in accordance with the mandatory allocation provision in the Magna Carta for MSMEs). On the other hand, there is the prevailing notion that this law is an intrusion into business matters, that lending is essentially a private concern, a free market issue. Government has no business telling banks whom they have to lend and how much."

Besides weak enforcement of the law, there is also the need to minimize the risks associated with MSME lending in order to increase private sector participation in the national effort of MSME development. Thus, as one officer of a big commercial bank opined, "it is important for the government to create the policy environment so that banks will feel foolish for not entering this market."

Working toward this end, a number of proposals have been raised, such as the strengthening of the Credit Information Corporation (CIC),[16] which is tasked to provide banks with timely and reliable information on potential MSME borrowers, and of the credit guarantee system (CGS).

Access to affordable credit

Partly due to issues raised above, MSMEs' access to credit from formal lending institutions continues to be extremely limited. Generally, Philippine MSMEs, especially those in the micro subsector, do not approach commercial banks for credit due to a lot of stipulations that are beyond their reach and capacity. Such stipulations include high interest rates, relatively high minimum loan requirements (higher than what

16 The creation of the Credit Information Corporation (CIC) was enacted in 2008 through Republic Act No. 9510, which states that it has the power and function "to receive and consolidate basic credit data, to act as a central registry or central repository for credit information, and to provide access to reliable, standardized information on credit history and the financial conditions of borrowers" (Section 5).

many MSMEs can afford), stringent and voluminous requirements and long processing time of loan applications, short repayment periods, and difficulty in restructuring loans. Moreover, many micro and small enterprises lack collateral and most MSME financing facilities are in urban areas only.

By definition, micro and small enterprises are constrained by their limited size and scale. The likelihood that losses will be incurred over and above income or earnings, especially in the early to medium stages of the business, is relatively high, necessitating an "incubation" period of trial and error up until the time the enterprise can become economically stable and stand on its own. As Development Bank of the Philippines President and Chief Executive Officer Emmanuel G. Herbosa thus observes about MSME lending, "it requires more assistance and handholding, especially in the aspects of risk management and cash management, as the entrepreneur is establishing himself and his business operations" (quoted in Ramos 2020).

In this context, attention is now focused on the Small Business Corporation (SBCorp). In 2001, through Executive Order 28, the Guarantee Fund for Small and Medium Enterprises (GFSME) was merged with the Small Business Guarantee Fund Corporation and came to be known as the Small Business Corporation. The SBCorp, an attached agency under the DTI, has as its sole mandate the provision of an array of financial services addressed to the MSME sector and, in particular, its poorer segment. As stated in its website, the SBCorp will "champion the neglected business segments of the country to get them to access the capital needed to grow successful" and "cause prosperity among *MSME segments traditionally considered unfinanciable*, thereby increasing economic diversity and inclusion" (SBCorp n.d.; italics mine).

The SBCorp explicitly identifies the type of MSMEs it prioritizes: micro and small agri- and aqua-enterprises, micro retailers, small island economies, MSMEs requiring rehabilitation arising from disaster, Islamic MSMEs, indigenous people (IP)-owned enterprises, and first-time small businesses (ibid.). In other words, the SBCorp prioritizes MSME lending for the poorest and socially excluded sectors from a clear developmental and public service mandate. Target beneficiaries, therefore, belong to subsectors associated with the highest risk for lending.

In 2017, the SBCorp received a boost from the current administration when it was tasked to implement the Pondo sa Pagbabago at Pag-asenso (P3). With the P3 Program, the SBCorp approved a total of Php 1.2 billion in credit line and released Php 784 million to 20,104 micro enterprises. The huge number of its beneficiaries is due to the micro amounts of Php 5,000 to Php 200,000 that it lends out per borrower, under its P3 Regular-Retail Program.[17] Launched with the purported aim by the administration to lessen cash-strapped MSMEs' recourse to usurious lending (known colloquially as the "5-6 scheme"), the P3 Program's combined interest rate and service fees do not exceed 2.5 percent monthly, much lower than the 20 percent charged monthly by so-called loan sharks.

Recently, in light of the COVID-19 pandemic and its ensuing economic crisis, the government has significantly increased its support for MSMEs through new infusion of funds to the P3 Program. SBCorp received a massive boost when it received Php 10 billion for MSME lending from the recently enacted Bayanihan to Recover as One Act (RA 11494) under a COVID-19 Assistance to Restart Enterprises Program (Ibañez 2020). With this, the SBCorp aims to expand lending to 50,000 MSMEs within a one-year period (ibid.).

The work ahead

Despite the Philippines having a plethora of policies on and programs for MSMEs, the sector today trails behind their counterparts in other countries in the ASEAN region. The proximate cause for this state is the low budgetary support that government agencies mainly responsible for MSME development receive. There is an urgent need

17 According to SBCorp (n.d.), these loans are given "depending on the size of the borrower's business and its ability to pay. For enterprises with at least one (1) employee, beneficiary can borrow up to P200,000.00. The fund should be used for the enterprise's expansion or acquisition of additional supplies of the business."

to significantly increase the budget of the DTI and attached agencies in charge of increasing the productivity and innovation of MSMEs. If the MSME Council is to effectively perform its leading role in MSME development, it has to be provided funds from the national budget. This also goes for the operations of Negosyo Centers in provinces, cities, and municipalities as mandated by law.

In this connection, while MSME development programs like the Shared Services Facility and the SBCorp have gotten increased funding recently through the P3 Program, their share of the national budget continues to be one of the smallest among government agencies. To stress the point, one just needs to compare the billions of pesos that go to social protection programs and the small amounts allocated to MSME programs. As argued by two GFI officers, support for MSMEs, and specifically micro enterprises, should be seen as complementary to anti-poverty programs such as the conditional cash transfer (CCT) program: the entrepreneurial poor need budgetary and other forms of support for their productive endeavors.[18] Programs like the SSF and the P3 promote the stability, productivity, and capacity of micro-enterprises that, in turn, will contribute to reducing poverty and help create sustainable and broad-based development. Deloitte, UNDP, and UNIDO (2004, 3), for instance, note that:

---

18 One former head of a GFI observed when comparing budgetary support for CCTs vis-à-vis MSMEs: "If it is okay to give cash to the poorest as in the case of CCT, what about the poor with micro or small businesses who just need the extra hand-holding, a little push? Aren't they an important subset of the poor who have the potential to stand on their own economically but need that extra push? If they succeed, they will be contributing to society by paying more taxes and generating employment [...]. JICA helped us plan the SMED Development Plan and brought us to Japan to see the experience there. There were so many subsidies, guarantees for the poor, and many financial institutions catering to SMEs. As such, MSME lending can act as a good additionality to CCT" (Interview with former GFI head, October 21, 2014).

Another GFI officer went one step further by stating that, "if we are prepared to do CCT, this is also good because [...] you are investing in productive activities. While it's true that there are risks [...] there is a real possibility of recovering the investment. With CCT, it's one way and the returns are a bit far off and there are also a lot of risks" (Interview with GFI officer, April 16, 2014).

> The social benefits of a strong and vibrant SME sector are also accepted, and provide empowerment and a route out of poverty for many of the poor in developing countries. SMEs have a positive impact on income distribution, although it is recognized that it is the smaller enterprises that must be specifically targeted in order for the benefits of SME development to reach the poorest.

Finally, as suggested above, MSME development programs have also been weighed down by their incoherent implementation—a problem that may be rooted in the dominance of a market-led policy framework on economic governance. As a former top government official observed, the government is not expected to intervene in the economy, as this should be the purview of the private sector and to do so would be to distort market signals.

There is an urgent need to rethink the government's policy framework especially in economic governance. Given the plight of MSMEs in the country in the last few decades, urgent and bold action from the government are needed to address their lack of access to credit and other types of support. This imperative is underscored with the advent of the COVID-19 pandemic that has worsened the social and economic conditions of the people. For as long as these MSME-related laws, institutions, and programs remain starved of public resources, the country's dream of inclusive development will remain out of reach. ■

References

ADB (Asian Development Bank). 2020. "Asia Small and Medium-Sized Enterprise Monitor 2020," Volume II (COVID-19 Impact on Micro, Small, and Medium-Sized Enterprises in Developing Asia). November 2020. Mandaluyong City: Asian Development Bank.

Aldaba, Rafaelita M. 2012a. "Small and Medium Enterprises' (SMEs) Access to Finance: Philippines." Philippine Institute for Development Studies Discussion Paper Series No. 2012-05. Makati City: Philippine Institute for Development Studies.

———. 2012b. "SME Development: Narrowing the Development Gap in the ASEAN Economic Community." *Philippine Journal of Development* 39, nos. 1–2: 143–69.

Balisacan, Arsenio M., and Hall Hill. 2003. *The Philippine Economy: Development, Policies, and Challenges.* New York: Oxford University Press.

Canivel, Roy Stephen C. 2020. "Groups Buck Added Paperwork Burden on MSMEs." *Philippine Daily Inquirer*, November 3, 2020. https://business.inquirer.net/311000/groups-buck-added-burden-on-msmes.

Caraballo, Mayvelin U. 2020. "Banks Fell Short of Mandated MSME Lending in 2019 – BSP." *The Manila Times*, May 4, 2020. https://www.manilatimes.net/2020/05/04/business/business-top/banks-fell-short-of-mandated-msme-lending-in-2019-bsp/722083/.

Clavesillas, Jerry. 2013. "Challenges and Opportunities of SME Upgrading with the Context of the Philippine MSMED Plan 2011–2016." *Philippine Journal on Innovation and Entrepreneurship* 1, no. 1: 73–74.

Cuaresma, Bianca. 2020. "PHL Banks Lend the Least to MSMEs Among Asean-5." *Business Mirror*, October 23, 2020. https://businessmirror.com.ph/2020/10/23/phl-banks-lend-the-least-to-msmes-among-asean-5/.

DBM (Department of Budget and Management). 2014. "XXII. Department of Trade and Industry." In *General Appropriations*

Act, FY 2015, 963–90. Manila: Department of Budget and Management.

Deelen, Linda, and Klaas Molenar. 2004. *Guarantee Funds for Small Enterprises: A Manual for Guarantee Fund Managers*. Geneva: International Labor Organization.

Deloitte (Deloitte Toche Tohmatsu Emerging Markets Ltd.), UNDP (United Nations Development Programme), and UNIDO (United Nations Industrial Development Organization). 2004. *Partnerships for Small Enterprise Development*. New York: United Nations Development Programme and United Nations Industrial Development Organization.

DOST–NCR (Department of Science and Technology–National Capital Region). 2015. "Small Enterprise Technology Upgrading Program." Accessed August 20, 2020. https://ncr.dost.gov.ph/program_setup.php.

DTI (Department of Trade and Industry). 2015. *The "Go Negosyo" Act: A Briefer*. Makati City: Department of Trade and Industry.

———. n.d. "2018 Philippine MSME Statistics in Brief." Accessed August 20, 2020. https://dtiwebfiles.s3-ap-southeast-1.amazonaws.com/e-library/Growing+a+Business/MSME+Statistics/2018/2018+Philippine+MSME+Statistics+in+Brief.pdf.

Department of Trade and Industry–Bureau of Micro, Small and Medium Enterprise Development (DTI–BMSMED). n.d. *Guide to the Magna Carta for Micro, Small and Medium Enterprises*. Makati City: Department of Trade and Industry.

Espenilla, Nestor. 2013. "Talking Points for Deputy Governor Nestor A. Espenilla Jr. for the Interview with *Business World* on SMEs." May 15, 2013, unpublished document.

Fonacier, Chuchi G. 2012. Untitled speech delivered during the official launch of FINEX-SME Plus, September 19, 2012, Shangri-la Hotel, Makati City.

GMA News Online. 2010. "BSP Airs MSME Concerns about Access to Credit." September 26, 2010. https://www.gmanetwork.com/

news/money/content/201976/bsp-airs-msme-concerns-about-access-to-credit/story/.

Habito, Cielito F. 2014. "Pitching In for Inclusive Growth." No Free Lunch, *Philippine Daily Inquirer*, September 2, 2014. http://opinion.inquirer.net/78077/pitching-in-for-inclusive-growth.

———. 2015. "Nurturing SMEs, the Japanese Way." No Free Lunch, *Philippine Daily Inquirer*, March 3, 2015. http://opinion.inquirer.net/83007/nurturing-smes-the-japanese-way.

Ibañez, Jenina P. 2020. "SB Corp. Receives P10B for Loan Program, To Take Applications Next Week." *Business World*, October 22, 2020. https://www.bworldonline.com/sb-corp-receives-p10b-for-loan-program-to-take-applications-next-week/.

ILO (International Labour Organization). 2020. "Statistics on Labour Productivity." Accessed August 20, 2020. https://ilostat.ilo.org/topics/labour-productivity/.

Maehara, Yasuhiro. 2012. "The Role of Credit Risk Database in SME Financing." In *The 25th Anniversary Publication of Asian Credit Supplementation Institution Confederation (ACSIC): The 25-Year History of ACSIC*, edited by the Asian Credit Supplementation Institution Confederation, 48–68. Tokyo: Japan Finance Corporation.

MSMED Council (Micro, Small, and Medium Enterprise Development Council). 2010. *Micro, Small and Medium Enterprise Development Plan 2011–2016*. Makati City: Micro, Small, and Medium Enterprise Development Council.

———. 2018. *Micro, Small and Medium Enterprise Development Plan 2017–2022*. Makati City: Micro, Small, and Medium Enterprise Development Council.

NEDA (National Economic and Development Authority). 2004. *Philippine Development Plan 2004–2010*. Pasig City: National Economic and Development Authority.

———. 2014. *Medium Term Philippine Development Plan 2011–2016: Midterm Update*. Pasig City: National Economic and Development Authority.

Nemoto, Tadanobu. 2012. "The Design of Public Credit Guarantee Scheme and the Significance of the Performance Evaluation." In *The 25th Anniversary Publication of Asian Credit Supplementation Institution Confederation (ACSIC): The 25-Year History of ACSIC*, edited by the Asian Credit Supplementation Institution Confederation, 28–47. Tokyo: Japan Finance Corporation.

OECD (Organization for Economic Cooperation and Development). 2010. "Facilitating Access to Finance: Discussion Paper on Credit Guarantee Schemes." Accessed March 28, 2014. http//www.oecd.org/globalrelations/4532327.pdf.

OECD (Organization for Economic Cooperation and Development) and ERIA (Economic Research Institute for ASEAN and East Asia). 2018. *SME Policy Index: ASEAN 2018; Boosting Competitiveness and Inclusive Growth*. Paris: OECD Publishing.

PSA (Philippine Statistics Authority). n.d. "Annual Survey of Philippine Business and Industry—Manufacturing" (All Releases). Accessed August 20, 2020. https://psa.gov.ph/manufacturing/aspbi.

———. 2013. "2012 Updating of the List of Establishments (ULE): Final Result." December 18, 2013. https://psa.gov.ph/content/2012-updating-list-establishments-ule-final-result.

———. 2019. *Philippine Statistical Yearbook 2019*. Quezon City: Philippine Statistics Authority.

Ramos, Marissa Mae M. 2020. "Banking on MSMEs: Making Business Loans Easy." *Business World*, February 24, 2020. https://www.bworldonline.com/banking-on-msmes-making-business-loans-easy/.

Republic of the Philippines. 2002. "Republic Act No. 9178 (Barangay Micro Business Enterprises (BMBEs) Act of 2002)." *Official Gazette,* November 13, 2002. https://www.officialgazette.gov.ph/2002/11/13/republic-act-no-9178/.

———. 2014. "Republic Act No. 10644 (Go Negosyo Act)." *Official Gazette,* July 15, 2014. https://www.officialgazette.gov.ph/2014/07/15/republic-act-no-10644/.

Rodriguez, Rufus. 2014. “The True State of MSME Financing in the Philippines.” Privilege speech delivered at the Sixteenth Congress of the Philippines, March 5, 2014.

SBCorp (Small Business Corporation). n.d. “Corporate Profile.” Accessed October 25, 2020. https://www.sbgfc.org.ph/about-us/corporate-profile.

THE CENTER

Established in 1985 by University of the Philippines (UP) President Edgardo J. Angara, the UP Center for Integrative and Development Studies (UP CIDS) is the policy research unit of the University that connects disciplines and scholars across the several units of the UP System. It is mandated to encourage collaborative and rigorous research addressing issues of national significance by supporting scholars and securing funding, enabling them to produce outputs and recommendations for public policy.

The UP CIDS currently has twelve research programs that are clustered under the areas of education and capacity building, development, and social, political, and cultural studies. In addition, the Center also convenes the Local-Regional Studies Network (LRSN), which supports projects of research centers in UP constituent universities.

THE PROGRAM

The **Political Economy Program (PEP)** adopts an interdisciplinary approach to the study of development policies and praxis, focusing on research that examines the interaction between state and market as well as facilitating academe-government-industry-civil society linkages aimed at promoting innovation-driven and equitable development. It seeks to help strengthen policy reforms aimed at advancing equitable development; promote an inclusive and innovation-driven industrial policy; and contribute to the popularization of the use of the political economy perspective in the study and resolution of development and economic problems.

The Program seeks to contribute to building the momentum for development policies and programs that promote domestic production, higher productivity, and the just distribution of development resources. It also strives to identify or create spaces for critical engagement and cooperation of the academic and research community, the government, and industry and producer groups.

The **UP CIDS Discussion Paper Series** is published quarterly by the University of the Philippines Center for Integrative and Development Studies.

Editorial Office
Lower Ground Floor, Ang Bahay ng Alumni, Magsaysay Avenue,
University of the Philippines, Diliman, Quezon City 1101

Telephone
(02) 8981-8500 loc. 4266 to 68 • (02) 8426-0955

Email
cids@up.edu.ph • cidspublications@up.edu.ph

EDITORIAL RESPONSIBILITIES

The Editor-in-Chief and the Program Editors ensure that the discussion papers contain research findings on issues that are aligned with the core agenda of the research programs under the University of the Philippines Center for Integrative and Development Studies (UP CIDS).

The responsibility of the Editor-in-Chief and the Program Editors is towards high standards of scholarship, the generation of new knowledge that can be utilized for the good of the public, and the dissemination of such information.

COVER IMAGE
INDUSTRY.GOV.PH

UNIVERSITY OF THE PHILIPPINES
CENTER FOR INTEGRATIVE AND DEVELOPMENT STUDIES
Lower Ground Floor, Ang Bahay ng Alumni
Magsaysay Avenue, University of the Philippines
Diliman, Quezon City 1101

Telephone: (02) 8981-8500 loc. 4266 to 4268 / (02) 8426-0955
Email: cids@up.edu.ph / cidspublications@up.edu.ph
Website: cids.up.edu.ph