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**Review of Existing Policies affecting
Micro, Small, and Medium Enterprises (MSMEs)
in the Philippines**
December 2004



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**The Small and Medium Enterprise Development for
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A DTI-TESDA-GTZ Program

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FOREWORD

The Medium Term Philippine Development Plan (MTPDP) 2004-2010 recognizes the significant contribution of micro, small and medium enterprises (MSMEs) in the country's development as they constitute 99.6% of businesses, generate 70% of jobs and 30 % in value-added.

However, MSMEs' potential to contribute even more into the economy is affected by legal, policy and regulatory limitations. In an attempt to know more about these impediments and the corresponding solutions to these growth barriers, the **German Technical Cooperation or the Deutsche Gesellschaft fuer Technische Zusammenarbeit (GTZ) through the Small and Medium Enterprise Development for Sustainable Employment Program (SMEDSEP)** commissioned a study that aimed to look at MSMEs vis-à-vis policies, laws and regulations, problems and issues that affect them. This study aims to look at the specific activities of MSMEs vis-à-vis policies, laws and regulations, the problems and issues that affect them, and to recommend solutions to address such.

The study also covered the BMBE Act of 2002, the Magna Carta for SMEs, Direct Regulatory Policy (i.e., Business Registration), policies related to Financing, Fiscal, Labor and Human Resources Development, Trade, Technology and Competition. A series of validation discussions with MSMEs was conducted to determine the actual effects of these policies, laws and regulations on the ground. The main findings were presented and discussed with representatives of the private sector specifically the Philippine Chamber of Commerce and Industry, industry associations, SMED Council, and other government agencies in October 2004.

We would like to express our appreciation and gratitude to GTZ through the SMEDSEP which made this study possible. The SMEDSEP is a joint undertaking by GTZ, the Department of Trade and Industry (DTI) and Technical Education and Skills Development Authority (TESDA) which aims to contribute to the establishment of favourable business conditions that shall result to increased SMESME competitiveness and greater employment.

It is hoped that the readers will find this study useful in our respective efforts to boost the country's MSMEs.



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Undersecretary, DTI Small and Medium Enterprise Development Group

Executive Summary

The study reviews the existing laws and policies affecting micro, small and medium enterprises in the Philippines. Why should micro-, small and medium enterprises (MSMEs) be singled out in a study of legal environments? After all, even large firms are subject to the same legal framework that makes the Philippines among the most regulated in Asia¹. If firms were of similar sizes and if there were no economies or diseconomies due to size, there would be no reason to study MSMEs. But 99.7% of all firms in the Philippines belong to the MSME sector. More importantly *size matters*, and perhaps even more so in the field of bureaucratic rules and regulations. LEs have a greater say in the crafting of laws and institutions that affect them. Unlike small firms, their internal structure provides them specialized agents (e.g. accountants) that can handle the minutiae of bureaucratic rules and regulations. Moreover, transaction costs associated with rules weigh more heavily on the MSME than on the LE.

The present study therefore aims to evaluate the existing laws and regulations that are relevant to the workings of MSMEs. An analysis of the ***intent/content*** of national laws and local ordinances that affect the different areas of activity of MSMEs is first undertaken. This includes the department orders and memorandum circulars of departments, agencies, or branches of national government (e.g. Department of Trade and Industry, the Bangko Sentral ng Pilipinas, the Bureau of Internal Revenue) tasked with their implementation. Given the existing plethora of laws and policies, some judgment had to be made with regard to the choice of laws and policies to be considered. Then ***effects*** of these laws and regulations on MSMEs are determined through the use of focused group discussions (FGDs) involving a number of micro, small and medium enterprise owners undertaken in two cities in the Visayas. Through such 'voices from the ground' we are able to present a number of doables – in the short, medium, and long term – that can subsequently be considered by policymakers in the formulation of policy towards MSMEs.

Of the many findings of the study, two obstacles to growth stand out, namely the difficulties encountered by the microenterprises with regard to registering their business and the lack of access, particularly of SMEs, to finance. With regard to the first, an attempt was made by the government to encourage registration, particularly to make these microenterprises emerge from the informal economy, through the Barangay Micro Business Enterprise (BMBE) Act of 2002. However, the generous incentives, offered by the law to make microenterprises register, proved to be the very reason why government agencies

¹ The Global Competitive Report 2000/01 reports that the burden of regulation in the country is only better than Bangladesh, India, China, Indonesia and Vietnam.

tasked with implementing the law (particularly the Department of Finance and the local government unit) did not ease the burden of registration. Hence there was a low turnout in microenterprise registration, calling into question the usefulness of the Act in the first place. The second obstacle to growth was the continued lack of access of SMEs to finance, forcing them to rely on own-savings or the informal sources of credit. In spite of the reforms of the financial system, which may have increased the flow of credit somewhat, SMEs complained that banks still considered their projects in terms of bankability, rather than viability, leading them to rely mainly on collateral-lending. Even the Sulong Program of Government was generally judged to have been undercut in effectiveness due to limited funding as well as the conduit banks' reliance on collateral.

In addition to the above findings, under fiscal policy, taxes (such as income tax, VAT, etc) did not seem to be significantly burdensome for MSMEs. However, they would benefit a lot from better information flows and assistance with regard to payment of their tax liabilities. This would even reduce the possibility of informal payments to government tax agents, hence would tend to reduce corruption. On the availment of incentives, the lack of regional offices of the BOI that could process their applications raised the cost for the SMEs to avail of such incentives. Moreover, the documentary requirements of incentive availment tend to discourage SMEs from availing of them in the first place.

In terms of trade policy, the recent Trade Reform Policy undertaken by government liberalized many of the imported input requirements of SMEs, possibly leading to a growth in their exports. But among export-oriented SMEs, there is a consensus that government should subsidize the cost of fairs and exhibits during which they showcase their products and meet potential customers. However, Customs practices vis-à-vis SMEs could still prove to be a burden to them, e.g. through long delays in the clearing of imports.

With regard to human resource (labor) development policy, MSMEs were found to have difficulties in meeting the minimum wage law requirements. The clamor is for a more productivity-based wage, including the use of piece-rate.

Technology policy with reference to industry is mainly confused, due to the attempt by government to include as many sectors as possible in the Investment Priorities Plan which in turn allows firms to avail of incentives. Moreover there is a lack of a legal framework for competition policy in the country, but this lacuna does not seem to impose much of a burden on MSMEs.

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Review of Existing Policies and Laws Affecting MSMEs in the Philippines

1.0 INTRODUCTION

As of 20 May 2003, the Department of Trade and Industry (DTI) has identified 107 laws and regulations affecting small and medium enterprises (SMEs) in various areas of their business. Probably a more thorough listing would be able to identify a hundred more². Admittedly, a number of these laws and regulations are designed to encourage the growth of these small enterprises. But it is legitimate to ask whether -- given the backdrop of such a legal and policy framework -- these laws and policies hinder their growth, instead of encouraging them to grow.

Why should micro-, small and medium enterprises (MSMEs) be singled out in a study of legal environments? After all, even large firms are subject to the same legal framework that makes the Philippines among the most regulated in Asia³. If firms were of similar sizes and if there were no economies or diseconomies due to size, there would be no reason to study MSMEs. But 99.7% of all firms in the Philippines belong to the MSME sector. More importantly *size matters*, and perhaps even more so in the field of bureaucratic rules and regulations. LEs have a greater say in the crafting of laws and institutions that affect them. Unlike small firms, their internal structure provides them specialized agents (e.g. accountants) that can handle the minutiae of bureaucratic rules and regulations. Moreover, transaction costs associated with rules weigh more heavily on the MSME than on the LE.

The present study therefore aims to evaluate the existing laws and regulations that are relevant to the workings of MSMEs. An internal analysis of their intent and content will be initially undertaken. Because of the sheer extent of laws and regulations emanating from both national and local government units, not counting the government agencies tasked with their implementation, a choice had to be made among them. The paper therefore does not purport to study *all* the laws and policies that affect MSMEs but only those that the

1. A comprehensive inventory of laws and regulations affecting SMEs in the manufacturing and processing sectors was published in the eighties by the DTI through its Bureau of Small and Medium Business Development (BSMBD). The study, undertaken by a team from the UP Business Research Foundation, Inc. had identified 278 laws and regulations!

³ The Global Competitive Report 2000/01 reports that the burden of regulation in the country is only better than Bangladesh, India, China, Indonesia and Vietnam.

researchers had identified as affecting them the *most* in the various areas of their business at this particular period of their development. Then, the choice was later verified and the *effects* of these laws and policies on the MSMEs themselves were identified through focused group discussions (FGDs) that were conducted in two cities in the Visayas.

The next section presents some of the literature from research conducted on MSMEs, and in particular the legal environment in which they operate. The third section discusses the conceptual framework of the study, specifically the justification for government intervention in their favor. The fourth section discusses the methodology that was used in the study. The fifth section, the longest one, presents the different laws and regulations that have been identified, their critical analysis, as well as the questions they raise with regard to their effects on MSME activity. In particular, the results of FGDs are presented to validate the findings of the study, followed by a list of doables in the short, medium and long-term. Finally, a last section summarizes the findings of the study by presenting a matrix of policy suggestions that have emanated from the analysis of the intent/content of laws and from the different FGDs.

2.0 REVIEW OF RELATED LITERATURE

International organizations and national governments have since time immemorial taken up the cudgels – the Philippines, included – for MSMEs. As a result, volumes have been written and researches undertaken on MSMEs. This section reviews mainly the literature relevant to the legal and policy framework in which they operate and how these affect MSMEs. We shall look mainly at empirical literature, carried at the international and the country level, with special focus on Philippine studies. Over the years, there have been many policy studies conducted about the Philippine MSMEs both by the government and private research institutions. Such studies are products of deliberate research or are a part or outcome of some sector specific programs or projects.

A study on “Small Industry Development” was conducted by Emmanuel Hife in 1979 and formed part of the study on *Industrial Promotion Policies in the Philippines* (R.M Bautista, J. H. Power and Associates, PIDS, 1979). It was based on a UP-ISSI survey that targeted 800 small firms that received government assistance in terms of training programs, financial and technical assistance, The samples were firms in Manila, and in Regions III, IV, VII and IX. The study, however, was based on only a part of the survey, with 138 respondent firms that were randomly picked. Among others, the research revealed that only a few of the respondents were aware of the agencies or programs meant for developing small-scale industries. A low response to government programs was likewise noted. A few firms were also found to have an unfavorable attitude towards certain government policies, such as the minimum wage law and the 13th month bonus, taxes, licenses and other government requirements. Most of the firms were agreeable to supervised-credit schemes, although these were more appreciated by regionally-based entrepreneurs rather than those based in Manila, probably because other sources of loanable funds and other services were more available in Metro Manila than in the regions.

The chapter on the Philippines entitled "The Role of Small and Medium-Scale Industries in the Industrial Development of the Philippines," (G.R. Tecson, L.J. Valcaerel and C. Nunez) which appeared in a book published by the Asian Development Bank on *The Role of Small and Medium-Scale Manufacturing Industries in Industrial Development: The Experience of Selected Asian Countries* (1990), was based on a monograph on the Philippines (1989) funded by the Asian Development Bank. The chapter looked into the contribution of SMIs in the country's output growth, their external constraints, their development process, as well as other aspects of their functioning. Moreover, a statistical study attempts to explain the difference in

performance of existing SMIs in three industries in terms of firm-specific characteristics. Finally a section evaluates the existing SMI promotion policies and offers policy recommendations.

The book *Macro Policies Affecting Small Enterprise Development in the Philippines* (1991) is a compilation of articles written by experts on SMEs. The objective was to analyze the different aspects of policy – industrial, financial, fiscal, labor, and direct regulatory controls – that impinge on the development of SMEs in the Philippines. In addition a number of government practitioners and policymakers wrote a chapter on the results of their extensive consultations with institutions involved in SME development in South Korea and Taiwan. This was in view of formulating executive and legislative action to remove the constraints hindering SME development in the country. It was the result of a research program organized by the Appropriate Technology International/ Philippines and the Congressional Planning and Budget Office of the Philippines and sponsored by the International Development Research Centre (Canada), the Appropriate Technology International and the U.N. Economic and Social Commission for Asia and the Pacific.

The paper written in 1998 entitled “Liberalization and small industry – have manufacturing SMEs in the Philippines benefited?” examines the impact of macroeconomic policy environment on the pattern of development of the country’s SMEs during the three and a half decades spanning the 1960s to 1990s. changes in trade policy were found to have been important in affecting the Philippine industrial sector and have exerted the most perceptible impact on SME growth. Periods of strong controls on imports were characterized by declines in the relative importance of the sector compared to large firms. In contrast, periods of liberalization created an environment that favored the growth of SME value added and employment. However, policy biases against SMEs may explain why a more open trade policy has not brought a stronger growth among Philippine SMEs compared to other neighboring countries. This study formed part of a bigger study conducted by the G. R. Tecson with Dr. E. Rodriguez of the World Bank in connection with the Bank’s evaluation of SME lending in the Philippines. The article appeared in *Small Enterprise Development*, in December, 1998.

The study written in 2001 entitled *The Support Environment for SMEs in the Era of Globalization* forms part of a research program written under the auspices of the Institute of

Small-Scale Industries of the University of the Philippines. It is an attempt to outline those elements of the support environment that SMEs need in to operate effectively and efficiently in the rapidly globalizing setting that SMEs find themselves in. These are: macroeconomic growth and stability, a liberalized trade environment, access to financing, investment in human and physical capital, collective support systems and a competitive cost of doing business for SMEs. The paper argues that in order to take full advantage of the promise that globalization offers, instead of being swallowed up in its train, a brand new class of SMEs – competitive, export-oriented, and open to foreign linkages – must be fostered. For this, a *new, world-class* support environment is needed

2.1 Relevant MSME Policy Studies and Emerging Issues

The ADB sponsored in 2003 the *Private Sector Assessment Study* which aimed at identifying policy and program support for the private sector found that, despite decades of introducing reforms, the private sector still faces major impediments that hinder them from fully exploiting their potentials. The major obstacles confronting the private sector are:

- poor adherence to the rule of law,
- unclear or inconsistent policies, laws, and programs,
- unclear property rights, inefficient dispute settlement mechanisms,
- low institutional effectiveness/capacity of supervisory and regulatory authorities, overlapping functions and lack of coordination among government implementing agencies,
- ineffective competition policy,
- significant involvement of the government in commercial activities,
- underdeveloped capital market,
- deteriorating quality of human resources,
- declining labor productivity in many sectors of the economy,
- inefficient infrastructure system are. All this reduces incentive to private sector participation in the economy.

According to the study, micro/cottage, small and medium enterprises (MSMEs), especially those that are located outside Metro Manila, are more severely affected by these inefficiencies. For example, participants in a focus group discussion representing the horticulture industry in Mindanao cited that it takes Philippine bureaucracy 106 hours to process export papers whereas it takes only 1½ hours for a Singaporean bureaucracy to do the same. However, the study pointed out that the private sector can be faulted as well. In particular, the poor corporate governance and lack of financial transparency of firms undermine their access to capital in the short-run and growth in the long-run. The study noted that one characteristic of the Philippine private corporations including those listed in

the stock exchange is their highly concentrated ownership structure and that families own not only a single company but group of companies.

Intal also observed in a 1997 PIDS Policy Notes entitled *Improving Support to Small and Medium Scale Enterprises* that among the many issues facing SMEs are technology transfer, human resource development, finance, regulatory red tape, and access to markets.

Wattanaputtipaisan, in her paper - *Promoting SME Development: Some Issues and Suggestions for Policy Consideration*, (Bulletin on Asia Pacific Perspectives 2002/03) claimed that while there is much evidence on the emergence of competitive industries driven by networks and clusters of SMEs, focus should be given to the enabling policy and institutional environment that influences the development of SMEs. Because of their limited scale of operations, the costs of participation and capacity-building are relatively more disproportionate for SMEs, compared with those shouldered by large firms. At the same time, by default or by accident, changes and adjustments in the policy, regulatory and institutional framework have not always empowered SMEs. She observed that the sector and its entrepreneurs are often constrained by opaque discretion, overbearing regulations, expensive delays and, above all, the well-known “perverse incentive syndrome”. She noted that remedial efforts have been made by countries to promote SMEs, including through the provision of both inducements and prerequisites for large-scale and transnational enterprises to foster backward and forward linkages with smaller-scale suppliers. But again, according to the author, this “carrot-and-stick” approach remains feasible and sustainable only with the continuous availability of SME inputs which comply with the exacting requirements of subcontracting and outsourcing.

It is interesting to note, however, a finding made by Digital Philippines for the Asia Foundation, *SMEs and e-Commerce in the Philippines* (2002) which claimed that while a third of the SMEs surveyed around the Philippines believe that obstacles and threats to their business are externally induced, government is not seen by many as obstacle or threat to business. In fact, only 3% of the 498 respondents from NCR, Cebu City and Davao City point to government acts and measures, such as regulatory measures, among others. According to the same study, more than 35% of their SME respondents believe that obstacles and threats to business are externally induced, and a quarter attributes it to competition brought about by too many businesses bringing prices down to competitive rates.

2.2 Key National Programs in SME and Implementation Issues

Certain government SME sector programs have also contributed to the development of policy studies and directions as an output of their program methodologies. The more recent programs include the following:

- KfW-SBC SME Credit Line: This project aimed to provide funds for re-lending to SMEs. It worked to improve the business climate, create jobs, and reduce poverty. It also assisted the government of the Philippines to open markets to broaden investment and trade opportunities, reduce corruption and increase
- Private Enterprise Accelerated Resource Linkages Project II: This CIDA project aimed to assist SMEs in enhancing international competitiveness and building international alliances. The project initially focused on 2 main sectors: furniture and houseware sectors and implemented 3 components including sectoral enhancement component, partnership development facility, capacity development for investment promotion.
- Business Advisory Project by the Canadian Executive Services Overseas: This project was designed to strengthen the capabilities of small and medium enterprises (SMEs), as well as non-governmental organizations serving SMEs through high impact business advisory services.
- Growth with Equity in Mindanao (GEM) Program: This program assisted small and medium business firms in making new investments and prospective investors to make them aware of opportunities for working with local SMEs.
- Rural Microenterprise Finance Program: This project aimed to provide adequate and appropriate financial services to the rural poor in order to finance livelihood project/microenterprises.
- Credit Lines for SMEs: This is KfW project involved the provision of sub-loans to finance importation of capital and intermediate goods and spare parts.
- Third Rural Finance Project: This project was funded by the World Bank and involved the provision of short/medium-term loans to finance private investments in the countryside.
- Promotion of Small Enterprises Project II: This project, funded by KfW ,involved the provision of sub-loans to SMEs to finance their working capital and fixed asset investments.

- Industrial Support Services Program II: Funded by JBIC, this project involved the provision of sub-loans and technical assistance to private industries particularly SMEs nationwide.
- Enhancement of Global Competitiveness for Quality Standards and Performance Project: This Spanish funded project aimed to strengthen the Philippine Bureau of Standards to improve its capacity to provide services standardization, certification of the country's industrial quality.
- Microfinance Loan Fund: This project was funded by the Spanish government and aimed to provide credit line facility on wholesale basis for eligible MFIs to finance microfinance sub-projects of their sub-borrowers.
- Creation of an Enabling Environment and Building Capacities for the Growth and Protection of the Informal Sector: This UNDP project aimed to provide capacity building assistance to the informal sector for increased access to productive resources, improved working conditions and strengthened participation in decision making.
- Development of Policy, Legislative and Institutional Responses for the Promotion for the Protection of Workers in the Informal Sector: This ILO funded project aimed to create an enabling environment for the growth and protection of the informal sector in the Philippines, through responsive provisions in policy, legal and institutional frameworks and the design of support programs.
- Credit Policy Improvement Project: This USAID project supported implementation of policies to make microfinance well targeted and sustainable.
- Accelerating Growth, Investment and Liberalization with Equity (AGILE): This is a USAID-funded project that provided technical assistance for public and private agencies competition to improve governance and implement policy more transparently, improve management of infrastructure, and stabilize and deepen financial and capital markets
- Microfinance Access to Banking Services: This USAID project supported microfinance services to micro-enterprises and individuals through Rural Banks.

There are also projects still in the pipeline that support the current efforts in the areas of financing and technology development. These include:

- Kigyō Shindan System (Management Consulting Program for SMEs). The primary purpose of this JICA incoming project is to train would-be SME counselors and

upgrade the skills of existing ones to enable them to competently provide better quality of business advice to SMEs.

- Access to Financing for Philippine SMEs. This CIDA project aims to support improvement of access by SMEs to financing.
- Small Enterprises Technology Upgrading Program. This KfW pipeline project aims to modernize SME quality control and packaging technology services provided by DOST.

2.3 Evaluating the Success of Program and Project Interventions

While the list of programs above is rather long, there has been little effort to assess the impact of such interventions to the development of the sector. And to date, it seems that are no studies quantifying the benefits that can be observed in return to the cost of interventions provided to the sector. The World Bank's *Market Oriented Strategy for Small and Medium Scale Enterprises Study* (2002) investigated the economic rationale for intervention in support of small- and medium-scale enterprises, on both theoretical and empirical grounds. It argued that the justification for SME interventions lies in market and institutional failures that bias the size distribution of firms, rather than on any inherent economic benefits provided by small firms. The report clarified that the role of the government is mainly to provide an enabling business environment that opens access to markets and reduces policy-induced biases against small firms. It further supports the idea that the government can accelerate the development of markets for financial and non-financial services suited to SMEs by promoting innovation in products and delivery mechanisms and by building institutional capacity. The study claims that improving the development impact of SME strategies will require much more attention to the monitoring and evaluation of intervention outcomes.

The study observed that in traditional SME interventions such as directed credit programs and technical assistance, the evaluation of the results of interventions frequently has been limited to measurement of program inputs or program outputs—for example, the number of loans granted, the number of clients served by a business advisory program, or the amount of market information provided. Attempts to measure the impact of interventions on SME performance are infrequently done and are plagued by measurement and methodological problems. The study claimed that improving the developmental impact of SME strategies will require much more attention to monitoring and evaluation of

interventions. The trend away from public provision of services and toward the development of markets calls for different approaches to the evaluation of the success or failure of intervention.

In support of its findings, the study offered indicators for monitoring government intervention in SME projects. Corresponding to the focus on institutional and market development, monitoring and evaluation, their recommendations cover:

Institutional Performance, according to indicators of:

- coverage (outreach), in terms of the number of individuals, enterprises, and organizations reached by an intervention;
- cost effectiveness, with the objective of providing a service (of a given type and quality) at the lowest possible cost; and
- financial sustainability, which refers to the extent to which the service can be provided without dependence on subsidies—i.e., the extent to which revenues generated from clients or other non-subsidy sources equal or exceed the costs of service provision.
- Institutional performance evaluation provides program managers and other stakeholders with continuous feedback on whether or not the program is reaching its intended clientele, what types of activities are more or less successful, and how the program can be better designed and managed. It also provides a basis for accountability in the use of public resources.

Market Development, according to indicators of:

- number, distribution, and quality of service providers;
- types and quality of instruments available in the market;
- the structure and degree of competition in the market;
- risks and transactions costs;
- the price of services and subsidy incidence; and
- awareness and willingness-to-pay for services on the part of SMEs.

Measuring the effects of intervention on the development of markets for financial and non-financial services is a critical need of the new approach to SME intervention, but one for which indicators and methodologies are not well established.

Economic Impact, according to indicators of:

- the magnitude and durability of the effect of the service on SME performance (sales, exports, productivity, etc.); and
- the developmental impact of the intervention at a sectoral or economy-wide level.

2.4 Sector Specific Studies

Many sector/industry specific studies have also been conducted both by the PIDS and ISSI. In particular the UP ISSI has recently produced the following studies on SMEs.

- *SME Sectoral Analysis (2001-2002)* - A validation of industry sectors and clusters to be given priority by the Development Bank of the Philippines' Industrial and Support Services Expansion Program, Phase 2 (ISSEP II). The sectors were selected on the basis of how they grew in operations and performed in export between 1994-2000.
- *Study on the Gifts, Toys and Hardware Sector in Region 6 (2000)* - An updated profile on the GTH sector as an input to development-policy making in the region. Identified the industry's strengths and weaknesses as well as opportunities and threats being faced

2.5 The Medium-term National Action Agenda for Productivity, 2000-2004

As the primary coordinator for the development of the Philippine MSMEs, the DTI developed the *Medium-term National Action Agenda for Productivity (MNAAP, 2000-2004)*. This document also identified key issues affecting the development of the MSMEs and from there developed strategies and programs for improving the sector. The National Agenda envisions markets that lead to the generation of more jobs, sustained income growth, and poverty reduction. This vision is consistent with the vision of sustainable development and growth with equity embodied in the Medium-term Philippine Development Plan (MTDP), 1999-2004.

The MNAAP will be achieved by pursuing critical activities in the following key result area: (1) science and technology; (2) human resource and labor-management relations; (3) efficiency of product markets; (4) infrastructure support; and (5) public sector governance.

A JICA funded study "Support Program for SME Development Plan in the Republic of the Philippines (March 2004) formed the basis for the formulation of the *SME Development Plan for 2004-2010*. It is a comprehensive study conducted in three phases: (1) a collection and analysis of baseline information on SMEs in the Philippines; (2) provision of knowledge and experience valuable to the formation of the SME Development Plan, including success practices of SME policies and programs in Japan and other ASEAN countries, Thailand and Malaysia; (3) identification of priority issues for SME development in the Philippines. The

study ends with a recommendation of specific measures and policies to be implemented in the SME Development Plan and action plans.

2.6 Other Commissioned Studies:

The Asia Pacific Centre for Research (ACRE) was commissioned by BSMED and the SMED Council to conduct a study entitled “Assessment of Existing Databases and Informational Needs of Small and Medium Enterprises (October, 1999). The objective of the research was to study the information needs of SMES, assess the accessibility and responsiveness of existing databases and recommend measures for improving databases and other information sources on SMEs. The informational needs of MSMEs were culled from three surveys conducted for the purpose: a quantitative survey (user survey), a qualitative survey through focus group discussions (FGD) in three survey areas, and a quantitative survey among selected information providers (provider survey). It showed that on the demand side, the vast majority of respondent-users (83%) consider the information given to them as being sufficient. Their assessment of the state of information in the Philippines shows favorable responses on the extent and accessibility of information but rather unfavorable responses on the infrastructure and reliability. On the supply side, information providers tend to focus more on finance, production and marketing, while focusing less on economics and human resource data. An analysis of demand and supply for information shows that on 47 informational items evaluated, there are very serious gaps that need to be addressed. To address these gaps, the study presents the BSMBD with initiatives that it could carry out in the immediate, medium and long- terms.

With regard to financing, the BSMBD likewise commissioned a study entitled “Lending and Borrowing Patterns of Micro, Small and Medium Enterprises” (National Confederation of Cooperatives NATCCO, 19??). The objectives of the study are as follows:

1. To come up with an inventory of loan and guarantee schemes to cover a number of specified topics;
2. to present the actual loans availed of by MSMEs based on records of financial institutions that participated in the different loan and guarantee schemes;
3. to find out the sources of funds of MSMEs and the factors affecting their availment of loans;
4. to assess the impact of RA 6977’s provision on mandatory allocation of credit resources to MSMEs and issues associated with its enforcement.

The results of the study were based on a secondary and primary data. Secondary data were gathered from records and files of relevant agencies, offices, and lending institutions, together with interviews conducted of selected conduits. Primary data were

taken from a survey of MSMEs conducted in six selected regions from Luzon, Visayas, and Mindanao.

Findings of the study reveal an increasing and encouraging trend in MSME lending by the banking system and other formal credit sources, especially because of the increasing business relationships between banks and MSMEs as well as the rapid economic growth experienced by the country in recent years. Moreover, government efforts to boost MSME growth over the last decade (1988-98) have contributed greatly to the increased supply of credit to the sector, while at the same time, leading to a proliferation of numerous, fragmented, often dysfunctional and clearly unsustainable lending and lending-related support programs. The study ended with a number of recommendations for the short and medium terms.

2.7 Key issues facing SMEs

The key issues identified from the policy studies are summarized here. Using the typology of J. Intal, there are four different types of SME from a policy viewpoint which face rather different issues and problems. The first subgroup is essentially in the domestic at-risk category. The other three subgroups are all internationalized or have the potential to be internationalized.

1. *Low growth domestic SMEs.* Over 70% of SMEs are either not oriented to growth or do not succeed in growing, and have no international activity. In aggregate they make a rather static contribution to the economy; although they employ a significant proportion of people, they do not contribute a lot to employment growth. Many only have a relatively short life expectancy, perhaps of 3 - 5 years, although this depends on the economy. Most of these SMEs are presently in the 'at risk' or 'insulated' categories, and the main issue that they face is how to best adapt to the increasing competitive pressures occasioned by open regionalism. The main issue that governments face is how to assist them to do this, because failure to do so is likely to lead to significant protectionist forces which resist moves toward open regionalism. The government have the potential to assist domestic SMEs to become more competitive in the following areas:

- *Access to information and markets:* ensuring that SMEs can easily find out about opportunities for development and growth, and can access them.
- *Finance:* ensuring that SMEs are not disadvantaged by systemic biases in financial markets.

- *Business environment*: ensuring that SMEs are not competitively disadvantaged by unnecessary regulations, or by macro economic policies.
- *Capability and HRD*: ensuring that SMEs can acquire the skills and advice necessary to increase their competitiveness.

2. *Entrepreneurial fast growth SMEs*. Evidence suggests that as much as 70% of net job creation and much longer term economic dynamism is attributable to a small proportion (perhaps only 5% to 25%) of SMEs that are growth oriented and entrepreneurial. These SMEs are especially important in restructuring existing industries (e.g. finding better ways to provide services) and generating new industries (e.g. software, multimedia services etc). Many of these fast growth SMEs are internationalized. The main issue for the firms is how to overcome the impediments to international entrepreneurship, including overcoming outdated regulations, getting access to markets, acquiring suitable managerial skills, and finding finance. International entrepreneurial SMEs face many problems, which are only compounded by their internationalization. The main problems and issues which are of relevance to these SMEs are:

- *Access to markets* - Gaining access to new markets is important to these SMEs, but access is often restricted because of outdated and inappropriate regulations.
- *Registration and legal incorporation* - Many of these SMEs need to establish a presence in a foreign market in order to be close to customers. Registration and legal incorporation requirements vary considerably, and are often unnecessarily complex and expensive.
- *Identification of opportunities* - Obtaining reliable information about market opportunities and about relevant regulations is sometimes difficult for new products, services or techniques.
- *Identification of suitable network partners and joint venturers* - In many cases these SMEs need to engage in joint ventures, networks, or alliances for internationalization. Finding suitable partners is often difficult.
- *Protection of intellectual property in a cost effective way* - Most economies in the region now have some form of recognition and registration of intellectual property, such as brand names, patents, and copyright. However it is often not economic for small entrepreneurial SMEs to try to enforce their rights through the existing legal systems.
- *Skills for management and staff* - Fast growing internationalized firms often need special management skills, and require specialist skilled staff. Acquiring these skills and advice is sometimes difficult, and investing in training is sometimes a risky intangible investment. For example, migration restrictions can make it difficult for these SMEs to bring in skilled staff to set up operations in a foreign market, and local staff when trained is sometimes head-hunted by local firms.

- *Start up assistance* - Starting up a business from scratch can be particularly difficult. It may help to provide special start up grants to help entrepreneurs get going, and provide training packages for aspiring managers.
 - *Exit and bankruptcy arrangements* - Many entrepreneurial ventures are not a success, but they are not necessarily failures in the sense of losing money. It makes sense to try to make markets contestable by reducing exit costs and impediments for ventures that are not up to initial expectations.
 - *Cultural awareness and support of entrepreneurship* - A career in entrepreneurship is still frequently regarded as less attractive and socially responsible than a career with a large firm or in a profession. Increasing the status of entrepreneurs in the community (by awards and special recognition), and increasing awareness of the importance of entrepreneurship (by entrepreneurial education in schools for example) can be effective ways for economies to encourage more entrepreneurs.
 - *Credit guarantee, start up, venture, and mezzanine capital* - Access to suitable finance at rates reflecting the real risk premium is always a problem for entrepreneurial firms, especially those which move across borders. Financial markets have tended to show a systemic bias against providing smaller firms with start up capital and capital at the lower end of the venture capital range.
 - *Telecommunications* - Access to reliable telecommunications (phone, mobile phone, pagers, fax, Internet, etc) at reasonable rates is especially important to small international firms.
3. *Internationalized subcontracting or supply industry SMEs*. Subcontracting SMEs are those which have integral links with a larger foreign firm, or to a domestic firm which is exporting. There are relatively few SMEs that are international subcontractors, probably less than 2% of non agricultural SMEs, but they are economically significant because they tend to be larger on average, employ more people, and use more sophisticated technology than other SMEs. They are also an important driver of economic integration, technology and skill transfer, and make a major contribution to economic and industrial development in the region. Subcontractors in the main supply industries (automobiles and auto parts, electrical goods, machinery, chemicals, clothing, textiles, footwear, computer hardware etc) have been subject to increased international pressure for over a decade. The main issues facing government are how to ensure a reliable and efficient subcontractor industry, and how to help their subcontracting SMEs adjust and remain competitive. The main policy issues and areas which are of particular relevance to these SMEs are, for example:
- *EDI standardization* - Subcontractors are distinguished by the extent of integration with the larger contractor, for example in design and accounting. Greater use of common Electronic Data Interchange protocols would increase efficiency, mobility and competition.

- *Quality improvement and accreditation* - Maintaining acceptable quality control standards, and being able to demonstrate their capability via accreditation is important to SMEs wishing to become or remain as subcontractors. Differing standards can also act as a barrier to entry.
 - *Technology transfer* - Contractors and subcontractors are a major source of technology and skill transfer to recipient economies. A question is how best to facilitate this and how the cost should be distributed between donors and recipients.
 - *HRD and skilled local staff* - Most subcontractors require skilled staff. Training local staff can be time consuming and expensive. Again the issue is how the cost of this should be distributed between the contractor, subcontractor, and the recipient economy.
 - *Competition policy and contractual relations* - There is often an imbalance of market power in favor of larger contractors. When this power is abused, it is difficult for the SME to obtain any real recourse.
 - *Access to foreign contractor firms* - Discriminatory policies by large companies which only subcontract to firms of the same nationality (even if located abroad) are becoming less common, but are still occasionally a problem.
 - *SME foreign direct investment (FDI)* - There has been a sharp increase in the number of SMEs investing abroad and then subcontracting work to local firms, According to UNCTAD, SME FDI is associated with more suitable transfer of technology and skills than that of larger firms. However SME international investors are not always given the same level of access and assistance that is granted to larger firms.
 - *Data bases for matching SMEs and contractors* – it would be feasible to look at matchmaking databases to match SMEs with specific capabilities to contractors with specific requirements. Internationalizing such data bases may also be advantageous for both contractors and subcontractors.
 - *Intra firm trade and taxation* - Intra firm or intra group trade is common in subcontracting arrangements, and it can cause problems in correctly assessing tax liabilities.
4. *Trading SMEs.* About 20% to 25% of manufacturing SMEs are engaged in international activity. Economically they are important because they make a significant contribution to exports, and thus to GDP. Apart from indirect SME exports which pass through subcontracting networks, about 35% of exports are directly sourced from SMEs in the Asian region, although some of these may be directed through trading companies or other intermediaries. The main issue for the SMEs is how to identify and take advantage of opportunities, and how to resolve or avoid impediments quickly and cheaply. The main policy issues which are of relevance to these SMEs are:

- *Access to markets* - Relatively minor impediments can be a major barrier to SME international trade. The impediments may be attributable as much to cultural differences and business practices, as to intentional government policy.
- *Simplified standardized customs procedures* - Standardizing customs procedures and allowing electronic submission and handling of documents has been effective in reducing transactions costs associated with SME international trade.
- *HRD* - SMEs engaged in international trade need better management skills, especially in areas of risk management, cultural understanding, export management, and trade financing.
- *Swift resolution of disputes* - SMEs cannot usually afford to engage in prolonged and expensive legal disputes; unless disputed issues can be resolved quickly it is of little use.
- *Trade finance and credit guarantee* - SMEs frequently have difficulty in obtaining trade finance and credit guarantees at rates approximating the real risk. Some economies have specialist SME credit providers or programs to help address the problem.
- *Trade facilitators* - A number of private sector companies play an important role in facilitating SME trade. Even SMEs themselves can often act as specialist facilitators to other SMEs or via networking as a group.
- *Export promotion and assistance* – while providing export assistance to increase the competitiveness of SME exporters help, it is possible for these measures to have distorting effects on the pattern of trade and resource use.

2.8 Summary

The list of government supported programs and interventions as well as policy studies on the development of SME are numerous. However, there is no available study or assessment of the impact of such interventions on the development of the sector.

Government SME assistance strategies often try to achieve a combination of equity objectives (alleviating poverty and addressing social, ethnic, and gender inequalities) and efficiency objectives (raising the productivity and profitability of firms). The confusion created by multiple objectives often leads to over-subsidized services that could be provided by the market. Direct provision of credit and non-financial assistance to SMEs tends to substitute for markets rather than dealing with the underlying causes of market underdevelopment.

In agreement with other recent studies, the combined findings of the studies screened here suggest that the overall business environment is the most important

determinant of SME competitiveness and growth, as well as a necessary condition for the success of targeted assistance programs. Necessary reforms to improve the business environment go beyond macroeconomic and structural adjustment to the alleviation of microeconomic and institutional constraints that discriminate against small businesses and reduce their growth and competitiveness.

The succeeding sections of this report will review the existing legal and policy framework for MSMEs combined with the results of focused group discussions done in Cebu and Bacolod Cities with the end in view of policy suggestions on how to create an enabling environment.

3.0 CONCEPTUAL FRAMEWORK

The country's statistical body reports that as of 2002 only 0.3% of all establishments in the Philippines are large (LEs), which puts the overwhelming majority of all firms in the MSME category⁴. This piece of evidence alone justifies the interest in MSMEs, not their ability to create jobs⁵ nor their efficiency⁶. According to Hallberg (2000) there is no 'ideal' size distribution of firms: there is only an existing size distribution, which in the Philippines is one that is very much skewed towards the small.

What determines the size distribution of firms in an economy? Here groups of factors have been culled from the literature on industrial organization (Hallberg, 2000). These are scale economies, transactions costs and market structure. Scale economies, often technology-based, determine the minimum efficient scale of production. Together with the (dis)economies of scale of organization, production economies of scale dictate the efficient firm size. Transaction costs⁷, on the other hand, increase the size of firms as transactions that are supposed to be undertaken by the market – such as resource allocation and structuring of transactions ---- are withdrawn and internalized by the firm. Thirdly, the size distribution of firms also reflects the distribution of market power as well as the segmentation and distortions in input and output markets. These in turn determine the differences in costs between large and small enterprises. The first determinant of size distribution, that is, scale economies, interacting with market size and the product composition of the economy, can be considered 'natural' and are not usually targeted by government programs. But the two other determinants of firm size, namely transaction costs and market power, often fall within the sphere of policy and institutions and can be influenced by government intervention. By considering some examples, one can easily have an inkling of the need for government intervention for small firms.

- a. Starting a business: The transaction cost of starting a business is raised by the number of complicated steps and signatures that must be obtained from the local

⁴ As of January, 2003, the SMED Council – the Council created by and charged to implement the policies of R.A. No. 6977 or the Magna Carta for Small Enterprises – defined the sectors in terms of total assets as follows: micro enterprises: P3 M or less; small enterprises: P 3 M - P15 M; medium enterprises: P15 M – P100 M. Large enterprises would therefore have assets of more than P100 M.

⁵ In a rare study on mortality rates of establishments, Rodriguez (2000) shows that the mortality rate is highest in the 10-99 employee category, followed by the 100-199 employee category between 1990-95.

⁶ Census data show that in 1998, MSMEs comprised 99.7% of all establishments in the country while contributing only 28% of (census) value added.

⁷ See Coase, 1937 and 1988.

government units. Large and small enterprises have to go through this same bureaucratic maze, but the transaction cost as a percentage of sales or income becomes larger for a small enterprise. Large enterprises usually have the correct information and political savvy, but more importantly, they have the specialized agents (in this case, an accountant) to handle such bureaucratic hassle.

- b. Financing : Small firms are often charged a higher price or are effectively eased out of the market in favor of larger ones. Administrative costs are necessarily higher for the bank to service a small loan rather than a larger one. And market failures do abound, biasing the credit mechanism against small enterprise. The lack of information on the creditworthiness of the small enterprise raises the cost of gathering information on the part of the lending institution which is then passed on to the borrowing firm. The perception of a higher risk of lending to a smaller clientele makes banks charge a higher interest rate or require a bigger collateral. This in turn raises the cost of borrowing to small enterprises or reducing/eliminating access to finance. Collateral, usually in the form of fixed assets and real estate, are much more difficult to come by for smaller than for larger firms. To the extent that both banks and non-banks, whether government or private, would demand such collateral for a loan, small firms are denied access to credit.
- c. Input and output markets: As buyers of inputs and as seller of outputs, larger firms may have more advantages. They can get bigger discounts from big purchases of raw materials than smaller ones. On the output side, the high fixed cost of acquiring information on potential buyers, whether domestic or foreign, on distribution channels or new technologies, etc. create biases against small size.

Thus, it cannot be denied that there often exist biases in the treatment that small enterprises receive from public and private sectors. The presence of such biases or distortions (market failures) demands the intervention of government⁸. However, intervention must go straight to the source of the distortion to avoid the creation of other policy-induced distortions in the economy (Krugman and Obstfeld, 2003). An example of such policy-induced distortions in the economy is found in the use of directed or subsidized credit programs by government. Instead of improving the access of small enterprises to credit, such programs merely hamper the development of viable financial institutions, and

⁸ This presupposes, of course, that government intervention can lead to better outcomes than no intervention at all.

even foster a 'non-repayment culture' among borrowing enterprises (Hallberg, 2000:12). An example is the Masagana 99, a program in which the Philippine government provided loans in the form of fertilizers to small farmers.

Need for an Enabling Environment

The foregoing discussion leads inevitably to the need of an environment that is conducive to the growth of MSMEs. It is premised on the assumption that small firms face constraints to growth that are specific to them and need to be eased. Moreover, their growth may require specialized institutions or instruments that may be underprovided in distorted and segmented markets (Hallberg, 2000:8). This calls for government intervention particularly in the following areas.

- Removing /easing the problem of market failures attributable to small size of firms;
- Reconsidering/altering the policies and regulations that raise the cost of doing business for small firms and hence reduce their competitive advantage;
- Fostering transaction efficiency by improving access to information, especially with regard to financing, output and input markets;
- Providing public goods that improve the competitive advantage of small firms and open access to markets, such as infrastructure, education, and technology development.

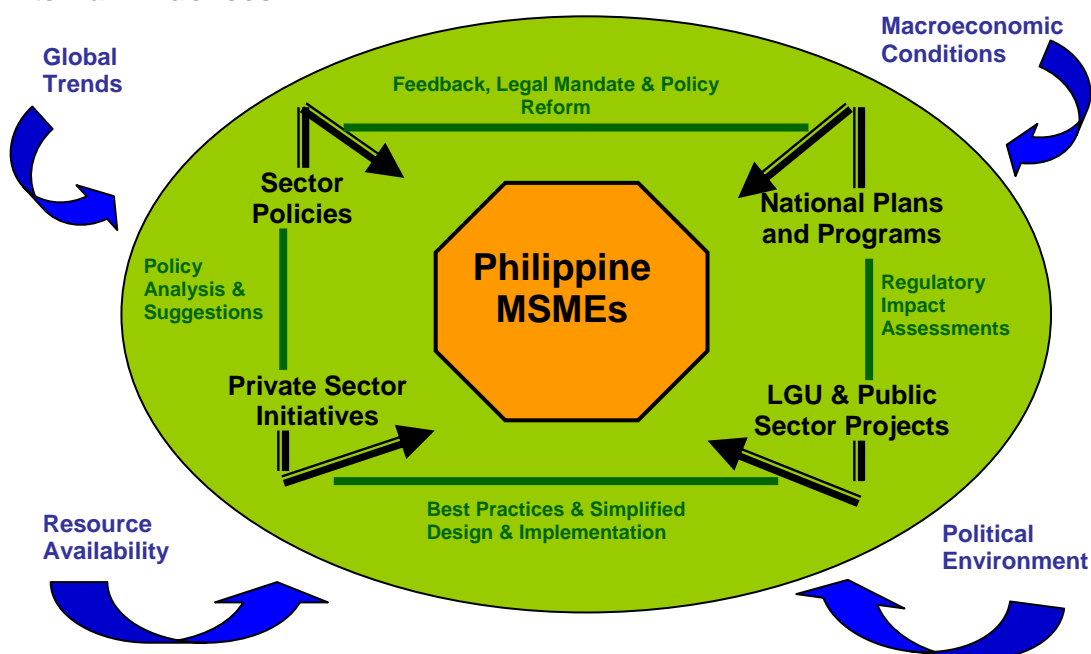
Oftentimes, it may only need to eliminate certain distortions created by policy itself, not by getting rid of the policy or regulation but by tweaking the implementation portion in consideration of the effects on different sizes of firms. For instance, in registering a business firm, actual Implementation of an existing law may require many complicated steps and/or many signatures that could daunt a microenterprise from entering the formal economy. One may not have to do away with a certain minimum number of steps but a government agency in charge of registration can reduce tremendously the transaction costs of going from one government office to another to fulfill the documentary requirement through the creation of a one-stop shop. For a small firm, this may tilt the balance in favor of emerging from the informal economy in which it has operated for years⁹.

Fig. 1 presents a simple framework that summarizes the research approach.

⁹ An example is a microenterprise that has operated as such for twenty five years. It is now at the verge of joining the formal economy because of the potentials of expansion but it is weighing it against the paperwork and paperpurchase of registration.

Fig. 1 Conceptual MSME Development Framework

External Influences



The growth and development of MSMEs are affected by the plans, programs and general policy environment where it operates. For optimum growth, there should be complementation and agreement between these elements. Sustainability of the programs and plans are ideally supported by long term policies and not by arbitrary or temporal whims of government administrations that change constantly. The latter leads to policy instability. There should be an effort to make policies complimentary and provide consistent input to the plans and programs that support development of MSMEs.

There are of course private sector initiatives such as those provided by Chambers of Commerce and emerging business development service providers that support MSME growth and development. The lessons of recent experience show that facilitating the provision of services by private providers and stimulating the demand for them by small enterprise clients is an effective way to raise the coverage, quality, and sustainability of services, and to increase their impact on small enterprise performance.

The shift toward market provision of BDS reflects a move toward a “systems approach” analogous to the microfinance revolution.

Sector policies (i.e., market, financing, taxation, etc.) should provide legal mandate to national plans and programs. There should be inter-policy linkage, e.g. marketing policies should investigate and incorporate provisions in available labor and matching skills; technology and competition policies to provide directional harmony, etc. In turn, this should be incorporated into plans at all levels and provide inputs for the development of programs and projects at the local level where the MSMEs operate.

But there should be a mechanism for feedback and policy reforms based on results of impact assessments from implementing at the local level. There should also be a mechanism for MSMEs to provide feedback to the programs and plans which should provide signal for review, enhancement, updating or revision of existing policies. An example is the elimination of policy biases such as official and unofficial levies that discourage small enterprises from growing and becoming formal. Institutional

Linkage between the private sector and local governments and projects typically should result in documentation of lessons learned and best practices as well as the simplification of design and project implementation or business support projects.

Outside these sphere, there are also external influences that affect each of the elements including the MSMEs as shown in Figure 1. The elements inside the sphere should be able to move flexibly and complementarily to positively and appropriately respond to any changes in these external influences.

The above framework focuses our attention on the need first to identify the major laws and regulations that impact MSMEs at different stages of their activity, and secondly to assess the effects of these laws and regulations on MSMEs. Only then can one determine the loci of intervention that government can apply. In the following section, we shall spell out our methodology in answering these two major approaches that are required by the study.

4.0 METHODOLOGY

As stated in the Introduction, the objective of the present study is to evaluate the legal and policy framework in which MSMEs operate in the Philippines and to offer suggestions that would improve the policy environment. To achieve this objective, two activities are undertaken:

- a. An analysis of the **intent/content** of national laws and local ordinances that affect the different areas of activity of MSMEs. This includes the department orders and memorandum circulars of departments, agencies, or branches of national government (e.g. Department of Trade and Industry, the Bangko Sentral ng Pilipinas, the Bureau of Internal Revenue) tasked with their implementation;
- b. Determination of the **effects** of these laws and regulations on MSMEs.

The first activity will entail an evaluation and critique **at the word-level** of relevant laws and regulations that the researchers have identified a-priori. This will mean an internal analysis of the intent and content of these laws and regulations.

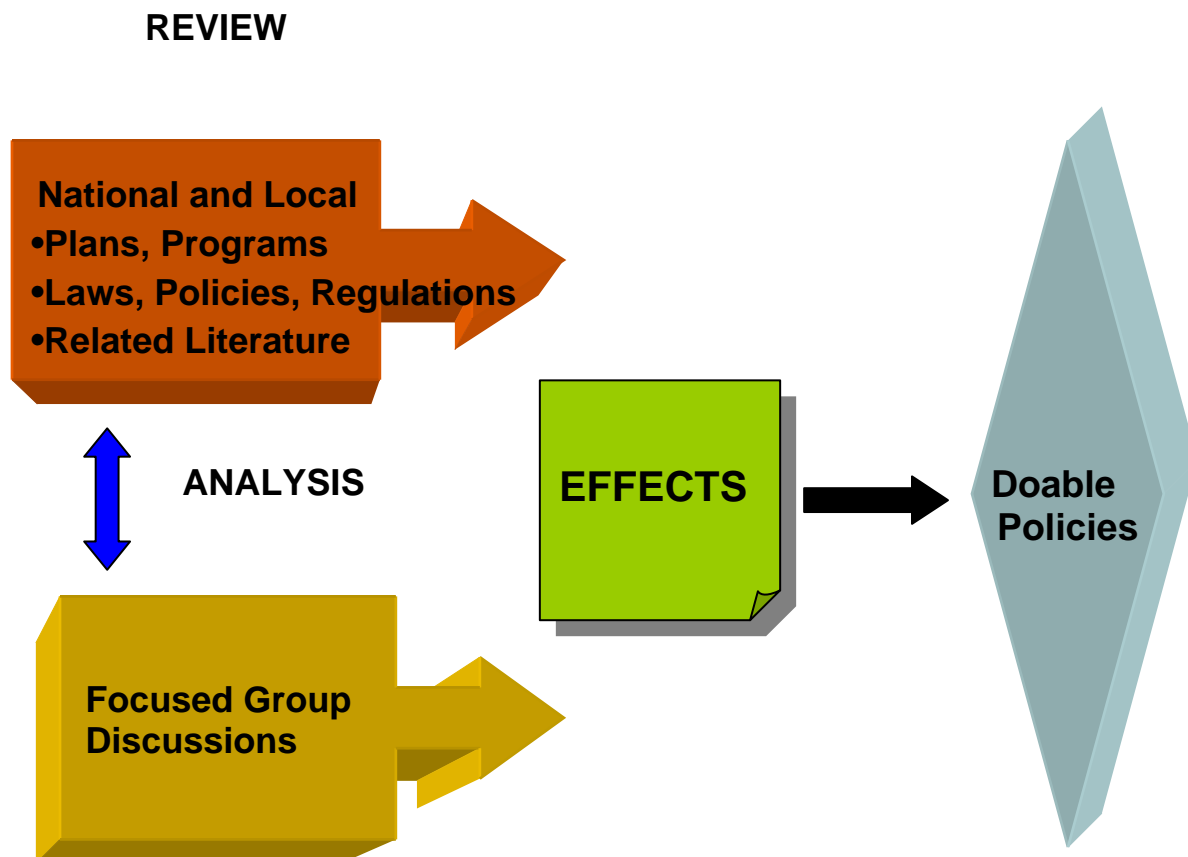
- c. The second activity, namely determining the effects on MSMEs of these laws and regulations will be undertaken. An analysis of the **intent/content** of national laws and local ordinances that affect the different areas of activity of MSMEs. This includes the department orders and memorandum circulars of departments, agencies, or branches of national government (e.g. Department of Trade and Industry, the Bangko Sentral ng Pilipinas, the Bureau of Internal Revenue) tasked with their implementation;
- d. Determination of the **effects** of these laws and regulations on MSMEs.

Whenever possible, the FGDs are undertaken for microenterprises (MEs) and for small and medium enterprises (SMEs) separately. The reason for this is the recognition that many¹⁰ microenterprises still belong to the informal sector¹¹ and there are laws and regulations that have been passed specific to them. An example is the Barangay Micro

¹⁰ The number is unknown. But if we believe estimates that cursorily show the informal economy as representing about 40% of the country's GNP, this number must be running to hundreds of thousands, considering that microenterprises surveyed by the NSO in 2002 and assumed to belong to the formal sector is 743.4 thousand.

¹¹ "Belonging to the informal sector" means prior to being registered with a government agency (e.g. the DTI or SEC) and/or operating without a Mayor's permit.

Figure 2 : POLICY REVIEW FRAMEWORK



Business Enterprises (BMBEs) Act of 2002, one of whose objectives is to integrate “those in the informal sector with the mainstream economy.” Moreover, such differential treatment is warranted by the fact that *implementation* may be different even among very small and small enterprises. For instance, the implementors of the Minimum Wage Law from the Department of Labor and Employment (DOLE) may find it more profitable to run after violators at the larger end of the SME category because of the sheer number of those at the other end. However, certain laws and regulations (e.g. tariffs on imported goods) do not distinguish between them, so that these laws and policies will be treated jointly.

4.1 Policy Areas to be Considered

Because of the number of laws, policies, regulations at both the national and local levels that could be studied, certain priorities had to be established, given the constraints of research time and financing. The following had been identified as the areas that are most critical to MSMEs.

- Starting a Business/ Registration
- Financing
- Taxes and infrastructure
- Labor and human resource development
- Trade
- Technology and Competition

Both the analysis of specific laws and the FGDs will consider the above areas as comprising the legal and policy framework of MSMEs.

4.2 Focused Group Discussions

FGDs have been conducted in Bacolod, Negros Occidental and in Cebu City, Cebu (For a detailed discussion of the guide questions and results of the FGDs, see Appendix A). The choice of geographical area was arrived at in consultation between the SMEDSEP and the DTI representatives at a preliminary meeting in August. The DTI staff in each locality was tasked with the invitation of the representatives from the MSME sector. A number of representatives wore at least two hats, namely as firm owner or manager and as officer of their industry association. Hence they could speak both as practitioners and as representatives of the industry or sectors which they represented. Following are particulars of the said FGDs undertaken:

Geographic Location	Date/Place of FGDs	Number of MSME representatives	Industry/sectors represented
Bacolod SMEs	15 September 2004/ Sugarland Hotel	16	Same for Micro and SMEs:
Microenterprises	16 September 2004/ Sugarland Hotel	18	<ul style="list-style-type: none"> • Tourism • Craffs • Food
Cebu SMEs	21 September 2004/ Holiday Plaza	9	Same for Micro and SMEs
Microenterprises	22 September 2004/	25	<ul style="list-style-type: none"> • I T • Furniture/Crafts/

	Holiday Plaza		Gifts & houseware • Food
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Separate FGDs were held for microenterprises and SMEs in each policy area, for better management of discussions and to avoid wide latitude of perspectives or concerns during the sessions. Because of the need of the hour, three sessions were conducted: a first session on the general awareness of laws and regulations according to the policy areas identified; a second session in which participants were grouped and asked to discuss the guide questions provided. This was to capture the laws and regulations that were particular to the sector/industry as well as to delve in greater detail into the different policy constraints. A third session was conducted in which the participants gathered in plenary to hear/countercheck the summary of laws and regulations identified during the second session.

The facilitator introduced the subject, guided the discussions and cross-checked the participants' comments with those of other participants' opinions. The facilitator encouraged all members to express their opinions and ensure an even participation of all members, that is, in order to avoid domination of the discussion by a few participants who were more vocal.

The basic techniques for FGDs were employed, such as providing review/preview/big view at the beginning and end of each discussion, asking questions to guide and focus the discussions, and if needed, providing the glass of focus to keep participants from straying from the subject. Representatives of the DTI were also at hand to provide expert opinion on the subject of laws and regulations being discussed. In particular, the details of RA 9178 (Barangay Micro Business Enterprises Act of 2002) were presented to the microenterprises by a representative of the DTI before the discussion of the Act.

The FGD made use of brown sheets, metacard pins and boards to facilitate the discussions and later on, the presentations of summary findings to the group. These were found helpful in ordering and re-arranging of thoughts and comments during the group discussions.

A Note on the Presentation of Results

The different questions that served as guide for the discussions emanated from the first activity of analysis of the intent/content of laws. As a result, the discussion and critical analysis of the different laws and regulations will be presented beginning with those relevant

to microenterprises, then those relevant to SMEs and finally those relevant to both. This will then be followed by a discussion of the results of the FGD discussions. These results represent the perceptions of representatives of the MSME sector regarding the *effects* on their businesses of the different laws and regulations of government affecting them. Every discussion will then be followed by a list of policy suggestions a propos the subject being tackled. These policy suggestions will be considered doable at the short, medium and long term, depending on the difficulty and feasibility of the policy suggestion. Finally a concluding chapter is provided wherein the findings are summarized in a matrix of policy suggestions or doables that emanate from both the analysis of the content/intent of laws and the different FGDs..

5.0 ANALYSIS OF RESULTS

5.1 The BMBE Act of 2002: For the Promotion of Microenterprises

RA 9178: BMBE Act of 2002: “An Act to Promote the Establishment of Barangay Micro Business Enterprises (BMBEs), Providing Incentives and Benefits therefore, and for Other Purposes

The Act's Declaration of Policy (Sec 2) states that it is “a policy of the State to hasten the country's economic development by encouraging the formation and growth of barangay micro business enterprises” (see Box 1 for definition) and the integration of “those in the informal sector with the mainstream economy”¹². This is to be achieved through the rationalization of bureaucratic restrictions, the active intervention of the government -- at the local level in particular -- and the granting of incentives and benefits. All these are in view of twin-goals of employment-generation and the alleviation of poverty.

In this Act, the benefits/incentives are many and generous:

- Exemption from income tax arising from the operation of the enterprise;
- Reduction or exemption from all local taxes, fees and charges;
- Speedy registration and processing of licenses/permits through One-Stop Business Registration Centers which LGUs are encouraged to establish.
- Exemption from the coverage of the Minimum Wage Law , provided “that all employees under the Act are entitled to the same benefits given to any regular employee such as social security and healthcare benefits”;
- Access to credit, though the opening of special credit window to service the financing needs of BMBEs by government banks (LBP, DBP, SBGFC, PCFC) and non-banks (GSIS and SSS). Special guarantee windows will also be opened to guarantee BMBE loans;
- Technology transfer, production and management training, marketing assistance will be provided by specific government agencies;
- Trade and Investment promotion, assuming these are provided by private sector organizations and NGOs.

5.1.1 Implementation Guidelines

The above benefits and incentives under the law implicate a number of government agencies (i.e., Dept of Finance for exemption from incomes taxes; the LGUs under the DILG for exemption from or reduction of local taxes, fees, and charges; DOLE for exemption from the minimum wage law; the BSP for access to credit; specialized government agencies for technology transfer, trade and investment promotion). Section 15 of the law (Implementing rules and Regulations) deputizes the Secretary of the Department of Trade and Industry to formulate the necessary rules and regulations *and to implement the provisions of (the) Act*". Thus, subsequent to the passage of the Act, different government departments and agencies issued their respective guidelines regarding the implementation of the law. Table 1 gives a summary of the different agencies of government together with the guidelines they issued. We shall discuss each of these guidelines and the problems encountered by microenterprises in achieving the objectives set out by the law.

Table 1: Relevant Guidelines to Implement RA 9178

Government Agency	Regulation	Date of issuance	Guidelines
Dept of Trade and Industry	DAO No. 01, Series of 2003	7 February 2003	Implementing Rules and Regulations of R.A. 9178
Dept of Finance	DO No. 17-04	20 April, 2004	Guidelines to Implement the Registration of BMBEs and the Availment of Tax Incentives under RA 9178
Dept of Interior and Local Government	Memo Circular No. 2003-69	8 April, 2003	Implementation of RA 9178 Providing Incentives and Benefits therefore and for Other Purposes Clarification on the Implementation of Section 7 of the Rules and Regulations Implementing RA 9178
	Memo No. 2003-172	23 August, 2003	
Dept of Labor and Employment	DO No. 45-03, Series of 2003	15 May, 2003	Guidelines for the Implementation of Section 8 of RA No. 9178
National Wages and Productivity Commission	NWPC Guidelines No.01, Series 2003	11 March, 2003	Guidelines on the Issuance of Wage Advisories for Barangay Micro Business Enterprises
Bangko Sentral ng Pilipinas	Circular No. 374, Series of 2003	11 March, 2003	Guidelines on the Implementation of Section 9 and second Paragraph of Section 13 of RA 9178

Source: BSMED files.

a. Department of Trade and Industry

In accordance with Section 15 of the Law, the Secretary of DTI issued DAO (Department Administrative Order) No. 01 formulating necessary rules and regulations to implement the provisions of the Act. This was after consultation with the DILG, the DOF and the BSP and the other concerned agencies. The DAO clarified that the BMBE “shall include any individual owning such business entity/enterprise, partnership, cooperative, corporation, association or other entity incorporated and/or organized and existing under Philippine laws; and registered with the office of the treasurer of a city or municipality in accordance with these (sic) implementing rules and regulations.” Further, under Section 4 (Who are eligible to register), it clarified that any person, natural or juridical, cooperative or association may apply so long it has the following qualifications:

- have an asset size of not more than three million pesos, excluding land, before applying for BMBE registration
- be engaged in the business activities defined by the IRR¹³.

This definition allows microenterprises that have previously registered under the Magna Carta to register again with the DTI as BMBEs. Given the incentives enumerated above, previously registered microenterprises tend to benefit from *re-registration* under the law. However, this means less tax income for both the national and local government, a possible cause of the footdragging by some LGUs in implementing the law.

In order to avail of the benefits and incentives, a microenterprise must first be registered as a BMBE. The procedures for registration appear under Section 6 of the DOA, as follows:

- An applicant for BMBE shall go to the Office of the Municipal or City Treasurer where the business is located.
- the applicant shall accomplish BMBE Form 01 in triplicate and submit to the Office of the Municipal or City Treasurer;
- The Municipal or City Treasurer evaluates the application. The application shall be processed within fifteen (15) working days upon submission of complete documents. Otherwise, the BMBEs shall be deemed registered;
- A registered BMBE shall be issued as CA as proof of registration, which will be effective for a period of two (2) years, renewable *for a period of two (2) years for every renewal*.

¹³ “A BMBE shall refer to any business entity or enterprise engaged in the production, processing or manufacturing of products or commodities, including agro-processing, trading and services.” “Services” shall exclude those rendered by any one, who is duly licensed by the government after having passed a government licensure examination, in connection with the exercise of one’s profession...”

The Law thus requires the Office of the Municipal or City Treasurer to verify the veracity of the submitted documents, i.e. to prove that the registering enterprise qualifies under the definition of the Law. Possibly to cut through the bureaucratic restrictions of registration and thus encourage the growth of the sector, a 15-day deadline is given the Municipal or City Treasurer to process the application. Otherwise the BMBE shall automatically be considered registered. Thus there seems to be an automaticity injected into the law. In reality, however, the documentary requirements specified by the DOF (see below) are rather daunting, and the processing cannot proceed unless the documentary requirements are met.

b. Department of Finance

Department Order no. 17-04 (April 20, 2004, "Guidelines to Implement the Registration of Barangay Micro Business Enterprises and the Availment of Tax Incentives under R.A. 9178) has the long list of supplementary rules and regulations on the IRR of the BMBE Act. The DOF issued the guidelines on the registration of the business enterprise and on the duties of the LGU and of the registered BMBE in the availment of the income tax and the Gross Receipts tax (GRT) exemption.

Registration The DOF clarifies the Law in stating that "the application for registration shall be not be processed by the Office of the Treasurer until all documentary requirements... have been submitted." It then proceeds to list the different documents that have to be submitted by the enterprise wishing to be registered. Together with the duly accomplished Application for Registration or BMBE Form 01, following are the documentary requirements identified by the DOF:

For the new applicant:

1. Registration as a business entity or enterprise from the appropriate government agency (e.g. SEC; CDA; DTI ;)
2. Taxpayer Identification Number (TIN);
3. Certificate of Registration from the BIR;
4. Mayor's Permit or City/Municipal. Business Permit;
5. Sworn affidavit executed by the sole proprietor or the President of the enterprise, as the case may be, that the enterprise is a barangay-based and micro-business in nature and scope, in substantially the form attached as Annex "A"
6. Sworn Statement of Assets and Liabilities showing the values of the assets owned and to be used in the conduct of business which shall be supported by pertinent information such as date of acquisition, acquisition cost and depreciated value. In case of asset acquired during the year of registration, it shall be supported by any of the following:

- i.) Invoice
 - ii) Official receipt
 - iii) Contract document or deed
- 7. Pictures of the place of business and its assets, other than cash, receivables and intangibles
- 8. Copy of Loan Contract/s if any, and Duly-Notarized Certification of Amortization Payments on the Loan;
- 9. Income Tax Return (ITR) with proof that it has been duly filed with the BIR, including attachments, if any, (for an existing business only)

For renewal of registration

- 1. Documents listed in section (1) to (8), inclusive; and
- 2. Annual Information Return (for the year immediately preceding the renewal of registration) duly filed with the BIR, together with its attachments.

The above documentary requirements can be daunting for microenterprises that are just emerging from the informal economy. They are not only many -- that is, nine (9) types of documents for the new registrant to accompany the application for registration -- but also they have to be secured from different places (DTI, or SEC or CDA; Mayor's office; the BIR; the financial institution in case a loan has been contracted) and require the services of a lawyer (sworn statements, notarized documents). Unless the above documents have been submitted, no processing can take place. Hence the automaticity regarding registration after the 15-day deadline is only apparent. Moreover the requirements seem tailor-made to those who are already registered since the new applicant is required to submit "Registration as a business entity or enterprise from the appropriate government agency (e.g. SEC; CDA; DTI)" as well as a "Mayor's Permit or City/Municipal. Business Permit". This implies that only those enterprises that are already part of the formal economy can be considered for registration as a BMBE. This seems to contradict one of the objectives of the Law, that is, "to integrate those in the informal economy with the mainstream economy" (Declaration of Policy) who, technically speaking, constitute those who have not registered their enterprises with any unit of government.

In addition to the duty of the City or Municipal Treasurer to conduct a verification of the physical existence of the business and the true amount of its assets, the Office of the City or Municipal Treasurer shall likewise "furnish the Revenue District Officer/s of the BIR in the locality concerned, on a quarterly basis, using a form prescribed by the Bureau, a list of all registered BMBEs of good standing." This List will form one of the bases for the BIR to grant income tax exemption to the BMBE. In addition, the Office shall also conduct a periodic evaluation and verification of the BMBE's financial status, including the actual amount and

condition of its assets. In addition, Section 8 of the Department Order lists the causes for the cancellation of registration.

Availment of Income Tax Exemption After enumerating eleven (11) cases when the income tax exemption shall *not* apply, the DOF stipulates that the BMBE that wishes to avail of the income tax exemption shall register with the BIR RDO (Regional Development Office) of the principal office or place of business where the BMBE is located. The following documents are again required in applying for registration:

- a. Copy of the BMBE's Certificate of Authority duly authenticated by the Office of the City or Municipal treasurer;
- b. Sworn statement of the values of assets owned and/or used /to be used by the BMBE and/or its affiliates reflecting their current values. Support in the form of pertinent information and documents must accompany the Sworn Statement, as follows:
 1. Acquisition cost, date of acquisition and depreciated value for existing assets;
 2. Invoices and/or official receipts for newly-acquired assets not yet depreciated;
 3. Duly-notarized copy of Contract of Lease for assets used in the conduct of business covered by lease agreement; and
 4. Copy of Loan Contract/s, if any, and Duly-Notarized Certification of Amortization Payments on the Loan.
- c. Certified list of branches, sales outlets, places of production, warehouse and storage places, or such other facility owned and/or operated by the BMBE indicating their respective addresses, whether located in the same municipality or city where the principal place of business is located, or elsewhere
- d. Certified list of affiliates, indicating addresses, line of business and responsible officers thereof;
- e. Latest audited Financial Statement, or Account Information Form or its equivalent containing data lifted from audited Financial Statements.

Availment of the Exemption from Gross Receipts Tax According to the Act, exempted from the GRT are all the interests, commissions and discounts derived from loans granted by the LBP, DBP, PCFC and SBGFC to duly-registered BMBEs, as well as loans extended by the GSIS or SSS to their respective member-employees for the purpose of establishing BMBEs. In order to avail of the GRT exemption, a certified true copy of the BMBE's registration with the BIR shall be submitted to the lending institution.

c. Department of the Interior and Local Government

It has been mentioned earlier that footdragging in the implementation of the law by local government units is mainly due to the possible decline in revenue collection as a result of the incentives provided by the law. An internal report of the DTI on compliance with the BMBE law shows that as of January 30, 2004, of the 114 cities in the country, 80 cities (or 70%) claim that they have started to implement the law, while only 656 of the 1,496

municipalities (or 44%) are implementing it. One can argue that the number of non-implementing cities and municipalities may grow over time, considering that the BMBE law became operative only in the year 2002.

It has been recognized that microenterprises do not register due to the paperwork and the time involved in registration. Thus, on April 8, 2003, the DILG issued MC No. 2003-69 in order to enjoin all local chief executives (LCEs) to implement RA 9178 “by establishing a One-Stop Business Registration Center in their areas to handle the efficient registration and processing of permits and licenses of BMBEs.”. As early as September 10, 2001 the DILG already launched the Anti-Red Tape Program for Local Governments with the issuance of MC No. 2001-120, which enjoined all city mayors and municipal mayors to install One-Stop Shops or One-Stop Processing Centers. These Shops are envisioned to facilitate the processing and issuance of business and building permits, the certificates of occupancy and civil registry and real property documents.

As of March 2004, however, only 28% (393 out of 1401) cities and municipalities from the 15 regions of the Philippines have established such One-Stop Shops. Other than NCR which has 100% compliance for its 4 cities, regions outside NCR have very low compliance rates, with Region 6 and 10 having the lowest, at around 2% compliance rates. (Table 2)

Table 2: Establishment of One-Stop Shops as of March 2004

Region	No. of One-Stop Shops	No. of Cities and Municipalities	Compliance Rate (%)
I	43	117	36.8
II	58	89	65.2
III	53	119	44.5
IV-A	64	133	48.1
IV-B	36	71	50.7
V	9	107	8.4
VI	2	117	1.7
VII	18	120	15.0
VIII	18	139	12.9
IX	8	66	12.1
X	2	85	2.4
XI	34	43	79.1
XII	11	45	24.4
XIII	38	70	54.3
NCR	4	4	100.0
CAR	4	76	5.3
Philippines	392	1401	28.0

Source: DILG files

The DILG subsequently issued MC No. 2003-172 clarifying implementation of section 7 of the Act which stated that

The LGUs shall issue the Certificate of Authority (CA) promptly and free of charge. However, to defray the administrative costs of registering and monitoring the BMBEs, the LGU may charge a fee not exceeding One Thousand Pesos (P 1,000.00)

The DILG clarified, upon consultation with the DTI, that there was no need for an enabling ordinance before LGUs can entertain applicants for CA under RA 9178. This was in response to the DTI 'complaint' on the inaction of some LGUs on the applications for CA 'because of the absence of an enabling ordinance implementing the law at the local levels.' The DILG thus directed its field officers to monitor LGU compliance with the mandate and objectives of RA 9178 and its IRR.

In April 30, 2004, the DILG issued MC No. 2004-50, which though not explicitly mentioning RA 9178 but rather in furtherance of a previous "Anti-Red Tape Project for LGUs" implicitly moves towards the objective of the BMBE Act. In this MC, the DILG prescribed standards in the simplification of Civil Application Systems, as follows:

Table 3: DILG-prescribed Standards on the Simplification of Permits

Civil Application Systems	Processing Time	Number of Documentary Requirements	Number of Steps	Number of Signatories
Business Permit	30 mins	6	6	2
Building Permit	480 mins	5	5	3
Certificate of Occupancy	480 mins	3	2	2
Real Property Documents	30 mins	4	2	2

Source: DILG files.

The above standards were supposed to have evolved from the current mode of issuance of said permits and certifications among cities and municipalities, according to their reports on the simplification initiatives on the Internal Regulatory or Civil Application Systems.

d. Department of Labor and Employment (DOLE)

The DOLE issued Department Order No. 45-03 as "Guidelines for the Implementation of Section 8 of RA No. 9178". Among others, the Guidelines state

One of the incentives granted to register BMBE is exemption from the Minimum Wage Legislation as provided under Section 8 of the Act. This incentive, however, should be in harmony with the Constitution and the Labor Code which mandate the State to regulate relations between workers and employers and to protect workers from possible exploitation. (DO 45-03)

Thus the BMBE law allows for exemption of coverage of the BMBE from the MWL. However, the same DO specifies that :

- a. all employees under this Act shall be entitled to the same benefits given to any regular employees such as social security and healthcare benefits;
- b. Workers in BMBEs shall continue to be covered by all applicable labor laws and benefits under the Labor Code including the non-diminution of wages.

The National Wages and Productivity Commission (NWPC) under the Department of Labor and Employment (DOLE) issued NWPC Guideline No. 1 “On the Issuance of Wage Advisories for Barangay Micro Business Enterprises” wherein the Commission shall propose wage rates in the Wage Advisories that are intended “to exert a persuasive effect on BMBE owners and provide a benchmark for workers.”

e. Bangko Sentral ng Pilipinas (BSP)

The BSP issued Circular No. 374 (March 11, 2003) to implement the BMBE of 2002. It stated the following:

- Regarding credit delivery, the BSP enjoined the Land Bank (LBP), the Development Bank of the Philippines (DBP), the Small Business Guarantee and Finance Corporation (SBGFC) and the People's Credit the Finance Corporation (BCFC) as well as the government non-banks, the GSIS and the SSS to set up a special credit window to service the financing needs of duly registered BMBEs. The said financial institutions are “encouraged to wholesale funds to accredited private financial institutions including community-based organizations such as cooperatives, NGOs and people's organizations engaged in granting credit for relending to BMBEs.”
- Interest on BMBE loans must be just and reasonable as may be determined by the management of the concerned entity to be consistent with its credit policies.
- On the amortization of loans: “The schedule of loans amortization shall take into consideration the projected cash flow of the borrowers. Thus, loans granted to BMBEs may, at the discretion of the lender, be amortized daily, weekly, and monthly or at such interval as the conditions of the business of the BMBEs may warrant.”
- On the waiver of documentary requirements: “Banks and other financial institutions shall not require from duly registered BMBE borrowers the submission of income tax returns as a condition to the grant of loans considering that BMBEs are exempted from income tax for income arising from their operations. They may, at their discretion, also waive the requirement of submission of financial statements from BMBEs: Provided that before granting any loan, banks shall undertake reasonable measures to determine that the borrower is capable of fulfilling his/its commitments

- On Credit guarantee: the Law provides that the *SBGFC and the* Quedan and Rural Credit Guarantee Corporation in the case of agri- business activities shall set up a special guarantee window to provide credit guarantee to BMBEs under the respective guarantee programs.

It can be seen that the Bangko Sentral eased its own regulations in order to improve the access to finance by microenterprises. As the subsection on microfinancing indicates, the actions of the BSP paved the way for the easing of credit to BMBEs.

5.1.2 Registration under the BMBE Act of 2002

As of January 30, 2004, however, only 1,206 MEs all over the Philippines have had their applications approved. This is only 0.16 percent of the total number of microenterprises (743,426) operating in 2002. It can be seen from Table 4 below that the highest rate of approvals (that is, relative to the number of microenterprises operating in each region) in the different regions of the Philippines is only less than half of one percent in the Central Visayas, while CAR has not reported any approvals.

Table 4: Approved Applications under BMBE Law vs. Number of Microenterprises

REGION	NUMBER OF APPLICATIONS APPROVED (As of Jan. 30, 2004)	NUMBER OF MICROENTERPRISES 2002	SHARE OF APPROVALS TO NUMBER OF MEs, 2002 (%)
Ilocos Region	26	45,945	0.06
Cagayan Valley	98	23,977	0.42
Central Luzon	161	83,356	0.19
Southern Tagalog	231	134,116	0.17
Bicol Region	34	29,307	0.12
Western Visayas	80	42,456	0.19
Central Visayas	180	44,492	0.40
Eastern Visayas	15	19,951	0.08
Zamboanga Peninsula	35	26,067	0.13
Northern Mindanao	17	30,791	0.06
Davao Region	18	32,813	0.05
SOCCSKSARGEN	29	26,935	0.11
NCR	265	166,757	0.16
CAR	0	13,470	0.00
ARMM	--	7,892	--
CARAGA	17	15,101	0.11
Philippines	1,206	743,426	0.16

Report on BMBE implementation excludes ARMM (City: 1; Municipalities: 94)

Source: DTI files; NSO..

Moreover, it is not clear whether these approvals were “new” enterprises that were emerging from the informal economy. The BMBE Act allows the re-registration of microenterprises that have already been previously registered.

For microenterprises to register under the Act, the granting of tax incentives by the Law assumes that they stand to benefit from them. And yet, those that are expressly targeted by the Act, namely the microenterprises belonging to the informal sector of the economy, work effectively outside the purview of any law. In other words, by being part of the informal economy, they have already exempted themselves from the constraints imposed by the regulatory framework. Examples of such virtual exemptions are as follows:

- Income tax exemption: They do not pay taxes on whatever net incomes they receive from their businesses.
- Local tax exemption or reduction: They do not pay local taxes and fees at the local level resulting from the operation of their business, since they manage to operate without having to secure a mayor’s permit.
- MWL exemption: They are not covered by the Minimum Wage Law to the extent that the DOLE, unaware of their existence, does not run after them for possible violations.
- Access to credit: They could have access to credit, except that they probably do not go the banks and non-banks to borrow under a registered name. They turn instead to other sources, usually relatives, or to the local “5-6 lender”¹⁴.

Hence there are no incentives that the law can offer that they do not already enjoy by being part of the informal sector. The guidelines issued by the DOF, requiring them to produce voluminous documentary requirements in order to benefit from incentives that they already effectively enjoy, are just additional disincentives from joining the formal economy.

The BMBE law assumes that the generous incentives it offers will entice a microenterprise to register. And yet, a microenterprise may not need such incentives because it may have other reasons why it may want to join the formal economy (see FGD below). By offering these incentives, the law merely drives certain government agencies (eg. the BIR, the DOF, DOLE) and local government units that stand to ‘lose’ (in terms of tax revenues foregone or mitigation of labor laws) *not* to implement the law. Or, non-implementation may take the form of making it difficult for microenterprises to register by requiring all sorts of documents and signatures to register. The end result is that very few microenterprises register, if at all, and the objective of the law is not achieved.

A law that aims to entice as many microenterprises as possible to register should therefore look for the real reason/s why microenterprises are discouraged from registering

¹⁴ A usurious money-lender that is ubiquitous in the provinces. They “lend 5 and must be paid 6” (hence the term 5-6) or effectively a 20% interest per week or 860% per annum.

and then must address such bottlenecks *directly*. Our FGD below reveals such bottlenecks as well as the reasons why microenterprises want to join the formal economy. Nowhere are the availment of incentives mentioned as reason.

5.1.3 Voices from the Ground: Results of FGDs

Of the 18 microenterprises who came for the Bacolod FGD, only two (11%) were aware of the existence of the BMBE Law. Moreover, only 8% knew of the Act among those who came for the Cebu FGD. Hence it would seem that a lack of knowledge of the existence of the Act that purports to benefit them is one of the reasons for the low turn-out for registration.

However, this is only one reason. A more serious reason concerns the difficulty of securing the Certificate of Authority that authorizes one to be a BMBE. The issuance of complicated guidelines on the registration of microenterprises, particularly by the DOF, and the voluminous documentary requirements is bound to turn away many a potential BMBE.

The reasons why a microenterprise would prefer to stay in the informal sector as against joining the formal economy were elucidated by the microenterprises themselves during the Bacolod FGD. These were as follows:

- Length of processing time for registration: The documentary requirements for registration are voluminous and would require time to gather. Moreover, processing time took days, if not weeks to accomplish. A participant said that he eventually had to hire an accountant to do the registration for him, so stressing was the experience.
- Cost of registration: Another participant said that the fees were rather high for a microenterprise like his and would have been better used as working capital. Another volunteered that the required documents were rather costly: health certificates, x-rays and stool examinations of workers, etc.
- Lack of information: on what permits to get, where to get them and how much they really cost. Some participants were afraid of 'hidden' requirements that they would be asked to comply with.

On the other hand, the participating microenterprises pointed out the benefits of registration:

- Expansion possibilities: Microenterprises that wanted to expand had to register. Not doing so would open them to legal tussle and even to harassment, especially by local government agents.
- Building consumer trust: Due to the legitimacy conferred by registration, customers' trust is built. They can go back to the registered enterprise for questions and other concerns.

- Issuance of receipts: Registration confers the benefit of issuing receipts that would allow them to easily track their earnings and losses for auditing purposes. Issuance of receipts also builds confidence among its customers.
- Brand ownership: A participant said that for 25 years, she has been making a product that the owners of 'pasalubong shop' in the city brands as its own. Because of a lack of registration, she cannot own the brand and hence cannot exercise some control over her price.
- Freedom from fear of closure by the government: Operating without a Mayor's permit will mean closure of the business by the local government unit (LGU).

Similar reactions to the law were gathered from the microenterprise participants of the Cebu FGD. One participant reacted that there should be some automaticity in the granting of the Certificate of Authority once they have been authorized to operate by the DTI and the LGU.

5.1.4 Policy Suggestions

Doable in the Short-term:

- Institute awareness campaigns on the BMBE Law.
- Create a one-stop shop to reduce the processing time of registration.
- Provide a checklist of documentary requirements and flowchart of necessary procedures for registration/renewal.

Doable in the medium term

- Simplify the documentary requirements for registration of BMBEs
- Study the need for and implications of the different incentives provided by the BMBE law (e.g. revenue implications of tax exemptions)

5.2 The Magna Carta for Small Enterprises

RA 6977: “Magna Carta for Small Enterprises”

An Act to Promote, Develop and Assist Small and Medium Scale Enterprises Through the Creation of a Small and Medium Enterprise Development (SMED) Council, and the Rationalization of Government Assistance Programs and Agencies Concerned with the Development of Small and Medium Enterprises, and for Other Purposes (24 January 1991)

RA 8289: An Act to Strengthen the Promotion/Development of, and Assistance to Small and Medium Scale Enterprises, Amending for that Purpose Republic Act No. 6977, Otherwise Known as the “Magna Carta for Small Enterprises: and for Other Purposes (6 May 1997)

The “Magna Carta for Small Enterprises” was the first piece of legislation to put under a “unified institutional framework all the government programs for the promotion and development of small and medium enterprises.” Previous to its passage, there were a number of attempts of government to promote them, especially through the creation of special lending and guarantee programs as well as the establishment of specialized institutions offering training, technical and extension services, information and marketing assistance. However these attempts were mainly fragmented and uncoordinated (Lamberte 1991). Existing laws, on the other hand, applied to establishments of all sizes and did not distinguish between large and small business entities. And although there was no law or regulation that was explicitly disadvantageous to their growth, it was believed that the policy environment *effectively* created an environment unfavorable to the development of small enterprises. Thus even the promotional programs and special credit facilities created by government could not offset the deep-seated policy biases against them (Llanto, Viray & Hyman, 1991). The Magna Carta could not serve as a magic wand to dissipate the biases created by the policy environment.

A short, cursory look at the policy environment would easily show why it cannot take a law like the Magna Carta to reverse such biases.

- **High Cost of Registration** There was policy bias in the high cost of legal registration and compliance with relevant regulations as elucidated by Zamora (1991). She noted the complexity of the requirements for registration, obtaining a business permit, availment of incentives from the Board of Investments (BOI). The end-result is that entrepreneurs

may opt to avoid the law, but may end up devoting time and resources (including corrupting public officials) to avoid detection.

- **Lack of Access to and High Cost of Credit** Lamberte (1991) for his part noted the deleterious effect of the low-interest rate policy (Usury Law) on small enterprises by shifting institutional credit toward the LEs. The government's response was to introduce skills and management training as well as special credit and guarantee programs for SMEs. And although these programs were found (Anderson and Khambata, 1981) to have increased access to institutional credit, the supply of credit was quite small relative to demand. However, Lamberte also underlined the fact that although the small enterprises were the intended beneficiaries of the special credit and guarantee programs of government (such as through the Philippine National Bank and the Development Bank of the Philippines), they were in the end crowded out of formal financial markets due to systematic credit rationing. As a result, they had to turn to informal credit sources as well as to self-financing to finance their investment and working capital needs.
- **Tax Burden** Guevarra (1991) noted that with regard to fiscal matters, small enterprises found compliance cost heavier than the tax burden itself. They tended to pay rather low income taxes, i.e. 0.62 percent of their gross incomes on the average. But because of the inefficiencies in tax administration and time-consuming red tape, they are driven to underreport their incomes and inflate deductions. Moreover SMEs could avail of certain tax incentives only after rigorous administrative requirements, thus effectively limiting availment to large ones.
- **Labor Cost** With regard to labor policies, Canlas (1991) noted that the minimum wage legislation, by increasing the labor costs of small enterprises, reduced their competitive edge. Moreover, there were long-term benefits that could be had from investments in human capital, such as vocational and technical training of workers.
- **Bias of Trade and Industrial Policies** Trade and industrial policies in general prevailing before the nineties proved to be biased in favor of the large enterprises (LEs). The system of tariff protection seemed to accord greater effective protection to LEs in that in 1974 (Anderson and Khambata, 1981) 68 percent of those employed in establishments with less than 10 workers were in sectors with negative rates of protection. And before the start of the Tariff Reform Policy in 1983, industry effective protective rate (EPR) showed a consistently significant relationship with the share of small enterprises (i.e. establishments with 10-99 workers). Moreover, certain types of imported equipment used by small enterprises were classified as consumer durables and were thus subjected to import duties higher than those imported as 'industrial type' by

LEs. Industrial policy tended to be skewed against small enterprises. Examples were incentives in favor of capital-intensive investment, which SMEs are barred from making due to prohibitively high financial requirements. Moreover, where incentive availment procedures were resource-using, effectively limiting access of SMEs to specific incentives.

Each of the above policy biases will be subsequently analyzed together with the different policy reforms that accompanied some of them. However it must be recognized that the Magna Carta addressed (or tried to address) two of the most pressing needs of SMEs, namely:

- a. the creation of a body that would advocate for/integrate the disparate incentives available to SMEs.
- b. Increasing the supply of credit available to SMEs.

The Magna Carta thus created the Small and Medium Enterprise Development (SMED) Council, whose mandate is to promote, the growth and development of SMEs by “facilitating and closely coordinating national efforts to promote the viability and growth of SMEs, including assisting relevant agencies in the tapping of local and foreign funds... as well as promoting the use of existing guarantee programs”. Being attached to the Department of Trade and Industry (DTI), its secretariat was designated as the Bureau of Small and Medium Business Development (BSMBD), now known as Bureau of Small and Medium Business Development (BSMED) , also of DTI.

To address the financing needs of SMEs, the Magna Carta created the Small Business Guarantee and Finance Corporation (SBGFC). It was mandated to “provide, promote, develop and widen in both scope and service reach various alternative modes of financing for small enterprises...” The Corporation would guarantee loans obtained by qualified small enterprises, even up to one hundred percent (100%). Likewise, it laid down the mandatory allocation of credit to small enterprises by requiring all lending institutions to set aside a portion of their total loan portfolio equal to five percent (5%) by the end of the year of effectivity of the law, rising to ten percent (10%) by the end of the second year through the fifth year, and five percent (5%) by the end of the sixth year, and may be reduced to zero by the end of the seventh year.

On its seventh year, in 1997, the Magna Carta was amended by RA 8289. First RA 8289 raised the value of total assets in order to qualify under each category.

Size Category	Value of Total Assets		
	Magna Carta	RA 8289	DTI, 2003
Micro	Less than P50,000	Less than P1,500,01	Less than P 3 M
Cottage	P50,001 to P500,000		
Small	P500,000 to P 5 M	P1,500,001 to P15 M	P 3 M – P15 M
Medium	P5 M to P20 M	P15,000, 001 to P 60 M	P 15 M – P 60 M

Moreover it gave registered small enterprises a share of at least ten percent (10%) of total procurement value of goods and services supplied to the Government, its bureaus, offices and agencies annually. Third, it revised the requirement for the mandatory allocation of credit of lending institutions, this time to six percent (6%) for small enterprises and two percent (2 %) for medium enterprises of their total loan portfolio for a period of ten (10) years from date of effectivity of the Act. In the following subsections, we shall discuss the policy of government towards SMEs in the light of the Magna Carta.

5.3 Regulatory Control Policies

Any government has in its arsenal regulatory control policies that are necessary in order to put order in the market system. Even right from the setting up of a business, government agency/ies is/are involved in the granting of license to operate, the acquisition of a business name, as well as in the issuance of all the necessary building, occupancy permits and other documentary proofs of legitimacy. Costs, however, are involved in meeting such regulatory rules and regulations of government. Unfortunately, such costs may vary inversely with size of firms because SMEs are by nature less specialized and hence less adept at complying with the bureaucratic requirements of such controls; they are also less able to marshal the political clout that sometimes become necessary with dealing with such regulatory controls.

5.3.1 Registering a Business

SMEs that want to start a business have to register with at least six agencies of government:

- the Department of Trade and Industry (DTI) which handles the registration of business name;
- the Securities and Exchange Commission (SEC) that provides the enterprise with a legal status;
- the Social Security System (SSS) to the extent that the enterprise hires the services of employees;
- the Bureau of Internal Revenue (BIR) for taxation purposes;
- the Department of Labor and Employment (DOLE) which monitors compliance with labor laws, especially the minimum wage law¹⁵;
- the Local Government Unit (LGU) which requires all businesses to secure a mayor's permit or a municipal license from the city or municipality in which they are located.

In addition, cooperatives are required to register with the Cooperative Development Authority (CDA) and depending on the type of business; SMEs must register with other relevant government agency (e.g. Bureau of Food and Drugs or BFAD for manufacturers of food products, cosmetics and drugs). Such registration requirements can be found in the

¹⁵ The Bureau of Local Employment, which handles registration with DOLE, encourages registration for enterprises with more than 5 employees and requires it for those with more than 50 employees

website of DTI (www.dti.gov.ph) under *Starting a Small Enterprise*. Table 5 below shows the number of steps that have to be undertaken by the registering firm.

Table 5: Number of Steps and Documentary Requirements for Registration

Government Agency	No. of Steps	Documentary Requirements
Department of Trade and Industry	7	Application form (duplicate), preferred name slip, index card from Info desk, 2 recent pass-port size pictures, other requirements depending on type of business; If foreigner: proofs of citizenship; if naturalized Filipino: proofs of naturalization
Securities & Exchange Commission	7	For partnerships: Name verification slip, articles of partnership, Undertaking to change name, Registration data sheet, clearance from concerned government agency, license of customs brokers; if foreign: foreign investment agent application form, proof of inward remittance of non-resident alien partner or affidavit manifesting intention not to register with BSP, if signed abroad: authentication from Phil Consular Office in city executed
Social Security System		For single proprietorships: R-1 and R-1A; For partnerships: R-1 and R-1A with Arts. of Partnership; For corporations: R-1 and R-1A signed by president or any corp officer; Arts. of Incorporation
Cooperative Development Authority	6	4 copies of Arts. of Cooperation, 4 copies of By-laws, 4 copies of Economic Survey (feasibility study), Bond accountable officers
Bureau of Internal Revenue	4	Tax Account Number (TIN), Registered business/trade name at nearest BIR office (together with Mayor's Permit, Cert of business name from DTI, Arts of Partnership or Incorporation, residence certificate), application form to obtain authority to print book of accounts, invoices, receipts, & other records, book of accounts, invoices, etc.
Department of Labor and Employment	Registration mandatory for firms with 50 or more workers; with 5 or more workers: encouraged to register	Registration form. For corporations: registration form with SEC Certificate of Registration
Local Government Unit:	3	3 copies of Application from the city hall, simple sketch of business location, Cert. of business name registration from DTI, if partnership or corporation: Acts of Partnership or Incorporation duly registered with SEC, copy of Certificate of Registration from SEC, Mayor's permit if applying for municipal licenses. (from Quezon City)

Source: DTI "Starting a Small Enterprise". www.dti.gov.ph.

The actual cost to be paid is affordable for an SME but as discussed under the BMBE Act for microenterprises, registration procedures may be cumbersome due to the time involved in going from one government agency to another to secure the necessary papers. For instance, with regard to the DTI registration, Fig.3 shows that it takes only about 2.9 hours (175 minutes) to register with DTI. But this presupposes that one has all the necessary papers. Otherwise processing cannot take place

Local government units (LGUs) have their own rules and regulations on obtaining permits, whether business, building, occupancy, real property documents. More recently, the DENR has imposed the Environmental Examination Clearance (EEC) in connection with environmental laws. There is a possibility that complexities could be introduced into these regulations in order to make of them a source of informal payments. The Department of Interior and Local Government (DILG) conducted a survey of the regulatory requirements in the issuance of business, building, and occupancy permits in connection with its project on the simplification of civil application systems. Table 6 shows that there exist differences across regions in the speed at which business permits can be issued. Region IV-A takes only 5 minutes to process an application, whereas NCR takes 720 hours (or more than a week)! The number of documentary requirements can vary from 3 in Region XI and XII to 8 in Regions II and III. Whereas Regions IV-A and V require only 2 signatures, Region I requires 7.

Table 6: Summary of Processes in the Issuance of a Business Permit

Region	Processing Time (minutes)	No. of Documentary Requirements	No. of Steps	No. of Signatures
I	18	6	7	7
II	15	8	6	3
III	30	8	6	3
IV-A	5	4	10	2
IV-B	255	6	5	2
V	30	6	10	2
VI	480	6	6	4
VII	480	5	6	5
VIII	360	4	6	5
IX	30	7	8	5
X	480	5	8	7
XI	60	3	6	4
XII	480	6	5	8

XIII	30	3	7	6
CAR	30	5	4	1
NCR	720	5	7	6

Note: 1 day is equivalent to 8 working hours or 480 mins.

Source : DILG files.

In order to reduce the length of the processing time, DILG asked the LGUs to set up one-stop shops wherein representatives of the different government agencies are gathered in one place. The applicant may then secure the required documents at a minimum of effort and effort. As of May 2004, the DILG reported all cities, capital towns and LGUs in other grown centers have complied with the Memorandum Circular. However, only about 22% of all 1st to 6th class municipalities have complied.

5.3.2 Availment of Incentives

The Board of Investments (BOI) is charged with the granting of incentives to local and foreign businesses operating in the country. However it has been criticized for not being friendly to SMEs and to cater to LEs instead. In 1988, when the BOI had embarked on a simplification of its own bureaucratic requirements on the availment of incentives, the processing time had been reduced from 112 to 65 working days (Zamora, 1991). Nevertheless, Zamora notes that the requirements had not changed, and only the internal procedures, so that further simplification and reduction of requirements are needed. In spite of the more SME-friendly procedures, the negative perceptions remain, so that the trend in BOI registrations by SMEs had gone down in favor of LEs.

The problems of availment of incentives will be discussed under the Trade Policy section because most incentives are given to export-oriented firms or to foreign direct investments.

5.3.3 Voices from the Ground: Results of FGD

As has been discussed in the section on the BMBE Act, the duration of the processing period for registration as well as the different kinds of permits are what discourage a would-be applicant from registering. The alternative, especially for the microenterprise, is to stay in the informal sector and hence to remain small (in order to remain 'invisible'). Aside from the processing time involved, some deplored the seeming lack of information dissemination regarding the registration process. A more recent addition to the documents businessmen have to present is the Environmental Examination Certificate

(EEC) . To be able to obtain one, however, could be costly because the information asked for is so sophisticated for a small business that a knowledgeable consultant has to be hired; Moreover, because of the absence of a provincial representative of the DENR, the time required is lengthened and the cost is raised since the regional representation who stays in Cebu has to go all the way to Bacolod in order to inspect the site before issuing the ECC.

5.3.4 Policy Suggestions

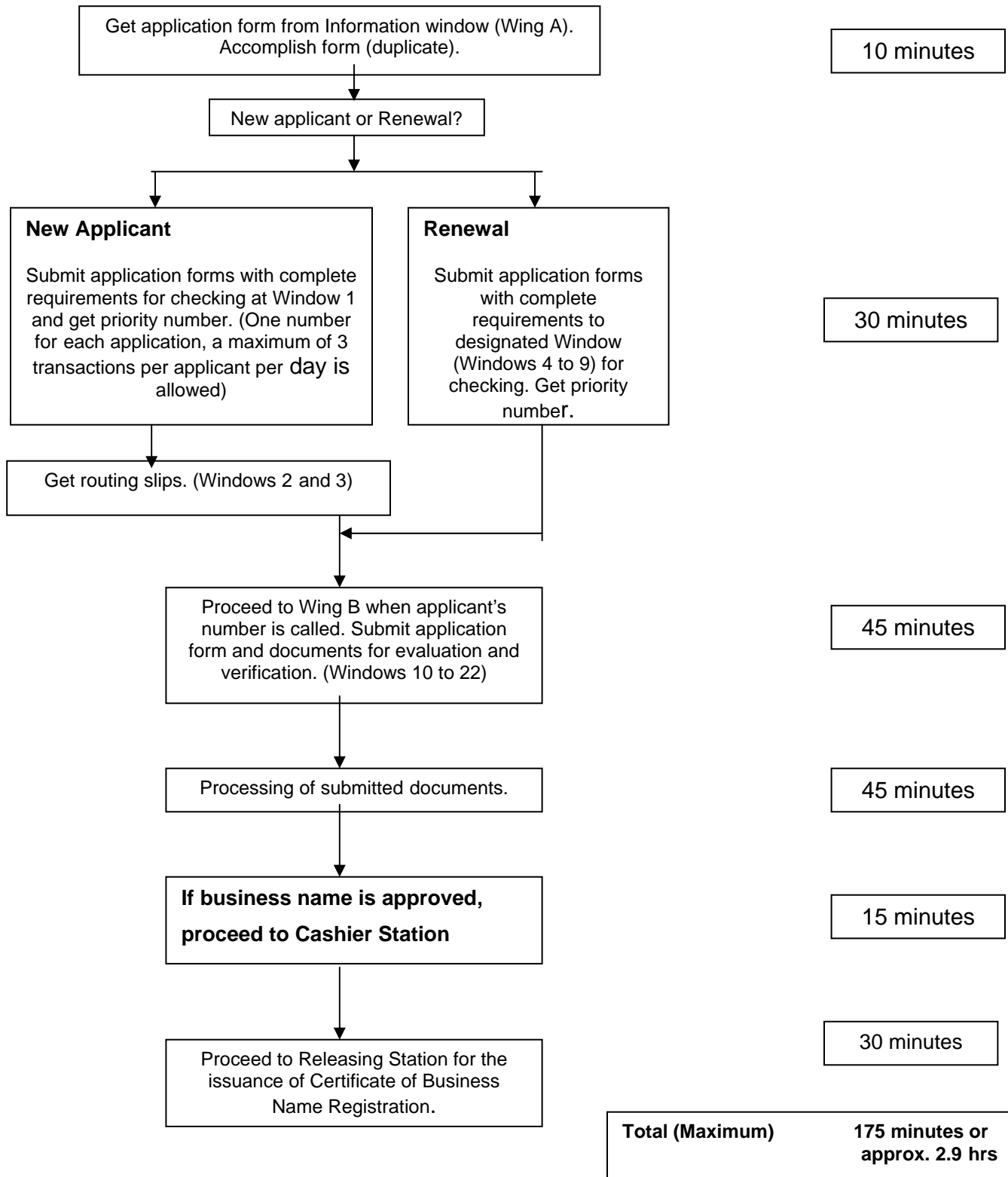
Doable in the Short-term

- A clear flowchart of the registration process, the list of documents required, the people whose signatures are needed, the other government agencies from whom other permits have to be secured, all these could be displayed in prominent places in public areas.
- Establish a One-Stop-Shop to reduce the processing time of documents for registration or renewal of permits.
- Simplify the ECC.

Doable in the Medium-term Further simplification of the process of registration and securing of different permits

Figure 3: Flowchart of Requirements for DTI Registration
DTI Registration Procedure

(Both for New Applicants and Renewal)



5.4 Financing Policy

This section looks specifically at the financing possibilities of microenterprises and of SMEs. The first subsection will analyze the state of microfinance and the second section delves into the availability of financing to SMEs.

5.4.1 Financing of Microenterprises

RA 8425: Social Reform and Poverty Alleviation Act of 1997 (Dec. 11, 1997)

RA 8791: General Banking Law or An Act Providing for the Regulation of the Organization and Operations of Banks, Quasi-Banks, Trust Entities and for Other Purposes (May 30, 2000)

In recent years, there has been an increasing interest in the microfinance sector in the country. Previously the track record of the sector has been mainly a disappointment because in spite of the presence of hundreds of small-scale rural banks, cooperatives, and NGOs that cater to the sector, the sum-total of all their activities can be said to be at best limited. It is said (ADB 2003) that only in the last five years or so that a large number of rural banks and cooperatives has found potential market niches in the sector.

Although the total volume of credit to the microenterprises from both formal and semi-formal microfinance institutions is not known, the major providers of microfinance can be identified: at least 100 of the 786 rural banks, many of the 3,000 cooperatives registered with the Cooperatives Development Authority (CDA), and about 500 of the roughly 900 microfinance NGOs. Moreover, one can add to this a large number of small, regulated financial institutions, such as pawnshops and lending investors.

However, whereas microfinance in the country has been associated with investments in small sari-sari or variety stores or in tricycles or in small stalls in public markets, currently it has come to be associated with financing even the loans of poor households. Thus according to the Social Reform and Poverty Alleviation Act (SRPAA) of 1997 (or RA 8425), 'poor households' include the disadvantaged sectors of the country, that is, farmer-peasant, artisanal fisherfolk (municipal, small scale or subsistence fishermen who use fishing gears but with either no need for boats or boats below 3 tons), workers in the formal sector and migrant workers, workers in

the informal sector, indigenous peoples and cultural minorities, those who work in the informal sector, differently-abled persons, women, senior citizens, victims of calamities and disasters, youth and students, children and the urban poor. It is also impossible to know if a loan is for investment or consumption purposes without examining the reason for the loan. But even then, due to the fungibility of funds, a loan taken out for the purportedly for investment purposes may end up being used for consumption purposes or to tide over a household need.

Hence, in the Philippines, microfinance is associated with poverty-alleviation programs of government. The government established the National Credit Council (NCC) in 1994 in order to rationalize government-directed credit programs and develop a national credit delivery system capable of addressing the issues of poverty (ADB 2003). In 1997 it issued the “National Strategy for Microfinance”, a national framework for microfinance with its emphasis on the role of the private sector and the need for an enabling policy environment. This set the stage for the passing of two important Acts which further strengthened the microfinance strategies of government. Table 7 provides the relevant laws and Executive Orders that detailed the guidelines for the implementation of the laws. In addition, a major donor-funded project, the Credit Policy Improvement Project (CPIP) of the USAID provided technical assistance to the NCC in order to help rationalize the credit and loan guarantee programs (ADB 2003)

Table 7: Laws Facilitating Microfinance in the Philippines

Law	Year	Title	Contents
RA 8425	1998	Social Reform and Poverty Alleviation Act	<ul style="list-style-type: none"> Reinforced the market-oriented approach to microfinance Created the People’s Development Trust Fund to provide grants and other financial assistance to MFIs for capacity building.
EO 110	2002	Directing PCFC to Administer the People’s Devt Trust Fund	Guidelines on the implementation of provisions of RA 8425
RA 8435	1997	Agriculture & Fisheries Modernization Act (AFMA)	Rationalized all agriculture-related credit programs of government.
EO 138	1987	Simplifying the Procedures on Phil Govt Approval of Projects/Investments	<ul style="list-style-type: none"> Prevented government line agencies from directly implementing credit programs Wholesaling of funds by government financial institutions to participating financial institutions, especially community-based organizations, e.g. on coops and microfinance NGOs as conduits

5.4.1a The Banking Sector and Microfinance

The Role of Financial Sector Reforms

A number of financial sector initiatives led indirectly to the growth of microfinance. First is the lifting of the Usury Law in 1983. The Usury Law (RA 2655) subsidized credit at lower than market interest rates in the belief that economic development will be hastened by cheap credit. However, the low interest rate, by preventing banks from pricing their products and services to recover fully their operational and financial costs, effectively crowded out lending to MSMEs. Banks preferred to lend to large-scale firms that had a track record of repayment and possibly the collateral –usually land -- to back up the loans. The removal of the interest rate restriction then opened the possibility for banks to lend at market rates to small borrowers. Secondly, the liberalization of bank entry and branching in 1995 (BSP Circular No. 93) allowed banks, especially the rural banks, to expand their lending activities to areas outside the traditional cities and populated municipalities. Thus, in general the liberalization of the financial sector paved the way for microfinance in the nineties.

The banking structure had evolved in a way that accommodated the prevailing market environment. Banks generally located themselves in populated cities and municipalities and catered to the needs of the LEs. The MSMEs, especially the smallest among the group, being left out of the formal financial system, relied mainly on their own resources or the informal microfinance providers. These were usually the local moneylenders who provided credit known locally as “5-6”. Other informal providers were trade creditors and farmer lenders, rotating savings and credit associations, and other self-help groups. Within the banking system, the Central Bank, through a system of tiered licensing, allowed the thrift banks and rural banks to locate in areas where there is a proliferation of small savers and borrowers, i.e. outside the National Capital Region. Incentives were provided to these banks:

- Lower minimum capital requirements
- Exemption from payment of all taxes and fees/charges, except the corporate income tax and local taxes, fees/charges for a period of 5 years from date of commencement of operations

Table 8 provides the minimum capital requirements which encouraged the establishment of many thrift and rural banks.

Table 8: Minimum Capital Requirements of Banks

Type of Bank	Minimum Capital Requirement (P million)	Minimum Capital Requirement (\$ 000)
Universal commercial banks	4,950.0	100,000
Regular commercial banks	2,400.0	48,000
Thrift banks		
W/head office in Metro-Manila	325.0	6,500
W/head office outside MM	52.0	1,050
Rural banks		
Within Metro Manila	26.0	520
Cities of Davao and Cebu	13.0	26
1 st -3 rd class cities & 1 st class municipalities	6.5	130
4 th -5 th class cities & 2 nd -4 th class municipalities	3.9	78
5 th -6 th class municipalities	2.6	52

Source: BSP, 2002.

The passing of the General Banking Law of 2000 together with a number of Circulars on the implementation of certain provisions of the Law, laid down clearly the Bangko Sentral's policy framework on microfinance. Table 9 highlights these law and regulations.

Table 9: BSP Policy Framework for Microfinance

Law/Regulation	Date of Issuance	Title/Contents
RA 8791 (esp. Sec. 40, 43, 44)	12 April 2000	General Banking Law (GBL) or An Act Providing for the Regulation of the Organization and Operations of Banks, Quasi-Banks, Trust Entities and for Other Purposes
Circulars: No. 272	30 January 2001	Guidelines for implementing the provisions of Sections 40, 43, 44 of the GBL
No. 273	27 February 2001	Partial lifting of the general moratorium on the licensing of new thrift and rural banks to allow the entry of microfinance-oriented banks
No. 282	19 April 2001	Guidelines governing the Rediscounting Facility available to rural and cooperative banks for the purpose of providing liquidity assistance to support and promote microfinance programs
No. 324	12 March 2002	Expansion of coverage of rediscounting facility (Circular No. 282) to include thrift banks
No. 340*	30 July 2002	Rules & regulations for the establishment of branches/loan collection and disbursements points

Circular Letter No. 2002-93	2 October 2002	(LCDPs) of microfinance-oriented banks Revised and additional reports for microfinance loans
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Three provisions of the GBL concern microfinance, namely Sections 40, 43, and 44.

*Subsequently amended by Circular Letters No 365 (16 January 2003) and No.360 (February 16, 2003)

- Section 40 on the Requirement for Grant of Loans and Other Credit Accommodations: While the GBL recognizes the importance of documentary evidence and other information for the proper evaluation of a credit application, the “Monetary Board shall recognize the particular characteristics of micro-financing, such as cash-flow-based lending to the basic sectors that are not covered by traditional collateral.”
- Section 43 on the Authority to Prescribe Terms and Conditions of Loans and Other Credit Accommodations: The Monetary Board has been vested by law to prescribe the maturities, as well as related terms and conditions for the various types of bank loans and other credit accommodations. The GBL grants the Monetary Board the authority to “regulate the interest imposed on micro finance borrowers by lending investors and similar lenders such as, but not limited to, the unconscionable rates of interest collected on salary loans and similar credit accommodations.
- Section 44 on the Amortization of Loans and Other Credit Accommodations: “The amortization schedule of banks loans and other credit accommodations shall be adapted to the nature of the operations to be financed. ... In case of loans and other credit accommodations to micro finance sectors, the schedule of loans amortization shall take into consideration the projected cashflow of the borrower and adopt this into the terms and conditions formulated by banks.

In order to flesh out the three important provisions on microfinance, a number of circulars were issued by the Bangko Sentral found in Table 9 above.

Circular No. 272, the first in the series, fixes the maximum principal amount of microfinance loans to P150,000 (or equivalent to the maximum capitalization of microenterprise under RA 8425 or the Socail Reform and Poverty Alleviation Act of 1997.) It has five important paragraphs a propos credit to microenterprises.

- In order to increase the access of MEs to bank loans para 1 states that: these loans are granted on the basis of the borrowers’ cash flow and are typically unsecured”. The Circular is therefore a clear signal to banks to grant loans to MEs not on the basis of collateral – usually chattel mortgage – but on the basis of the borrowers’ cash flow.

- Since Section 44 of the GBL says that the bank, in drawing up the terms and conditions of the loan must take into consideration the projected cashflow of the borrower, para 3 of the Circular says that “microfinance loans may be amortized on a daily, weekly, bi-monthly or monthly basis, depending on the cash flow conditions of the borrowers.” According to Lamberte (2001) this provision on the amortization schedule mimics the credit arrangements that are prevalent in the informal credit markets.
- Through para 4, the BSP reiterates the importance of not subsidizing the loans through a lower interest rate than the prevailing one “to enable the lending institution to recover the financial and operational costs incidental to this type of microfinance lending.” This is a clear signal that the BSP wants to foster viable microfinance institutions.
- Para 5 of Circular 272 exempts the microfinance loans from the documentary evidence that banks would normally require of creditors for the proper evaluation of credit application. Such evidence may just simply increase the cost of lending to MEs. For instance, MEs are exempt from the payment of income taxes under the BMBE Law. Thus, para 5 states that in the case of microfinancing loans “a bank may not require from its credit applicants, a statement of assets and liabilities, and of their income and expenditures and such information as may be prescribed by law or by the rules and regulations of the Monetary Board...”
- Through para 7, the BSP encourages the granting of loans to MEs by exempting such loans from “rules and regulations which may have been issued by the Monetary Board with respect to unsecured loans under Section 41 of the GBL” under of course certain conditions on the bank.

Because of the precarious position of banks resulting from the Asian Financial Crisis of 1997, the BSP declared a moratorium on the opening of new banks, stressing instead the need to strengthen the financial position of existing banks through merger or consolidation. However, in order not to reduce the flow of financing to microenterprises, the BSP declared a partial lifting of the general moratorium on the licensing of new thrift and rural banks, thus paving the way for the entry of micro-oriented banks. This was the gist of Circular No. 273. It allowed the establishment of microfinance-oriented banks on a very selective basis, provided it is a thrift or rural bank¹⁶. This was followed up by Circular No. 340 which clarified the rules and regulations on the establishment of branches./loan collection and disbursement points (LCDPs) for both microfinance-oriented and non-Microfinance-oriented banks.

¹⁶ Among others, Circular No. 273 required that while the capitalization requirement for thrift banks must be met under the existing regulations, rural banks that are established as a microfinance bank must have “minimum paid-in capital of P5 M or the applicable existing capitalization for new rural banks, whichever is higher.” Para 3, Circular No. 273.

In order to provide liquidity in support and promotion of microfinance programs of rural banks and cooperative banks, the BSP issued Circular No. 282 which opened its Rediscounting window to these two types of banks. It therefore granted a Microcredit (MCR) line to eligible rural and cooperative banks, expanding the facility to include thrift banks under Circular No. 324.

The Role of Rural Banks

RA 7353: Rural Bank Act of 1992; An Act Providing for the Creation, Organization, and Operation Of rural Banks, and for Other Purposes (April 2, 1992)

Rural banks grew out of a system of private banks subsidized by government in the fifties to service the borrowing needs of the agricultural sector. Many of them grew out of the operations of moneylenders (AIM, 2002) and so are more ready to be innovative in their lending to microenterprises that are just being weaned from borrowing from the informal sector. Undergoing a crisis in the eighties in which a third of them had to closed, rural banks have now become more conservative in lending. Over the years, they have also shifted from servicing the agricultural sector to non-agricultural sectors (commerce and industry). R.A. 7353 (An Act Providing for the Creation, Organization, and Operation of Rural Banks, and for Other Purposes or Rural Bank Act of 1992) was passed in recognition of the need “to promote comprehensive rural development” through the establishment of a rural banking system designed to make needed credit available and readily accessible in the rural areas on reasonable terms.”

Because of their geographical outreach as well as their wide client base, rural banks are said to be ideally suit to provide commercial loans to microenterprises. Section 6 of RA 7353 states that in the granting of loans, the rural bank shall give preference to the application of farmers and merchants whose cash requirements are small.” Table 10 which shows their average loan sizes indicates that it is less than P30, 000 or less than \$1,000.

Table 10: Loans granted by rural banks

Year	No. of Loans	Amount of Loans Granted (M Pesos)	Average loan size (P 000)	Average loan size (\$)
1990	684,991	9,349	13.65	561
1991	537,788	10,519	19.56	712
1992	564,939	12,708	22.50	882
1993	747,759	18,548	24.81	915

1994	505,880	15,187	30.02	1,136
1995	892,303	27,770	31.12	1,210
1996	1,138,791	35,994	31.56	1,204
1997	300,923	18,743	26.05	884
1998	1,368,063	38,291	27.99	684

Note: Average loans in \$ estimated by dividing average loan in pesos by exchange rate of peso to dollar period average.

Source: Bangko Sentral ng Pilipinas

Rural banks have become very competitive over the years. Being aware of the competitive pressures from commercial and thrift banks as well as pawnshops, finance companies, and even informal money –lenders, many have decided to go into specialized microfinance services. A number have adopted variants of the Grameen model in order to remain competitive in lending to at low cost to small borrowers who might also be high-risk. Lamberte (2001) cites the case of the CARD Rural Bank's use of a modified Grameen Bank technology. Others have created special credit windows for salaried people with families in small and micro enterprises. Recognizing the need of rural banks for capacity building in their expansion of loans to the microfinance sector, the MABS (Microenterprise Access to Banking Services) project funded by the US-AID has tapped the Rural Bankers Association of the Philippines to provide "the technical assistance, training and limited resource support to participating rural banks. A second project proposed by the RBAOP Academy for Banking in the Countryside (ABC) was expected to offer a full course curriculum in microfinance, but as of early 2003, it had not yet gotten off the ground.

The Role of Government Banks

Aside from providing the enabling policy environment, the Philippine government plays a direct role in providing microfinance through its government banks and numerous directed credit programs. Directly, through their retail lending windows or indirectly through the wholesale lending windows of these two banks – the Development Bank of the Philippines (DBP) and the Land Bank of the Philippines (LBP) – the government attempts to increase the access of MEs to sources of loanable funds. Of the two government banks, the LBP seems closer to MEs than the DBP. We shall therefore relegate discussion of DBP to the section on SME lending.

The **Land Bank** was first set up to serve as the financial arm of the land reform program, having been established by RA 3844 or the Agricultural Land Reform Code of 1963. However ten years after its establishment, that is in 1973, it became a comprehensive or universal bank

through a presidential decree, and caters to agribusiness projects and rural industries. It was later to expand its agrarian activities with the passage of RA 6657 or the Comprehensive Agrarian Reform Law (CARL) in 1988. Cooperatives then became its main conduit in support of the agrarian reform beneficiaries under the comprehensive agrarian reform program (CARP). Through its branch network, it operated as a commercial bank while its field offices took charge of its agrarian reform function. The profits from the former were channeled to the benefit of small farmers, fisherfolk and other SMEs in the countryside. However on 23 February 1995, when it received its new charter under RA 7907, it assumed development approach in banking under the Unified Systems Project. By merging its field banking and agrarian operations, it was able to cut down on operating expenses and became more efficient in service delivery.

The **Development Bank of the Philippines** on the other hand is a development bank that provides medium and long-term loans to different sectors of the economy, including SMEs. It likewise provides whole-sale lending for microenterprises and strengthens its linkages with microfinance institutions such as development banks, rural banks, NGOs, people's organizations, and cooperatives.

5.4.2b The Non-Banking Sector and Microfinance

The Role of Cooperatives/Cooperative Rural Banks

RA 6389: An Act Creating the Cooperative Development Authority...
(September 10, 1971)

RA 6938: An Act to Ordain a Cooperative Code of the Philippines
(March 10, 1990)

Cooperatives are another source of microfinancing. Although in existence since the early 1900s, the government thrust appears to have been to increase their number rather than improve their financial viability. RA 6389¹⁷ created the Cooperative Development Authority (CDA) which was tasked to oversee the development of cooperatives which must be registered with CDA. Chapter XIII of RA 6938 (an Act to Ordain a Cooperative Code of the Philippines)

¹⁷ The complete title of RA 6389 is as follows: "An Act creating the Cooperative Development Authority to promote the viability and growth of cooperatives as instruments of equity, social justice and economic development, defining its powers, functions and responsibilities, rationalizing government policies and agencies with cooperative functions, supporting cooperative development, transferring the registration and regulation functions of existing government agencies on cooperatives as such and consolidating the same with the authority, appropriating funds therefore, and for other purposes",

allows cooperatives to become a cooperative bank (including a cooperative rural bank), putting them under the authorization of the Central Bank.

Cooperative banks have been saddled with problems because of a history of lack of commitment to a social approach as well as a lack of regulation or supervision (ADB, 2003). They are said to be burdened with poor repayment, mounting arrears, and even management-related problems. Donor efforts to improve their financial viability have allowed a number of them to expand their microfinance operations. In an effort to strengthen their financial capabilities, the National Credit Council, together with the CDA and major credit cooperative representatives formulated a Standard Chart of Accounts, which approximates that of the banking sector (ADB 2003). Data from the People's Credit and Finance Corporation (PCFC) which is a wholesale lending institution established in 1995 show that cooperatives make up the a third of the total number of conduits of PCFC. Add to this the number of cooperative rural banks. 23% of cooperative loans are between P 1M-4 M and 15% of loans are less than P1 M.

Table 11: PCFC conduits by loan portfolio and institutional type, as of December 2002

Outstanding Loan Portfolio	Total	Percentage share	Cooperatives	Rural Banks/Coop Rural Banks	NGOs	Others
P100M & above	2	1		1	1	
P50M-99 M	6	3.20		5	1	
P20M- 49 M	11	5.88	1	8	2	
P10M-19 M	24	12.83	3	17	2	1
P5m – 9 M	51	27.27	17	28	6	
P1M – 4 M	63	33.68	23	27	13	
Less than P 1 M	30	16.04	15	7	8	
Total	187	100.0	59	93	33	1
Percent. Share			32	50	18	

Source: AIM 2003. (Table 2)

The Role of Non-Governmental Organizations (NGOs)

An upsurge of NGO activities dates back to the mid-eighties but their microfinance activity started only in early nineties, in response to substantial financial and non-financial support from government, donors, and international NGOs. However, ADB 2003 reports that a large majority of microfinance NGOs are neither sustainable nor viable due to their weakness in ownership, governance, and institutional capacity. Nevertheless, taken individually, a few NGOs have managed to achieve financial self-sufficiency and operational efficiency, such as the Center for Agricultural and rural Development (CARD) and the Tulay sa Pag-unlad Inc. (TSPI).

Together with a third NGO, namely the Negros Women for Tomorrow Foundation (NWTF), their loan portfolio accounts for about 2/3 of all microfinance NGOs' combined portfolio (ADB 2003:20). Table 12 provides certain indicators of the microfinance activity of these three NGOs.

Table 12: NGOs in Microfinance

Indicator	CARD	TSPI	NWTF
No. of branches	30	26	15
No. of borrowers & savers	84,037	39,378	35,010
Value of loans outstanding (P M)	379	196	179
Average loan balance (P)	4,110	5,984	5,125
Repayment rate (%)	99.9	98.5	99.2
Portfolio at risk (%)	0.43	3.0	2.1
Operational Self-sufficiency (%)	139.5	122.7	102.4
Financial Self-sufficiency (%)	118.5	110.8	85.7

Source: ADB 2003: Table 2.7; from the Microfinance Council of the Philippines 2002B, p. 8.

It can be seen from the Table that the three NGOs have a rather considerable outreach, their number of borrowers and savers numbering from 35,000 to 84,000. The size of their loans on the average is about P5000, making them appropriate conduits of microfinance. Repayment rates are high and comparable to commercial financial intermediaries.

5.4.1c Voices from the Ground: Results of FGDs

Of the microenterprises from Bacolod who belonged to the formal sector, a large majority shied away from financial intermediaries, and borrowed instead from family members and friends. A few have tried but were discouraged from borrowing from financial intermediaries because of collateral requirements, although one participant stated that their loans were non-collateralized because of their small size. This was in stark contrast with the microenterprises that belonged to the informal sector which as a whole expressed no problems with regard to access to finance because they could borrow easily from the Negros Women for Tomorrow Foundation (NWTF). They considered interest rates at the NWTF low, possibly compared with that of usurious money-lenders from which other microenterprises without backing of an NGO borrow. They said that they cannot borrow from banks because of the need for a land-based collateral and because they are unregistered, hence unrecognized by the banks. They expressed contentment over the flexibility in payment modes that they could choose from in their

loans with NWTF. Likewise, they acknowledged that the insurance, rebates and dividends they get from NWTF allowed them to take risks and responsibilities in their chosen businesses.

Microenterprises in Cebu complained of the difficulty they face in credit access. Some of their loans are too small for commercial banks to process while being too large for microfinance institutions. Some that have tried to avail of government financing experienced long waiting time for their loans to be processed, i.e. from 6 to 13 months. GFIs are not wont to inform them of the status of their loan applications, making them wait indefinitely for loans that never come.

5.4.2d Policy Suggestions

Doable in the Short Term : The information problem as to available sources of credit must be addressed quickly and effectively. A user-friendly and updated compilation of such sources must be made available in the DTI website or in a newspaper of general circulation.

Doable in the Medium Term: Study of the guarantee scheme and its effectiveness in improving credit access to microenterprises in lieu of real estate collateral.

5.4.2 Financing of SMEs

RA 6977 : “Magna Carta for Small Enterprises” (24 January 1991)

RA 8289 : An Act ... Amending RA 6977, Otherwise Known as the “Magna Carta for Small Enterprises: and for Other Purposes (6 May 1997)

Section 13 of the Magna Carta for Small Enterprises mandated an allocation of credit resources to small enterprises by requiring all lending institutions to set aside a portion of their total loan portfolio to small enterprise credit, i.e. 5% percent by the end of the year of the effectivity of the Act (i.e. 1991) 10% by the second to the fifth years (i.e. 1992-1995), 5% by the end of the sixth year (1996) and this may come down to zero by the end of the seventh year (1997). RA 8289 which amended the Magna Carta in 1997 extended this mandatory allocation to at least 6% for small enterprises and 2% for medium enterprises, respectively for a period of ten years from the date of effectivity of the Act.

Table 13 shows that the total funds set aside for SMEs by the lending institutions from 1991-2002 exceeded the percentage required by the Magna Carta. It seems therefore that the mandatory allocation was not all that restrictive. What is not clear, however, is whether banks would have acted in a similar manner, had the allocation not been mandated by law.

**Table 13: Compliance with Mandatory Requirement of the Magna Carta
1991-2002 (P Billion)**

Year	Loan Portfolio	Total Funds for SMEs	Mandatory Requirement*	SME credit/Loan portfolio (%)
1991	201.6	16.8	9.6	8.35
1992	208.2	26.8	20.8	12.87
1993	276.5	34.2	27.6	12.38
1994	385.3	53.12	38.5	13.79
1995	560.2	86.9	56	15.52
1996	791.6	113.8	39.6	14.38
1997	946.3	124.3	47.3	13.14
1998	1,027.8	240.7	61.6	23.42
1999	1,001.5	248.1	60.1	24.78
2000	986.4	231.6	59.2	23.48
2001	992.2	248.5	59.5	25.05
2002	953.2	259.6	57.2	27.23

* Note: See text for mandatory requirement of Magna Carta and its Amendment.
Source: Bangko Sentral ng Pilipinas

With the amendment of RA 8289, one can see from Table 14 that loans to SMEs as a proportion of the net loan portfolio of banks from 1998 to 2002 still followed the rule of 10% mandatory allocation for the 2nd to the 5th years of the Magna Carta. In fact, it very much exceeded the rule. However, the data also show that especially after 2000, the net loan portfolio of banks actually decreased, so that the absolute amount of SME loans, while complying with the law, did not increase much. It must be noted though that SME loans had been increasing faster than other types of loans, judging from the rising ratio of SME loans to the loan portfolio of banks.

Table 14: Loans to SMEs, 1998 – 2002 (P Billion; %)

Year	Small		Medium		Small & Medium		Net Loan Portfolio	
	Amount	Share	Amount	Share	Amount	Share	Amount	Total
Dec. 1998	141	13.7	99	9.6	240	23.3	1,028	100
Dec. 1999	148	14.8	100	10.0	248	24.8	1,002	100
Dec. 2000	125	12.7	106	10.8	231	23.4	986	100
Dec. 2001	155	15.6	94	9.5	249	25.1	992	100
Dec. 2002	166	16.9	99	10.1	265	27.0	953	100

Source: BSP (from Table 11-4-3, JICA, 2003)

Thrift and rural banks, because of the small sizes of their average loans, would be ideal lenders to SMEs. However, it seems that commercial banks, because of their sheer size, as shown in the Table 15 below, dominate the SME lending of the banking system. .

Table 15: Market Share of the Philippine Banking System, as of Dec. 31, 2003
(P billion: based on assets)

Type of Bank	Amount	Percent Share
Commercial banks	3,297.20	90.0%
Thrift banks	274.17	7.48%
Rural banks	83.33	2.28%
Cooperative Banks	5.60	0.15%
TOTAL	3,660.30	100%

Source: SRSO, BSP

In mid year 2002, commercial banks provided about 83% of all loans to SMEs. In contrast, thrift banks have extended only about 12% of all SME loans and rural banks only about 2%.(Table 16) And yet the loans to SMEs make up a larger portion of these banks' total loans than commercial banks (that is, 25% of commercial bank loans, 41% of thrift banks', and 47% of rural banks' total loans).

Table 16: Composition of loans by type of bank as of June 2002 (P billion)

Type of Bank	Small		Medium		Small & Medium		Net Loan Port.	
	Amount	Share	Amount	Share	Amount	Share	Amount	Share
Commercial	136	82.4	84	84.9	220	83.3	879	89.4
Thrift banks	19	11.5	12	12.1	31	11.7	76	7.7
Rural banks	10	6.1	3	3.0	13	5.0	28	2.9
TOTAL	165	100	99	100	264	100	983	100

Source: BSP (JICA, 2003: Table II-4-4.)

Only 5 out of the 912 banks in the Philippines are said to provide more than half of total loans to SMEs, indicating the lack of accessibility of SMEs to the banking sector, as corroborated by the FGDs conducted in Bacolod and Cebu.

5.4.2a The SULONG Program

The **Small Business Guarantee and Finance Corporation (SBGFC)** had been created by the Magna Carta for SMEs to "to provide, develop, promote, develop and widen in both scope and service reach various alternative modes of financing for small enterprises". Recently, it launched the SME Unified Lending Opportunities for National Growth (SULONG) in order to increase access of SMEs to credit. It is a unified lending program designed to:

- Simplify and standardize the lending procedures of GFIs (government financing institutions), thereby enhancing the SMEs' access to needed funds;
- To shorten the list of documentary requirements to further facilitate the lending process;
- To create a wider, borderless financing system that will afford the SMES greater access to short- and long-term funds;
- To lower the effective cost of borrowing by SMEs and liberalize the requirement.

Wholesale lending is done by participating GFIs which are : the Development Bank of the Philippines (DBP), the Land Bank of the Philippines (LBP), the SBGFC, and the Social Security System (SSS), the National Livelihood support Fund (NLSF), the Philippine Export-Import Credit Agency (Ex-Im), the Quedan & Rural Credit Guarantee Corporation (QUEDANCOR), and the People's Credit and Finance Corporation (PCFC).

There are two types of loans:

- A short-term loans payable in one year for the following purposes:
 - Export packing credit (up to 70% of LC or PO)
 - Temporary working capital (up to 70% of working capital)
- A long-term loan, payable in a maximum of five years for the following purposes:
 - Purchase of equipment
 - Building or warehouse construction
 - Purchase of lot
 - Purchase of inventories or as permanent working capital

The program can fund up to 80% of incremental cost of long-term loans. Both term loans are up to a maximum of 5 million. The program has a total fund allocation of P100 million or about 38% of all loans to SMEs by the banking sector.

The interest rate charged by the participating GFIs is the same rate for the program based on a regular review. In launching of the program, the interest rate for loan releases until June30, 2003 are as follows:

- 9% for short-term loans
- 11.25 for medium-term loans of up to 3 years;
- 12.75% for loans over 3-5 years

In terms of collateral, short term loans, depending on whether it is export financing or for temporary working capital are as follows

Export Financing	Temporary Working Capital
Post dated check	Post dated check
Registered/unregistered real estate mortgage (REM) or chattel mortgage (CM)	Registered/unregistered REM or CM
Assignment of letter of credit (LC) or purchase order (PO)	Assignment of LC or PO
Assignment of life insurance	Guarantee Cover
Guarantee cover	Corporate Guarantee (if franchisee)
	Assignment of lease rights (if franchisee)

For long terms loans, the collateral required are:

- Post dated check
- Registered/unregistered REM or CM
- Guarantee cover
- Assignment of life insurance
- Corporate guarantee (if franchisee)
- Assignment of lease rights (if franchisee)

The SULONG program has been credited with having increased the credit available to SMEs since its start in 2003. Interest rates are said to be lower than previous loans to SMEs, i.e. 9% for direct loans from participating GFIs compared to 11-12% for ordinary loans. Moreover, SULONG loans require other forms of collateral to supplement personal guarantees and other types of security, unlike other loans to SMEs that require 100% land-based collateral only. Moreover, the application form consists of only two pages and is in uniform format that can be used by all banks participating in the SULONG program.

Lending is said to be brisk as a result of the program. However, there is fear that the success of the program can be the source of its own difficulties, since the attractiveness has already led to shortages in the supply of credit to SMEs, as the results of our FGD show. Moreover, in actual practice, the participating banks and non-banks are said to be reluctant to shed off their land-based collateral-based requirement.. Likewise, the simplification of the examination process and the lowering of the interest rate have not been effectively pursued (JICA, 2003).

5.4.2b Other Types of SME Loans

In many cases the SMEs remain clue-less as to the availability of credit to them. The lack of information to an ordinary SME as to where to access credit is a serious problem that must be addressed. The UP-ISSI has tried to alleviate this problem by publishing in 1996 and in 2002 a compilation of available sources of SME financing, the eligibility criteria of borrowers, the cost of borrowing, etc. However this has to be updated constantly because of the changing products of the different financial institutions. Moreover this compilation must be made available in a website (e.g. DTI website) or a newspaper of general circulation. As of the time of writing, the BSMED came out with a preliminary list of credit windows available to SMEs. The long list and differentiation of available credit contrast with the number of credit facilities listed in the seventies and eighties. In the past, SME lending used to be limited to government banks and to funds coming from foreign donors. Currently, the interest of lending to SMEs is beginning to be

discovered even by privately-owned financial intermediaries, possibly due to the lack of borrowing by LEs.

5.4.2c Voices from the Ground: Results of FGDs

The experience with the SULONG program had been mixed. While it has been credited with having increased credit to SMEs, our FGDs showed that there were a few firms that had benefited from loans as a result of the Program. They contrasted the loans under the Program with the PO-based financing from the Small Business Corporation (SBC) or with loans available to non-exporters. Others, presumably those whose loan applications were turned down, had strong reservations with regard to the Program. One SME from Cebu called it the 'ATRAS' Program while another from Bacolod called it 'So Long' Program, hinting at the length of processing time of a loan application. They thought that collateral requirements are difficult to comply with. They accused the government financial intermediaries and the SB Corporation of having a 'collateral-mentality', looking at the bankability rather than the viability of an SME. A rural banker said that unless the government banks give the example of not asking for stringent collaterals, the private sector cannot be expected to be less cautious. Moreover, the SULONG program is undercut by the lack of clear guidelines and supervision of the financial intermediaries that should facilitate credit access. Each financial institution has been left free to come up with its set of requirements, particularly after the slowdown in the economy. They also voiced the opinion that credit is constrained since there seems to be some regional or area allocation of SULONG funds. Bacolod has much demand for credit, but the SULONG program cannot seem to accommodate such a demand due to a shortage of funds. .

The IT sector SMEs in Cebu claimed that banks do not know how to value locally-produced software and other IT assets as collaterals. Moreover, they stressed the need for financing of R&D. Some SMEs have also expressed the opinion that their immediate needs for short-term financing are not met. so that they turn to informal sources (such as own-saving or that of relatives).

5.4.2d Policy Suggestions

Doable in the Short-term :

- The information problem should be addressed quickly and effectively. A user-friendly and updated compilation of all available sources of credit has to be made available to SMEs in the DTI website and/or in a newspaper of general circulation
- .Training of financial institutions on risk-based management to reduce their dependence on collateral-lending.

Doable in the Medium-term :

- The SULONG Program will have to increase its presence through a bigger allocation of funds. Moreover, its supervisory powers of financial institutions will have to be strengthened in order not to be undercut by additional requirements/collateral by participating financial institutions.
- A thorough study of the IT sector should be undertaken to determine its financing needs.
- Opening of a credit window for research & development

Doable in the Long-term

- Creation of credit investigation agencies specializing on SMEs for use of financial intermediaries. This will reduce the FI's reliance on collateral.

5.5 Fiscal Policy

RA 8424: National Internal Revenue Code of 1997 (December 11, 1997)

RA 7716 : An Act Restructuring the Value-Added Tax (VAT) System, Widening its Tax Base and Enhancing its Administration...
(May 5, 1994)

RA 8241 : An Act Amending Ra 7716, otherwise known as the Expanded Value-Added Tax Law (December 20, 1996)

5.5.1 Income Tax

Small SMEs that are organized as single proprietorships are subject to a tax rate of 0-35% of net income; if organized as corporations they are subject to a tax rate of 35%. However, according a study by Yoingco and Guevarra (1990), the effective tax rate of MSMEs (i.e. the ratio of income tax collected to gross income) is only about 0.62% and for corporations, only 1.35%. Thus Guevarra (1991) believes that the income tax is not significant to them. On the other hand, the compliance costs may be significant for small firms where the owner is into everything in the business: production, marketing, and bookkeeping. Record-keeping for tax purposes may constitute a substantial part of the businessman's time because hiring the services of an accountant may be too costly for an SME. Moreover, the lack of information with regard to their tax liability invites harassment on the part of tax agents.

SMEs can benefit a lot from the information and assistance that could be provided with regard to the payment of their tax liability. A simple flow-chart on the steps they need to take as well as guidelines on deductions and how to determine net income publicized in the language of the province and in prominent places in town will go a long way towards helping the smallest of the SMEs.

5.5.2 Value-Added Tax (VAT)

SMEs who in the course of his trade or business, sells or leases good, properties and services will have to pay the VAT if the aggregate amount of actual gross sales receipts exceed P550,000 for any twelve-month period. On the other hand, if the firm's gross sales is

below this amount, he does not have to pay VAT but a tax equivalent to 3% (4% two years later) of his/her gross quarterly sales or receipts. A VAT-exempt person may however apply for registration as a VAT-registered person. The reason for opting to be VAT-registered is that exemption from VAT means inability to claim a tax credit for VAT paid on inputs. Likewise the buyers from the tax-exempt SME may also be unable to claim a credit on any input tax and is subject to a tax on gross sales.

The compliance cost of VAT can be high for an SME, especially in terms of the time involved in filing for a refund or VAT credit. Although only four documentary requirements are specified, VAT declarations will have to be filed monthly or quarterly. Moreover if the SME's quarterly sales/receipts (net of VAT) exceeds P2.5 M and/or if quarterly purchases (net of VAT) exceed P1 M, the owner must file a Summary list of sales or purchases, respectively, in triplicate. Quarterly Summary Lists require 6 to 10 documents and must be submitted in diskette form where total sales for the quarter exceed P2.5 M. Guevarra (1991) reported that during public consultations, traders expressed a preference for a turnover tax on gross income if the paper requirements of VAT were to be eliminated. She therefore suggested that MSMEs opt for a fixed percentage on gross income instead of VAT.

5.5.3 Local Taxes and Fees

The entrepreneur of an SME is likewise liable to local government units for payment of real property tax and the local business tax. In addition there are other regulatory fees, (e.g. garbage fee) whose monetary value differs among LGUs. Currently, land values are under-assessed and businesspersons generally pay a property tax based on values that are very much below market values of the land. Hence, the real property tax cannot be used as an instrument of land use policy.

5.5.4 Tax Incentives to SMEs

EO 226: Omnibus Investments Code of 1987 (July 16, 1987)

EO 226 or the Omnibus Investments Code provides certain incentives for those who invest in preferred areas of investment found in the Investment Priorities Plan (IPP) of the Board of Investments (BOI). In relation to incentives enumerated under the subsection on Trade-related incentives, following are additional incentives:

- Exemption from wharfage dues and export tax, duty on imports and fees
- Additional deduction for labor expenses (ADLE)
- Additional deduction for necessary and major infrastructure works (This privilege is not provided to mining and forestry-related products)
- Excise tax on export goods that are locally produced or manufactured may be credited or refunded upon submission of proof of actual exportation and upon receipt of corresponding foreign exchange payment
- Excise taxes on distilled spirits impose a lower tax on products made from materials that are indigenously available (e.g. coconut, palm, sugarcane).

However it may be more difficult for an SME than an LE to avail of these incentives because:

- There is no BOI office in certain provinces where a 'critical mass' of such potential registrants does not exist. Regional offices exist outside Metro Manila, but they can be found only in major cities (e.g. Cebu)
- The BOI incentive availment requires certain documents that an SME may not systematically keep in his records, unlike large ones.
- The incentives are related to preferred areas under the IPP whereas that the production line of the SME may not necessarily fall under any of these areas;
- Some of these incentives may require large-scale production, such as the deduction for expenditures on infrastructure and public facilities.

The BOI does not seem to attract local registrants as much as foreign ones.

We have tried to determine the size distribution of BOI-registered firms that apply for availment of incentives. The major difficulty encountered is that the BOI processes firms by "project cost" so it was not possible to really determine the true size structure of the firms that applied for availment for a given year. For instance, the Appendix Table of this section gives the classification of project size, based on project cost, using the classification of firms by asset size of the SMED Council. However, if one uses the classification of firm sizes by number of employment, one is off the mark: not one can be classified as microenterprise. Average employment per (average) project shows that projects considered 'microenterprise' should be considered 'small' and those considered 'small and medium' should be considered 'medium' in size of employment. Thus even a large enterprise with a micro-sized project could be classified as a 'microenterprise'.

The data given below show that the average cost of projects for enterprises that applied for incentives in 2003 is rather large.

Firm Size	Ave. Project Cost	Ave. Employment
Microenterprises	P 2,045,000	35
Small enterprises	8,641,000	163
Medium enterprises	38,326,000	180
Large enterprises	882,994,000	280

Table 17 below gives the number of firms that applied for incentives.

Table 17: Number of firms that availed of incentives, BOI, 2000-2004

Year	Micro		Small		Medium		Large		Total	
	No.	%	No.	%	No.	&	No.	%	No.	%
2000	14	11	39	29	43	32	37	28	133	100
2001	22	12	60	34	36	20	61	34	179	100
2002	12	8	54	36	41	27	43	29	150	100
2003	12	12	36	36	28	28	24	24	100	100
2004*	8	10	32	39	20	24	23	27	83	100

* Note: Data for 2004 are from January to July.
Source: BOI files.

It is clear that availment of incentives among BOI-registered firms are on the high end of the size spectrum. As discussed above, even those projects classified in the Table as 'small' may be categorized as high-medium or large enterprises.

5.5.5 Voices from the Ground: Results of FGD

The SMEs of Bacolod premised their remarks with the idea that taxes are beneficial and have to be paid. However, having said this, they listed a number of unwanted areas in the areas of taxes and infrastructure that they would like to see addressed, namely:

- Local taxes can increase transactions cost for the individual SME: To deliver goods van permits have to be secured and paid for. However if the van delivers to say three contiguous provinces, they have to secure and pay for individual provincial permits.
- Some local charges and fees can hamper the growth of business in the locality. Lack of information on 'hidden and unjustified' taxes can open the possibility for corruption.
- The proceeds of some local taxes are not spent properly. For instance, a garbage fee is collected but the garbage collection is delayed or altogether not done.
- There is fear that national taxes, like the VAT, can be increased due to the government's fiscal problems.
- With regard to infrastructure, they would like to see more farm-to-market roads in the countryside and better transportation/communication with other countries through the building of international ports and airports. They noted that the closes international seaport is in Cebu and exports have to be shipped from there.

- The negative effect on productivity of inconsistent utility services in the province as attested o by brownouts and lack of telecommunication facilities (e.g. phone lines)
- A land-use policy that is rationally planned and properly implemented.

Discussion among the Cebu SMEs revealed the following:

- There are complicated requirements for the filing of taxes. Sometimes those that want to pay the right taxes are the ones who are subjected to harassment by the authorities. A simplification of tax requirements and procedures, especially for microenterprises, is needed.
- There is need for a review of the local real estate tax.
- Economic zones are geared towards attracting foreign rather than local investors.
- There is lack of information as to incentives available to industries (e.g. the IT industry)
- High cost of power reduces the competitiveness of industries, particularly the IT industry. The lack of adequate power and communication facilities in the rural areas reduces the possibilities for the IT industry.

5.5.6 Policy Suggestions

Doable in the Short-term : To address the problem on the lack of information, a simplified flowchart of procedures for the payment of national taxes can be displayed in prominent places. Similarly a checklist of local taxes with their corresponding value of fees to be paid should be displayed prominently.

Doable in the Medium-term :

- Study on the further simplification of tax procedures/documentary requirements should be undertaken, especially with the SMEs in mind.
- Local campaigns to link payment of taxes to certain local expenditures, e.g. garbage.
- Local campaigns on the improvement of local governance

Doable in the Long-term

- Reduction of human interaction in the payment of taxes (through possible computerization) to avoid under-the table payments.
- Strengthening the linkage between taxes and expenditure on infrastructure
- Creation of economic zones geared to local investors (e.g. Hsinshu Park in Taiwan)
- Review towards rationalization of real estate tax.

Section Appendix
Table 18: BOI Projects that Applied for Incentives
Jan-Dec 2003 (in thousand pesos)

MICROENTERPRISES

FIRM NAME	PROJ COST (000)	EMPLOYMENT	OWNERSHIP
Arc International	2,759		100% French
CDMI Asia Limited	2,650		100% Hongkong
CG Bioblend Corp.	1,398	17	100% Fil
Comtech Worlwide Solutions Phil., Inc.	2,435	32	99% Ame, 1% Fil
Citibank NA	1,400		100% Ame
Genpro Intl. Inc.	2,727		Unknown Natl.
Global Power Designs Manufacturing Phil., Inc.	2,500	44	60% Fil, 33% Can, 7% Dutch
Heng Seng Fashion, Inc.	2,830	33	100% Fil
Info Source-out Inc.	928	14	80% Fil, 20% Chinese
Myles-Vie Hair & Dolls Maister, Inc.	1,452	56	100% Fil
Reliance Garments Manufacturing Corp.	500	39	15% Indian, 85% Fil
Seer Technologies, Inc.	2,957	45	100% Fil
TOTAL: 12	AVE: 2,045	AVE: 35	

SMALL ENTERPRISES

FIRM NAME	PROJ COST (000)	EMPLOYMENT	OWNERSHIP
A&L Foods Corp.	11,300	57	90% Ame, 10% Fil
AE Design Concepts, Inc.	12,218	60	100% Fil
Artisan Creations Intl. Corp.	12,938	143	100% Fil
Asian Style Apparel, Inc.	10,000	210	99.5% Indian, 0.5% Fil
Asiana Phil. GSA, Inc.	8,936	27	50% Fil, 50% Korean
Celloom Furniture Corp.	13,025	100	100% Fil
CG Livestock & Poultry, Inc.	15,221	11	100% Fil
China Thread Devt. Company Ltd.	10,600		100% Hongkong
Creative Treasury, Inc.	6,656	78	60% Fil, 40% Hongkong
Davao Industrial Plastic Strap Corp.	13,750	31	100% Fil
Delta Fishland Corp.	6,800	105	100% South Korean
Digitizedata.com, Inc.	4,000	214	100% Fil
Don Roberto's Winery	5,500	40	100% Fil

Corp.			
E-Z Business Solutions, Inc.	11,512	23	100% Fil
Earthsave Manufacturing, Inc.	5,356	160	40% Proc, 60% Fil
Floro Intl. Corp.	11,200	211	100% Fil
Greenfield Family Corp.	12,230	47	60% Fil, 40% South Korean
Henkel-Asia Pacific Limited	11,000		100% Hongkong
Hewlett-Packard AP Limited	10,930		100% Hongkong
Horeb Resources & Ventures, Inc.	3,588	25	100% Fil
Immanuel Big Bird Farm	4,000	12	100% Fil
Infinit-E Asia, Inc.	11,230	20	100% Fil
Innovative Design Concepts, Inc.	8,094	3,119	99% Ame, 1% Fil
Inter Coco Phil. Manufacturing Corp.	5,000	50	99% South Korean, 1% Fil
KP Chemical Inc.	7,249	41	3% Fil, 97% South Korean
LMY Craft Intl. Corp.	13,896	103	100% Fil
Lola Concordia Farm & Processing	4,320	26	100% Fil
Multi-link Apparel Corp.	3,707	45	100% Fil
Nopa Foods Corp.	4,575	37	60% Fil, 40% Japanese
Pentathlon Systems Resources, Inc.	8,947	46	100% Fil
Pililla Poultry Fertilizer & Feeds Corp.	3,331	82	100% Fil
Poit East Technology Phil., Inc.	7,862	35	100% Fil
Premium AC Corp.	8,636	20	100% Fil
Prime Fruits Intl., Inc.	6,450	90	100% Fil
R'South Gasoline Station	13,031	87	100% Fil
RSA Strategic Solutions, Inc.	4,000	22	100% Fil
TOTAL: 36	AVE: 8,641	AVE: 162.93	

MEDIUM ENTERPRISES

FIRM NAME	PROJ COST (000)	EMPLOYMENT	OWNERSHIP
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Acbel Polytech Phil., Inc.	76,927	244	99% Taiwanese, 1% Fil
Athena E-Services Corp.	26,494	466	100% Fil
Basic Necessity Inc.	70,000	70	100% Fil
Betafoam Corp.	25,000	55	100% Fil
BSC Emission Testing Center	20,400	108	100% Fil
Catarman Industries, Inc.	20,357	145	100% Fil
Dahon Dagat, Inc.	21,600	24	100% Fil
Double Fashion Ltd., Inc.		147	100% Fil
E-Scribir, Inc.	18,005	280	100% Fil
Eastern Visayas Seafood Corp.	50,000	510	100% Fil
Feedworld Inc.	42,000	24	86% Fil, 14% Ame
Firm Builders Realty Devt. Corp.	87,000	93	100% Fil
Formostar Garment Co., Inc.	30,480	792	100% Taiwanese
Freshtex Phil., Inc.	39,214	96	50% Fil, 50% German
FTN Garments Corp.	63,995	502	99% South Korean, 1% Fil
Green Carbon, Inc.	17,698	23	75% Fil, 25% Ame
Hugle Technologies, Inc.	48,250	63	100% Fil
Kitanglad Farms, Inc.	17,226	62	100% Fil
Lexin Phil. Ltd.	35,134	386	92% Hongkong, 8% Japanese
Lipa Agricultural Devt. Corp.	22,000	67	100% Fil
Metro Kidapawan Telephone Corp.	40,327	8	100% Fil
Naglayan, Inc.	40,005	171	100% Fil
Nation Petroleum Corp.	72,000	17	100% Fil
Phil.-Nippon Kyoei Corp.	48,650	49	60% Fil, 40% Japanese
Phil. Coco-Products Enterprise, Inc.	16,500	72	10% Fil, 60% Taiwanese
Philnor Aqua, Inc.	36,000	29	60% Fil, 40% Norwegian
Pilipinas Kyohritsu, Inc.	45,000	500	3% Fil, 97% Japanese
Precision Knitting Mills, Inc.	18,046	22	
TOTAL: 28	AVE: 38,326	AVE: 179.46	

LARGE ENTERPRISES

FIRM NAME	PROJ COST (000)	EMPLOYMENT	OWNERSHIP
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Aboitiz Transport System Corp.	2,430,000	314	100% Fil
Agricrops Industries, Inc.	500,000	67	100% Fil
Aklan Sampaguita Gardens Resort, Inc.	102,854	59	60% Fil, 40% Ame
Allegro Microsystems Phil., Inc.	551,045	188	100% Ame
Asian Terminals Inc.	1,808,232	623	65% Fil, 35% Australian
Biotech Farms, Inc.	139,590	24	94% Fil, 6% Proc
Caltex Services, Inc.	410,850	25	100% Ame
Coats Manila Bay, Inc.	190,705	42	60% Fil, 40% British
Coco Davao, Inc.	136,063	956	100% Fil
Dole Phil., Inc.	116,202	351	100% Ame
E-Performax Contact Centers Corp.	508,625	1,393	50% Fil, 50% Ame
Enrico Agri-Ventures	133,378	191	100% Fil
Foremost Water Systems, Inc.	120,600	125	100% Fil
Genpack Corp.	1,048,581	174	100% Fil
Iplus Intelligent Network, Inc.	193,000	55	100% Fil
Isarog Pulp & Paper Co., Inc.	209,949	150	83% Fil, 1% French, 16% Mal.
J-Joyful Handy Craft	1,513,000	23	100% Fil
Kemwerke, Inc.	8,550,000	10	100% Fil
Laguna Water Corp.	1,686,000	180	100% Fil
Level Up! Inc.	118,761	91	100% Fil
Nakayama Technology Corp.	280,000	178	98% Japanese, 2% Fil
People Support Inc.	146,521	685	100% Ame
Qinteraction Phil., Inc.	116,447	788	100% Ame
Sanent Realty & Devt. Corp.	181,457	22	100% Fil
TOTAL: 24	AVE: 882,994	AVE: 279.75	

Source: BOI files

5.6 Human Resource Development Policy

HRD policy in the Philippines could be divided into those that pertain to **labor standards** (i.e. minimum wage legislation, contracting and subcontracting, security of tenure, labor benefits, safety, collective bargaining, health standards, etc.) and to **labor training** (creation of the TESDA, dual training systems, etc.). We shall be discussing these two divisions separately in this section.

5.6.1 Labor Standards

5.6.1a Minimum Wage Legislation

The Labor Code

RA 602 : Minimum Wage Law (April 6, 1951)

RA 6640 : An Act Providing for an Increase in the Wage of Public or Government Sector Employees on a Daily Wage Basis and in the Statutory Minimum Wage and Salary Rates of Employees and Workers in the Private Sector and for Other Purposes
(December 10, 1987)

RA 6727 : Wage Rationalization Act , (July 7, 1989)

The Philippines has a long history of minimum wage legislation (MWL) dating back to RA 602 (passed on April 6, 1951). Over the years it has undergone many changes in jurisdiction (from the Court of Industrial Relations in the early to currently the National Wages and Productivity Commission under the Department of Labor and Employment (DOLE) and content. However it has remained basically a piece of social legislation that considers the need of workers and their families, given the inevitable rise in the cost of living over time. On the other hand, there are dissenting voices that argue for its abolition, given that it merely creates unemployment, and if not accompanied by increases in productivity, raises the cost of production of the firm. In the case of SMEs in particular, it removes their wage advantage over large enterprises that generally have to confront unionized employees and pay higher wages to union members as a result of collective bargaining (Canlas, 1991). And among the SMEs, Canlas (1991:153) argues that the off-farm SMEs, found in rural agricultural

areas, may be the most affected by the MWL. This is because they may suffer from an artificial shortage of workers, and hence an increased labor cost, given that a number of these agricultural workers might be tempted to migrate to urban areas during the slack season and spurred by the rural-urban wage differentials created by the MWL. Eventually these migrants become unemployed/underemployed in the urban areas, but refuse to return to their rural setting. Society then suffers losses from increased urban congestion and other related social ills. Moreover the economic loss may result due to their foregone output in the rural sector that is not compensated for by their migration to the urban areas.

5.6.1b Other Labor Standards

In addition to the MWL, there are other labor standards that have to be complied with by the employer. Following is only a short summary of labor policy (<http://www.dole.gov.ph>) in the country.

- **Equal work opportunity:** Male and female employees are entitled to equal compensation for work of equal value and to equal access to promotion and training opportunities. It is against the law to discriminate against women employees. The minimum age of employment is specified: 18 years for hazardous jobs and 15 years for non-hazardous jobs. But a child below 15 may be employed by parents or guardians in a non-hazardous job if employment does not interfere with the child's schooling.
- **Security of tenure:** No employee can be dismissed from work except for a just or authorized cause, and only after due process. Just cause refers to any wrongdoing committed by an employee including: 1) serious misconduct; 2) willful disobedience of employers' lawful orders connected with work; 3) gross and habitual neglect of duty; 4) fraud or willful breach of trust; 5) commission of crime or offense against the employer, employers' family member/s or representative; 6) other analogous cases. Authorized cause refers to an economic circumstance not due to the employee's fault including 1) the introduction of labor-saving devices; 2) redundancy; 3) retrenchment to prevent losses; and 4) closure or cessation of business.

Due process in cases of just cause involves: 1) notice to employee of intent to dismiss and grounds for dismissal; 2) opportunity for employee to explain his or her side; 3) notice of decision to dismiss. In authorized causes, due process means written notice of dismissal to the employee specifying the grounds, at least 30 days before the date of termination.

- **Work Days and Work Hours :** The normal hours of work in day is 8 hours. This includes breaks or rest period of less than one hour, but excludes meal periods, which shall not be less than one hour. An employee must be paid his or her wages for all hours worked. If all or any part of his or her regular work hours fall

between 10:00 pm to 6 a.m., he or she shall be entitled to a night shift in addition to his or her regular work hours, or works for more than 8 hours in one day, he or she shall be entitled to overtime pay, except when he or she is classified as managerial or field personnel, or is one who works in the personal service of another, or is one who is paid by result.

- **Wage and Wage-Related Benefit:** Wage includes overtime, night differential, rest day, holiday and 13th month pay. It also includes fair and reasonable value of board, lodging and other facilities customarily furnished by the employer. Wage must be fixed for a given period or for a specified task or result. If wage is for a fixed period, the minimum wage for a regular 8-hour workday shall not be lower than the minimum daily wage applicable to the place of work as determined by the Regional Tripartite Wage and Productivity Board having jurisdiction over the employer. If wage is paid by result, the worker shall receive at least the prescribed minimum wage for 8 hours of work. An employer cannot make any deduction from an employee's wage except for insurance premiums with the consent of the employee, for union dues or for withholding taxes, SSS premiums and other deductions expressly authorized by law.
- **Computation of Wages :** Rules of computation are given determine overtime wages on ordinary days, on rest day, special or regular holiday, wages for night shift, when it is a regular work or when it is overtime work, and on the 13th month pay.
- **Safe Working Condition :** Employers must provide workers with every kind of on-the-job protection against injury, sickness or death through safe and healthful working conditions
- **Rest days and Holidays:** Regular holidays and special days are specified.
- **Leaves:** There are three types of leaves which an employer is obliged to extend to its employees: service incentive leave, maternity leave, and paternity leave. The duration and required salary granted are specified.
- **Administration and Enforcement:** Under the visatorial power, the Secretary of DOLE through the Regional Director or an authorized representative can inspect or investigate the premises or records of the employer at any time whenever work is being undertaken. The power is intended to determine whether the employer is complying with labor standards or other obligations to its workers as prescribed by the Labor Code.

Through the Enforcement Power, the Secretary or Regional Director can: 1) order an employer, after due notice and hearing to comply with labor standards; 2) issue a writ of execution in case the employer does not honor the order of compliance; 3) stop work or suspend operations if the violation poses an imminent danger to the health and safety of workers. If work is stopped or suspended due to imminent danger, the employer has a right to a hearing, to be conducted within 24 hours from the time work or operations are stopped. The hearing is to determine whether or not it is safe for work operations to resume.

- **Right to Self-Organization and Collective Bargaining :** Except those classified as managerial or confidential, all employees may form or join unions for

purposes of collective bargaining and other legitimate concerted activities. An employee is eligible for membership in an appropriate union on the first day of his or her employment.

In addition there are social legislations which provide social security benefits to workers. Social security benefits are sourced from a common fund sustained by contributions from employers or employees or both. There is, moreover, a retirement law which provides retirement benefits equivalent to 22.5 days salary for every year of service for optional retirement at 60 (RA 7641, amended by RA 8558) or under applicable agreement or for compulsory retirement at age 65. Any labor dispute that arises – be it between the employer and its employees or employee's organizations, two associations of employees, or member of employees' organizations – are to be judged/arbitrated, depending on the type of dispute, by different offices/courts.

5.6.1c Contracting and Subcontracting

Labor Code, Articles 106-109 (Presidential Decree No. 442 (As Amended)
A Decree Instituting A Labor Code, Thereby Revising And Consolidating Labor And Social Laws To Afford Protection To Labor, Promote Employment And Human Resources Development And Ensure Industrial Peace Based On Social Justice, May 1, 1974)

Department Order No. 10, DOLE 1997; revoked by DOLE thru another D.O. No. 3, (29 May 2001)

Contracting is considered legitimate if a) the contractor or subcontractor carries on a distinct and independent business and undertakes to perform the job work or service on its own account and under its own responsibility, according to its own manner and method and free from the control and direction of the principal in all matters connected with the performance of the work except as to the results thereof; b) the contractor or subcontractor has substantial capital or investment; c) when the Agreement between the principal and the contractor or subcontractor assures the contractual employees entitlement to all occupational safety and health standards, free exercise of the right to self-organization, security of tenure, and social and welfare benefits (Vinoy v. National Labor Relations Commission, G.R. No. 126586, 2 February 2000 and Lim v. National Labor Relations Commission, G.R. No. 124630, 19 February 1999). In particular, D.O. 3 prohibits labor-only contracting (Sec. 2, D.O. No. 3) where the contractor or subcontractor merely recruits, supplies or places workers to perform a job, work or service for a principal, and the following elements are present:

- a. The contractor or subcontractor does not have substantial capital or investment to actually perform the job, work or service under its own account or responsibility' and
- b. The employees' recruited, supplied or placed by a contractor or subcontractors are performing activities directly related to the main business of the principal.

The rationale for prohibiting labor-only contracting is to ensure that labor laws and the Labor Code are followed and that workers are not exploited. The labor-only contractor does not have capital to run a business or the capacity to pay its workers, hence cannot independently undertake to perform a subcontracted job or service.

5.6.1d Analysis of Labor Policy in the Philippines

All the above and other labor policies of government have been designed to protect the worker and ensure that he receives what is due him as a human being and as a member of society. The government makes sure that there is a minimum amount of regulation necessary for the effective functioning of labor markets. However, rigid labor laws have been found to lower labor force participation, increase unemployment, and force workers into the informal economy (World Bank, 2004). There is some wide latitude in labor policy among countries, especially between developed and developing ones: for instance, some countries like Burkina Faso, Cameroon, Jamaica, Hong Kong (China), New Zealand, Spain and the United Kingdom do not have regulations on the premium for overtime work whereas Chad, Italy and Mali require a 10 percent premium over wages paid for normal hours of work (25 and 30% for the Philippines for an ordinary day and for rest day, special or regular holiday, respectively). Another example is the absence of a mandatory minimum wage in several OECD countries. Based on indices that tried to document the systematic differences in employment regulation among countries, the World Bank is able to judge in general the degree of flexibility of countries in terms of their employment regulation. It was thus able to compare the labor situations in these countries, given their degree of severity of employment regulation. It has found that employment regulation generally increases the tenure and wages of incumbent workers but that strict regulatory intervention may bring about certain unwanted side effects such as: to limit job creation forcing workers to stay on jobs they do not like; to lengthen unemployment spells, hence leading to obsolete skills; to lessen R%D investment in technologies, and restrictions on hiring and firing to result to smaller firm sizes. All these serve to reduce growth in productivity. Moreover, excessive employment regulation is associated with higher unemployment, especially of young people and of women, forcing them to join the informal sector, where workers do not have social protection.

5.6.1.e Voices from the Ground: the Result of FGDs

The microenterprises were particularly limited by the imposition of minimum wages which they find difficulty in meeting. Together with the SMEs they don't believe in the national standardization of minimum wages because of the difference in regional characteristics and productivities. MSMEs prefer to use what they consider a more productivity-based wage, namely one that is piece-rate which is paid by how much is produced per hour. Productivity must be one of the criteria for determining increases in the minimum wage.

Some of the participants expressed concern over the firing policy of labor. They consider it unfair that labor is free to join the firm but the firm is not free to fire them, unless they fulfill certain requisites (such as notice to the employee of intent to dismiss and grounds for dismissal, etc.)

Moreover the visitorial power of the DOLE representative can have lop-sided effects favoring labor as when labor's rights are upheld without giving due hearing to the employer's side. Employers felt a pro-labor stance of DOLE representatives, giving the employers a sentiment that they are oppressors, rather than the "creators" of employment that the government expects SMEs to be. They suggested a constant dialogue with the DOLE officials to determine issues that the DOLE might have against them and of which they may not be aware.

An SME likewise expressed his dissatisfaction over government's penchant of increasing the number of holidays, with the announcement of local holidays and presidential-decreed holidays, in addition to changes in the dates of holiday celebrations (in order to have a 'longer week-end'). This of course increases their labor cost as they need to pay overtime pays or reduce production.

Labor contracting is also considered by some participants as being necessary due to the seasonality of the work.

5.6.1f Policy Suggestions

Doable in the medium term: Repeal of some sections of the MWL to allow for hourly rather than daily rates.

Doable in the long term: Study of labor laws for the possibility of introducing some flexibility into employment regulation.

5.6.2 Labor Training

R.A. No. 7686 : Dual Training System Act of 1994 (February 25, 1994)

R. A. No. 7796: "Technical Education Skills Development Act of 1994" or the TESDA Act of 1994." (18 January 1995)

The presence of positive externalities or spillovers to society of training that cannot be captured fully by the firm or the trainee himself is a justification for government provision of training in order to avoid a possible underinvestment by the private sector. A possible case where the firm may under invest in training is when the skills to be taught to the employee is generic and can be transferred to another firm when the employee leaves the former and joins the later. Or in certain instances specific skills maybe taught that are useful only to the firm that undertakes the training, but the trainee does not have the incentive to pay for it since he/she cannot sell the skill to any other firm. In both cases, the slack in investment in training may be taken up by government. This is the economic reason for the passage of laws to this effect. MSMEs, especially, do not have the wherewithal to invest in enough training for their employees whereas the large enterprises do so systematically and oftentimes on a large scale. To the extent that training cost as a percentage of labor-related cost tends to be higher in MSMEs as compared with LEs, government's shouldering part of this cost reduces the cost burden for MSMEs.

Moreover, to the extent that the pool of skilled workers is small relative to the demand for them (or dwindling as in the case of IT workers who prefer to work abroad), the competition for skilled workers may be tilted in the favor of large enterprises who not only can pay the right wages but also offer non-wage benefits (such as additional training, a multinational name, etc.). Government can then be justified in intervening to reduce the advantage of large enterprises (Canlas, 1991).

The laws that strengthen such a form of government intervention exist. For instance, there is the Dual Training System that provides for vocational and technical training in conjunction with school training as early as a decade ago. The vocational and technical training of government has been reorganized and centralized so as to have a single authority to determine policy more effectively. the Technical Education and Skills Development

Authority (TESDA) took over the National Manpower and Youth Council (NMYC) and the Bureau of Vocational and Training Education (BVTE), absorbing the vocational and technical education-related personnel and functions of two Departments of government, i.e. the Department of Education, Culture and Sports (DECS) and the DOLE.

Hence the institutional backbone to address the training needs of MSMEs already exist. There remains the need to discover the actual training requirements of MSMEs with regard to training. The Philippine Trade Training Center (PTTC) has come up with a 2004 **Compendium of HRD and Entrepreneurship Training Programs for SMEs**. It is very comprehensive and offers a guide to SMEs on what is available in terms of training (on the following broad topics: business technology and technical skills, entrepreneurship, finance, general management, human resource development, information technology, marketing, and production, quality, & productivity) as well as the training institution that offers them. Judging from number and quality of courses that are offered, there seems to be considerable amount of training that is undertaken for SMEs. Provision of this compendium is a step in the right direction because it addresses the problem of a lack of information on the availability of training on specific skills. However, it is not known to what extent these training packages actually address the needs of SMEs. Are these training packages arrived at in consultation with SMEs? What is the actual demand for these skills for which training is being offered? Since training resources are scarce, there has to be some prioritization that must be made as to which skills are most needed by them.

5.6.2a Voices from the Ground: Result of FGDs

Because the FGD was geared towards the regulatory framework and hence, the laws, policies, and regulations faced by MSMEs, and because there are no specific laws that pertain to HRD, the participants did not specify their needs. This must be tackled in another FGD. However, they did stress their need for training. One SME from Bacolod stressed the need for training of managers in order to improve the productivity that must accompany increases in minimum wages. Moreover, the IT group from Cebu noted the growing mismatch between the educational training of new graduates and the actual needs of industries. An example deplored is the diminishing fluency of Filipinos in speaking English (i.e. demanded by call-centers). Some likewise raised the need for training in languages other than English because of the growing foreign market penetration by SMEs. More and

more they feel the need for interpreters (e.g. fluent in Japanese or Chinese) who have currently to be paid at rates considered prohibitive by the SMEs.

5.6 2b Policy Suggestions

Doable in the short term: To prioritize and hence address more effectively the training needs of MSMEs, to include in the PTTC Compendium of HRD and Entrepreneurship the actual size of classes that have been serviced by such training courses.

Doable in the medium term: In view of the necessity to address more effectively the training needs of MSMEs, to devise a way by which MSMEs are consulted in the development of training packages offered by the different training institutions.

Doable in the long term

- Study to give greater weight to productivity improvements in determining the minimum wage.
- Study to allow for piece-rate (productivity-based) wages in certain cases for SMEs.

5.7 Trade Policy

5.7.1 Trade Reform Policy

A little more than five decades of industrialization saw the shift from inward-looking import substitution industrialization strategy towards a more outward looking growth strategy. While some of the Philippines' neighbors had long ago shed off their protective cover and proceeded to NIChood, it was only in the last two decades that the country became serious about its trade reform policy. In a better-late-than-never case, the Philippine government eventually saw the futility of too much protection. Through a series of reforms, the government was able to lower the tariffs considerably (Table 19)

Table 19: Average Nominal Tariffs in Agriculture and Manufacturing
1985 – 2000 (%)

Year	Agriculture	Manufacturing	Overall
1985	35	27	28
1995	28	19	20
1996	29.3	13.4	15.6
1997	25.3	11.4	13.4
1998	18.9	9.4	10.7
1999	16.3	8.1	10
2000	14.4	8.0	8

Source: Tariff Commission (Austria 2001)

and to reduce its dispersion within and across economic sectors and industries. By 2004 average (nominal) tariff was 4.19% overall in 2004, down from 41.37% in 1980, the year when the first program was initiated. Over the same time period, the average tariff rate in the manufacturing sector fell from 39% in 1980 to 3.3% in 2004. Import liberalization which begun in earnest in 1986 saw the dismantling of quantitative restrictions from about 33% of tariff lines in 1984 to about 2-3%.currently (Cataylo-De Dios, 1995). A series of Executive Orders gradually liberalized the economy under the Tariff Reform Policy (TRP) of the country (Table 20).

Table 20: Executive Orders of the Tariff Reform Policy

Executive Order	Year	
EO 644	1981	TRP I : Level and dispersion of tariffs lowered to 10-50 range from 0-100%
EO 470	1991	TRP II : Reduced tariffs in manufacturing; established 4-tier tariff schedule of 3-10-20-30-%; NTMs converted into tariff equivalents
EO 189	1993	Modification of tariff duty on capital equipment & machineries
EO 204	1994	Modification of tariff duty on garments and textiles
EO 288		Reduction of tariff on non-sensitive agricultural products
EO 313	1996	Tariffication of quantitative restrictions on agricultural commodities
EO 465	1998	Correct remaining distortions in the tariff structure and smoothen pace of scheduled tariff reduction
EO 63	1999	Modifying the rates of import duty, esp. iron & steel products
EO 264	2003	Transfer of aggie products on sensitive list to CEPT list
EO 299	2004	Rollback of tariffs to 1998 levels

The results of the Trade Policy Reform (TRP) are documented in two volumes (Medalla, Tecson & Associates, 1990 & 1991). The studies of the manufacturing sector and of individual industrial sectors all point to the efficiency gains attributed to liberalization. The reduction in tariff levels and of reduction of the inter-industry dispersion of tariffs led to a removal of penalties on the export sector. It shifted the structure of exports to manufactures and catapulted a number of penalized industries into the export sector. Expert opinion likewise credits the TRP with improvement in competition, reduction in the concentration ratios of industries, and the general stability of prices.

To the extent that SMEs were in agriculture or were export-oriented, they were being penalized by the protective structure. The scale bias was evident in that before the trade reform, the higher the share of MSMEs in industry employment or value added, the lower the industry effective rate of protection. Moreover, the quantitative restrictions on imports tended to hurt MSMEs more than the LEs because of the non-market administration of quotas and import licenses. In the absence of generally accepted criteria for allocation, scale-based criteria (such as asset size, production capacity, capacity to import, etc) are often resorted to, thus introducing a scale-bias to import quota allocation. Limits to access to capital and intermediate goods imports, which may be crucial to production effectively, bar MSMEs from entrance into certain industries or prevent them from growing. Hence, the progressive dismantling of the protective barriers constituted for SMEs a veritable shot-in-the-arm. Data from the censuses of manufacturing establishments (CME) showed that with the reduction of the bias against MSMEs resulting from trade liberalization and tariff reduction, there was a perceptible rise in their share of manufacturing value added and employment, reversing the generally declining trend that began to be observed in the late 50s (Rodriguez and Tecson, 1998). It also removed the export bias that catapulted a number of them into global

prominence. They were then able to emerge from their penalized position to export orientation, as discussed below.

In terms of linkages with global markets, one can surmise the weak linkage of the microenterprises from the fact that in 1994, firms with less than 10 employee category exported less than half of one percent (or 0.44%) of their total output. Contrasting with these, firms in the 10-99 and 100-100 worker category were found to have exported almost as much (i.e. 18% of their total output) as the average firm in the entire manufacturing sector for 1994 (19%). Table 21 below shows the linkage of the SMEs with global markets. It shows that the highest export orientation of SMEs can be found in labor-intensive manufacturing, that is, the share of exports in SME output is generally higher in food, textile, garments, footwear, wood & wood products, furniture & fixtures, pottery, earthenware & china, metal furniture, and other manufactures. Export orientation is also high in non-ferrous metals, machinery, both electrical and non-electrical, as well as in professional equipment, where SMEs may be expected to be in the labor-intensive lines.

Table 21: Share of SME exports in industry output and exports, 1993

Industry Description	Export Orientation: Share of Exports in		Share of SME Exports in Industry Output
	SME output	In Industry Exports	
Manufacturing	19.11	23.74	4.54
Food	22.37	48.77	10.91
Food, nec	3.40	15.23	0.52
Beverage	0.05	90.3	0.45
Tobacco	1.93	12.23	0.24
Textiles	32.85	20.9	6.87
Wearing apparel	54.38	40.39	21.96
Leather and leather products	42.17	13.03	5.49
Footwear	36.36	4.72	1.72
Wood and cork products	25.33	56.91	14.42
Furniture and fixtures	35.39	69.27	24.51
Paper and paper products	9.20	76.73	7.06
Printing and publishing	10.12	-	
Industrial chemicals	16.11	10.96	1.77
Other chemicals	3.15	72.03	2.27

Petroleum	0.72	0	0
Prods. Of petroleum and coal	0.27	-	
Rubber Products	10.91	21.44	2.34
Plastic products	7.07	67.21	4.75
Pottery, china, earthenware	40.70	6.64	2.7
Glass and glass products	12.41	24.37	3.02
Cement	0.04	0	0
other non-metallic mineral prods.	8.26	59.68	4.93
Iron and steel basic products	5.55	40.28	2.24
Non-ferrous metal	68.97	0.56	0.39
Fabricated metal products	9.55	11.57	1.10
Machinery exc. Electrical	53.25	3.09	1.65
Electrical machinery	64.54	2.76	1.78
Transport equipment	7.27	67.08	4.88
Prof'l and scien. Equipment	70.61	35.72	25.22
Furnitures, metal	56.70	0	0
Other manufactures	51.33	36.03	18.49

Source: NSO (special tabulation of the ASE, 1994)

The third column showing the share of SMEs in industry exports indicate that for some industries, SMEs do most of the exporting and these industries are generally industries that are not export-oriented (i.e. paper and paper products, other chemicals, plastic products, other metallic mineral prods, iron & steel basic products, transport equipment). But for those that are export-oriented, e.g. electrical machinery, LEs dominate the industries so that the SMEs do not occupy an important share in their exports.

Thus given the export-oriented character of some of our SMEs, they cannot afford to be saddled with high import tariffs on their intermediate products and raw materials, which would reduce their competitive edge in foreign markets. In order to find out if our SMEs are being so penalized, we requested the Tariff Commission for the average tariffs on the inputs of a number of industries with a high export orientation or with a large SME sector. The average tariff of the manufacturing industry in 2004 is 6.94 against which we will be comparing the average tariff on inputs of our SME export-oriented sectors. Table 22 provides such data.

Table 22: Average tariff on inputs into export-oriented industries (%)

Sector	Average Tariff on Inputs (%)
Manufacturing average	6.94
Food	6.56
Leather & leather products	11.16
Footwear exc rubber, plastic or wood	13.58
Furniture & fixture, exc primarily of wood	6.64
Printing, publishing and allied industries	6.83
Industrial chemicals	2.38
Miscellaneous products of petroleum & coal	4.25
Plastic products	6.14
Non-metallic mineral products	3.14
Fabricated metal products exc. Machinery & Equipment & furniture & fixtures of metal	6.69
Manufacture of machinery & equipment exc. Electrical	3.13
Repair furniture & fixture of metal	7.64
Other manufacturing industries	1.89

In general, one can say that the Trade Reform Policy had reduced the tariffs considerably on inputs of most sub-sectors in manufacturing. One can only pick out from the list above leather & leather products, footwear except rubber, plastic or wood, and repair of furniture & fixture of metal as having tariffs on inputs that are higher than the average tariff on the inputs of the entire manufacturing sector. However, one cannot say the same for sectors that have to rely on inputs that come from the agricultural sector where the tariffs have remained high.

5.7.2 Trade-related Incentives to SMEs

EO 226: The Omnibus Investments Code of 1987 (July 16, 1987)

RA 7918: An Act Amending Art. 39 of EO 226 (February 24, 1995)

All exporters – direct or indirect – are entitled to the following incentives.

- Exemption from advance payment of customs duties and taxes
- Duty-free importation of machinery and equipment, raw material imports and packaging
- Tax credit for imported inputs and raw materials primarily used in the production and packaging of export goods which are not readily available locally;
- A tax credit of 25% of duties paid on raw materials and capital equipment and/or spare parts; the credit is available to exporters of non-traditional products which use or substitute locally produced inputs.

Export-oriented entrepreneurs are likewise eligible to apply for incentives if they are located in the Philippine Economic Zone Authority (PEZA), Clark Special Economic Zone Authority (SEZ), and in the Subic Special Economic and Freeport Zone Authority (SSEFZ).

These incentives are:

- Exemption from corporate income tax from 4-8 years;
- Exemption from duties and taxes on imported capital equipment, spare parts, raw materials and supplies
- Exemption from national and local taxes
- Tax Credit for import substitution
- Tax credit on domestic capital equipment
- Tax-free and duty-free importation of breeding stocks and genetic materials;
- Tax credit on domestic breeding stocks and genetic materials
- Exemption from Value Added Tax (VAT) for certain exporting industries.

5.7.3 Customs Practices towards SMEs

The reliance of some SMEs on the import and export markets make them enter the realm of Customs policy and administration. From preliminary data gathered by the ADB in collaboration with the World Bank on the “Investment Climate in the Philippines” (January, 2004), small firms are reported to contend with much longer delays in getting delivery of imports (from the time goods arrive at the point of entry) and in clearing customs (after goods arrive at the point of exit). Deficiencies in infrastructure and weak governance are said to affect small firms adversely.

5.7.4 Voices from the Ground: Results of FGDs

In accordance with our finding on the negative effect of tariff on SMEs’ imports, the FGDs did not reveal any complaint with regard to manufacturing tariff. However food exporters from Bacolod at one point did raise the issue of high tariff on agricultural inputs but did not pursue it further when told that the tariff on sugar is quite high¹⁸. However, with regard to the incentives they are entitled to as exporters, SMEs from Bacolod complained that the papers have to be processed in Cebu or Iloilo because of the absence of a trade representative in the province of Negros. This unnecessarily raises the cost of incentives availment for them.

SMEs from Cebu expressed their desire for government assistance (subsidies) to help local businesses join trade fairs and exhibits, especially those held abroad. Moreover, information regarding such trade fairs and exhibits are also said to be unavailable. They also

¹⁸ Bacolod is the capital city of Negros Occidental which once thrived on sugar exports to the United States.

asked for support in the form of information dissemination on foreign markets. Commercial attaches, they said, should be doing the job of publicizing their local businesses to potential foreign clientele. IT SMEs from Cebu likewise expressed their desire to create a website that would publicize their local software industry.

It was likewise learned from the exporters from Cebu that in January of next year, they will have to secure the signature of customs brokers. This is in compliance apparently with a new law professionalizing the custom broker profession. On the side of the exporter, of course, this was simply another requirement in addition to the long list they are currently trying to fulfill.

With regard to Customs, the FGD did not reveal that they were being burdened unnecessarily by Customs practices. However, some SMEs expressed their dismay on the presence of cheap products in the market which they attribute to smuggling.

5.7.5 Policy Suggestions

Doable in the Medium-term :

- Study the possibility of regionalized availment of incentives.
- Study the possibility of granting some subsidy for trade fairs and exhibits.

Doable in the Long-term: Tariff liberalization in the agricultural sector in order not to burden exporters.

5.8 Technology and Competition Policy

Technology and competition are two areas where the Philippines has a long way to go to arrive at even a modicum of legislative and institutional wisdom. And in the area of small business, the terrain is probably even sparser. This is because small business in the country is still associated with low productivity, obsolete technology and poor working conditions. And yet the experience of interacting with 'small industry' in Bacolod and Cebu generally debunks this preconception. One was brought face to face with entrepreneurship at its best even among the smallest of firms. And maybe it is even better that we are rather 'latecomers' when it comes to legislation and institution-building in order to benefit from the 'best practices' at home and abroad. For after all, these are two areas of growth where regulation, in the form of laws and monolithic institutions, are least necessary. We shall discuss technology and competition policy one at a time.

5.8.1 Technology policy

At the national level, the country is reputed to be among countries which spends less than one percent of its GDP on R&D. Only in the late eighties, i.e. 1988 was a Presidential Task Force on Science and Technology formed to assess the state of Philippine S&T. The Task Force identified three factors that inhibited technological development: low rates of investments in S&T, both by the public and private sectors; underutilization of available S&T infrastructure; and weak linkages between technology generation, adaptation and utilization. Four-fifths of R&D expenditures was accounted by the public sector. The Task Force likewise noted the thinning supply of S&T manpower, partly due to brain drain of S&T personnel, but mainly caused by the low turnout in the educational system. The report underscored the need for a comprehensive strategy to invigorate domestic S&T activities (Abrenica and Tecson, 2001).

After this, a 10 year Science and Technology Master Plan was instituted to last for 1990-2000. It called for (i) modernization of the production sectors through technology transfers from foreign and local sources and through industry-academe linkages; (ii) upgrading of research and development capabilities; and (iii) development of S&T infrastructure and raising national S&T consciousness. It called for the commercialization of 50 technologies, mostly agro-based, promotion of technology

business incubators and science parks; upgrading of S&T services provided by public agencies such as testing, standardization and quality control; and strengthening the engineering and science education. However, the core strategy lay in the development of 15 leading edge sectors, purportedly chosen on the basis of their growth potentials. Actually it was a mixed bag of industrial technologies, merely indicating the confusion of the government as to which technologies to target. Then later, with the intervention of the Export Development Council, the target sectors were raised to 24, including “export winners” and even broad areas such as housing, environment, defense and disaster. Its only change was the addition of the sectors and was renamed “Science and Technology Agenda for National Development” (STAND). It can thus be seen that S&T policymaking in the Philippines was not immune to political lobbying. The Plan was later to be redrawn, this time to include “vanguard projects” which remained diffuse, ranging from coconut to information technology.

Technology policy in the Philippines is generally in the hands of the Department of Science and Technology (DOST). It was founded to give direction to the S&T efforts of the country. From the start however it was plagued with a low budget and a lack of highly qualified personnel. Even more importantly, DOST was criticized for having weak links with industry. Its budget for commercialization was only for the researches of its many institutes. And the fact that there was little commercialization that took place meant that there was little demand for its research output.

In addition incentives were given to R&D development. In 1992, a major legislation (RA 7459) provided numerous incentives to inventors, including financial assistance for commercial application of inventions. However a survey by Halos (1998) reveals that most respondents did not avail of the incentives as they found the procedures “too cumbersome” (Cororaton 1998).

Moreover, DOST was supposed to link up with the country’s Commission on Higher Education (CHED). But the fact is that the CHED has failed to intervene even in public institutions to align curricula with industry needs. Hence the mismatch between demand and supply of graduates, and the ensuing unemployment of the educated persists.

Its linkage with DTI has floundered in a sea of industries to be supported. DTI's incentives are granted to industries that are under the Investment Priorities Plan (IPP) but which are drawn independently of the S&T plan. It is said that the first set of S&T targets had to be revised because no incentives can be given to industries that are not included in the IPP. DOST have to make sure that the subsequent list of S&T targets were aligned with DTI's priorities. Moreover DOST was committed to support DTI's export winners, which aside from electronics and some areas of services had dubious technological advantages.

In so many words, the Philippines, it must be admitted, has a confused technology policy.

5.8.1a Voices from the Ground: Results of FGDs

The country is littered with factories housing antiquated technologies embodied in old machinery. Technological upgrading is considered costly. But the effect on poor recovery and productivity is acknowledged. The SMEs that came for the FGDs were clear that embodied new technology in machinery as well as technology transfer were the top priority. They believe that a sharing of technological research output and information should be encouraged. They borrow in order to keep up with the new technologies embodied in the machinery. However, they claimed that the environment for invention and innovation hardly exists in the country today. They need patents and technology protection in order to establish their identity as well as to prevent imitation, but they (for instance, the furniture makers) are aware of the difficulty, if not the impossibility, of patenting their own designs. Not only do they not receive any government support for their R&D efforts; they even have to pay prohibitive fees for testing standards. They would like greater visibility for the government office that is supposed to encourage technology development.

5.8.2 Competition Policy

I In a survey of existing laws and regulations on competition in the Philippines, Abad (2002) antitrust regulation is not new in the Philippines. Old antitrust provisions of

US laws found their way into the Philippine Constitution and the Criminal and Civil Codes. RA 3815 as amended (the Revised Penal Code of the Philippines) punishes anticompetitive behavior as a crime. On other hand, RA No. 386 of 1949 (Civil Code of the Philippines) allows for the collection of damages arising from unfair competition in agricultural, commercial or industrial enterprises or in labor. It likewise allows damages to be collected from abuse in the exercise of rights and in the performance of duties, as in the abuse of a dominant market position by a monopolist. Moreover, RA no. 165 (An Act to Prohibit Monopolies and Combinations in Restraint of Trade) allows treble damages for civil liability arising from anticompetitive behavior. Then there are special laws addressing unfair competition practices. For instance, RA 8293 (Intellectual Property Code of the Philippines: 1997) provides for the protection of patents, trademarks, copyrights. Likewise, RA 7394 (Consumer Act of the Philippines, 1932) provides for consumer product quality and safety standards while the Price Act (RA 7581, 1991) defines illegal acts of price manipulation such as hoarding, profiteering, and cartels. Two laws were passed during Martial Law: Batas Pambansa Blg 68 (Corporation Code of the Philippines, 1980) which provided for the rules on mergers and consolidations as well as the acquisition of all or substantially all the assets or shares of stock of corporations, and the Batas Pambansa Blg 178 (Revised Securities Act, 1982) which prohibits and penalizes the manipulation of security prices and insider trading. Thus, legally speaking, there is *some* notions of a competition policy. However, it is not well-articulated and is spread across much legislation. Because of the lack of clarity of the laws, Abad (2001) cites case law or judicial interpretation in defining unlawful monopolies, combinations in restraint of trade and unfair competition practices. Up to now, however, there have been only two cases decided by the Supreme Court in which it defines monopoly.

Likewise, international agreements to which the country is a signatory implicitly encourage competition at the global level. Those that have direct bearing on competition policy and restrictive business practices are: Antidumping: Agreement on the Implementation of Article VI of GATT. Agreement on Subsidies and Countervailing Measures; Agreement on Safeguards, esp. Art II-2 on voluntary export restraints, orderly marketing arrangements, etc.; the GATS (General Agreement on Trade in 'services) esp. Art VIII on the supply of services by a monopolist in a member country; TRIPS (Agreement on Trade-Related Aspects of Intellectual Property Rights) such as trade in

counterfeit goods, abuse of intellectual property rights by rights holders (Art 8) and licensing practices (Art. 31 and 40); and TRIMS (Agreement on Trade-Related Investment Measures, esp. Art 9 on investment policy and competition policy.

Certain agencies of government have supervisory and/or regulatory powers over enterprises, such as DTI and its attached agencies, BTRCP (Bureau of Trade Regulation and Consumer Protection, BFAD (Bureau of Food and Drugs), BPS (Bureau of Product Standards) which take care of the protection of consumer welfare, whereas the Intellectual Property Office (formerly the Philippine Patents Office) is tasked to protect intellectual property.

5.8.2a Voices from the Ground: Results of FGDs

Even less than technology policy, the lack of a competition policy is not seen by the SMEs invited to FGDs as imposing immediate burdens on them. The IT sector from Cebu, however, suffers from the fact that “there are no laws geared towards fair competition.” Hence, not only are they competing with international players, but also with ‘fly by night’ enterprises whose activities can ruin that of their sector. Likewise SMEs feel disadvantaged by the economies of large enterprises but have no one but themselves (or hopefully the government) to turn to. They would like to see the promotion of creativity and innovation not only in the market but more importantly in the academe where they should draw their resources. But they are acutely aware of the mismatch between their needs and the academic preparation of new graduates.

5.8.3 Policy Suggestions

Doable in the Medium-term Create linkages with developed-country providers of technology: e.g. large companies or experts from developed countries.

Doable in the Long –term

Technology scanning for SMEs : This could be a project that could be undertaken by the relevant institute of DOST

Develop an S&T policy that is both effective and relevant to the private sector

6 SUMMARY & CONCLUSIONS

The growth and development of MSMEs are affected by the plans, programs and general policy environment where it operates. Where there is no agreement and complementation, there is very little room for development. Sustainability of the programs and plans are ideally supported by long term policies and not by arbitrary or temporal whims of government administrations that change constantly. There should be an effort to make policies complementary and provide consistent input to the plans and programs that support development of MSMEs.

Table 23 provides the summary matrix of doable policies according to problem issue and MSME activity. These policies were culled from the analysis of the content/intent of laws and the feedback from the MSMEs themselves through the focused group discussions.

Table 23: Existing Policies Affecting MSMEs in the Philippines / Policy Suggestions

Area of MSME Activity	Laws/Policies	Problem/Issue	Policy Doables
Registration of microenterprise Registration of SMEs/ Permits to Operate/Renewal	RA 9178 : BMBE Act of 2002 : Guidelines of DOF, DTI, DOLE-NWPC, BSP, DILG DTI,/SEC/CDA, LGU, DOLE, BIR, SSS, DENR, Special agencies depending on industry	Lack of awareness of BMBE law. High cost of registration due to documentary requirements and long processing time; Lack of information on registration procedures Provision of incentives under the BMBE law may run counter to some govt agencies' objectives & may be cause for their footdragging on registration of microenterprises.	Short-term: <ul style="list-style-type: none"> • Institute awareness campaigns on the BMBE law. • Create a one-stop shop to reduce processing time. • Provide a checklist of documentary requirements and flowchart of necessary procedures for registration/ renewal to be prominently displayed in public areas Medium term <ul style="list-style-type: none"> • Simplify documentary requirements for registration of BMBEs and SMEs • Study the need for and implications of the different incentives provided by the BMBE law (e.g. revenue implications of tax exemptions)
Financing	Microfinance: RA 8425 Social Reform and Poverty Alleviation Act of 1997 RA 8791 : General Banking Law Circulars of BSP re Microfinance Framework SMEs: RA 6977: Magna Carta for SMEs; RA 8289 : Amendments to the Magna	Lack of information on available sources of credit Lack of orientation of banks re lending to small business, hence still dependent on collateral in lending.	Short-term <ul style="list-style-type: none"> • Make available a user-friendly and updated compilation of all available sources of credit to SMEs in the DTI website and/or in a newspaper of general circulation. • Train financial institutions on risk-based management. • Simplify the EEC Medium-term : <ul style="list-style-type: none"> • Study the guarantee scheme and its

	Carta		effectiveness in improving credit access to microenterprises in lieu of real estate
	<p>RA 7353 : Rural Bank Act Charters of Land Bank and DBP;</p> <p>RA 6389: An Act creating the Cooperative Development Authority;</p> <p>RA 6938: Cooperative Code of the Philippines</p>	<p>The SULONG program, while promising, has too little budget to meet demand of SMEs; also SBGFC is undercut by additional requirements and collateral by participating FIs.</p> <p>Lack of credit for R&D; financing needs of IT sector unknown</p> <p>SMEs examined on bankability instead of viability, hence dependence on collaterals; stems from lack of info on SME performance</p>	<ul style="list-style-type: none"> The SULONG Program will have to increase its presence through a bigger allocation of funds. Moreover, its supervisory powers of financial institutions will have to be strengthened in order not to be undercut by additional requirements/collateral by participating financial institutions. Thorough study of the IT sector should be undertaken to determine its financing needs. Open a credit window for research & development <p>Long-term</p> <ul style="list-style-type: none"> Create credit investigation agencies specializing on SMEs for use of the financial intermediaries. This will reduce the FI's reliance on collateral.
Tax burden and infrastructure needs	RA 8424 : National Internal Revenue Code of 1997	<p>Complicated procedures on tax payment</p> <p>Lack of information on taxes and fees open possibility for petty corruption</p> <p>Non-payment or</p>	<p>Short-term :</p> <ul style="list-style-type: none"> Provide a simplified flowchart of procedures for the payment of national taxes which can be displayed in prominent places. Display prominently a checklist of local taxes with their corresponding fees. <p>Medium-term :</p> <ul style="list-style-type: none"> Study further simplification of tax procedures/ documentary requirements especially with the SMEs in mind. Institute local campaigns to link payment of taxes to certain local expenditures, e.g.
	<p>RA 7716 : Value-Added Tax (VAT) Law ; RA 2241 : Amendment to RA 7716; Local Ordinances on taxes, fees & other charges</p> <p>RA 226 : Omnibus Investment Act</p>		

		<p>discouragement to pay proper taxes due to lack of transparency on how proceeds are being used;</p> <p>Petty corruption arising from complicated procedures/ or documentary requirements for payment of taxes</p> <p>Perception that industrial parks cater to foreign investments rather than local</p> <p>Need to rationalize real estate tax</p>	<p>garbage.</p> <ul style="list-style-type: none"> Local campaigns on the improvement of local governance <p>Long-term</p> <ul style="list-style-type: none"> Reduce human interaction in the payment of taxes through possible computerization. to avoid under-the table payments Strengthen linkage between taxes and expenditure on infrastructure Create economic zones geared to local investors (e.g. Hsinshu Park in Taiwan) Rationalize real estate tax.
Labor & human resource development	<p>The Labor Code RA 602 : Minimum Wage Law</p> <p>RA 6640 : Act Providing for an increase in the Wage of Public or Government Sector Employees</p> <p>RA 6727 : Wage Rationalization Act</p>	<p>There is need to prioritize training needs of SMEs, hence the need to know which ones are the most needed.</p> <p>To make training more demand-driven, there is need to consult the users for the development of training packages.</p> <p>SMEs have difficulties in paying the minimum</p>	<p>Short term:</p> <ul style="list-style-type: none"> Include in the PTTC Compendium of HRD and Entrepreneurship the actual size of classes that have been serviced by such training courses. <p>Medium term:</p> <ul style="list-style-type: none"> Devise a way by which MSMEs are consulted in the development of training packages offered by the different training institutions. <p>Long-Term</p> <ul style="list-style-type: none"> Study how to give greater weight to productivity improvements in determining the minimum wage. Explore other approaches to productivity-based payments to workers.

		wage. There is need to study in greater depth the labor laws in the Philippines, to make them more flexible and productivity-based.	
Trade policy	'Trade Reform Policy through a number of Executive Orders	Cost of incentive availment increases because of lack of incentive-granting office in the province	Medium-term <ul style="list-style-type: none"> Study the possibility of regionalized availment of incentives. Study the possibility of granting some subsidy for trade fairs and exhibits. Long-term: <ul style="list-style-type: none"> Pursue tariff liberalization in the agricultural sector in order not to burden exporters.
	EO 226 : The Omnibus Investments Code of 1987	Cost of joining trade fairs and exhibits where products are exposed to potential buyers can be prohibitive.	
	RA 7918 : An Act Amending Art. 39 of EO 226 (February , 1995)	Tariffs on agricultural inputs (e.g. sugar) increases the cost of production for exporters and hence reduces competitiveness	
Technology and Competition Policy	Science and Technology Master Plan	Technology transfer is key to the acquisition of technology. But local manufacturers end up at subsidiaries rather than sub-contractors of large firms who can supply the needed technology	Medium-term <p>Creation of linkages with developed-country providers of technology: e.g. large companies or experts from developed countries.</p> Long –term <p>Technology scanning for SMEs : This could be a project that could be undertaken by the relevant institute of DOST Develop an S&T policy that is both effective and relevant to the private sector.</p>
	RA 3815 : Revised Penal Code		
	RA 386: Civil Code of the Philippines		
	RA 165: An Act to Prohibit Monopolies and Combinations in Restraint of Trade	Technology upgrading is necessary for all industries. But firms/industries may not be knowledgeable on	
	RA 8293: Intellectual		

	<p>Property Code</p> <p>RA 7394: Price Act of the Phil</p> <p>BP 68: Corporation Code of the Phil</p> <p>BP 178: Revised Securities Act</p> <p>International treaties : GATT, GATS, TRIPS, TRIMS</p>	<p>technology.</p> <p>Previous attempts at drawing up a good S&T policy had been unsuccessful.</p>	
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