

# Access to SME Credit: Financing the Future

by Janelle Dumalaon

One million pesos was the amount **Myla Tudtod** added to her business as a result of the First-Agro Industrial Rural Bank's (FAIRBank) lending program for small and medium enterprises. Myla is the proud owner of *Makimsa Boutique* and *MKS Trading*, both named after her three daughters whom she strives to support single handedly with these businesses: Rhenie **May**, **Kimberly** Claire and **Saira** Camille. *MAKIMSA Boutique* produces office, school and sports uniforms and other custom-made clothing needs of government and private offices and individuals. *MKS trading*, on the other hand, delivers various supplies such as office and business machines, gadgets related to safety, security and sports, musical instruments, office supplies and even food.



At first glance, nothing seems special about this scenario. However, what makes it exceptional is the story prior to the loan. Myla faced the same situation as many small and medium entrepreneurs seeking credit. She did not have sufficient real estate assets to offer as collateral to secure a loan, rendering her unqualified to borrow from most banks.

It even came to the point where, driven by the lack of access to formal credit, she borrowed PhP 250 000 from a loan shark at an 8 percent interest rate per month. Despite having already paid about PhP 300 000 just in interest, the loan shark calculates a PhP 400 000 remainder. *I do not understand where the figure came from. I want to be free from this*, she says.

Fortunately for Myla, FAIRBank paved the way towards her million.

Adopting a new approach that allows borrowers to put up non-real estate assets as collateral, Myla and many other small and medium business owners are now able to access loans legally and under fair conditions. They are then able to expand their businesses and meet production needs. In Myla's particular case, her loan was pegged at an interest rate of 2 percent, a marked improvement from her earlier, more informal loan arrangements that left her vulnerable to the mercy of the loan shark.

For FAIRBank, loans such as Myla's represent an increase in their small and medium loan portfolio. For Myla, the loan represented the ability to improve her business by purchasing newer and better equipment and ensuring sufficient inventory stock, thereby better satisfying and increasing her clientele. Her clients now include Coca Cola, CSB staffers (a big manpower firm in Cebu), WT Construction Co, SunStar Daily, University of San Carlos, University of Cebu and even FAIRBank. *"To date, I have 67 institutional clients"*, she says proudly.

More than the practical gains to her business, however, Myla sees in the loan the chance to improve the quality of life for her daughters, the namesakes of her businesses, and for whose sake the businesses are running. She says, *my daughters are now all enrolled in good schools in Cebu and I have set up a trust fund for them. My investment is in their future.*

*Myla Tudtud in MAKIMSA Boutique. Her FAIRBank loan of one million enabled her to upgrade her equipment and increase profits.*



The 2007 Asia Small and Medium Enterprise (SME) Competitiveness Study concludes that close to 80 percent of the enterprises surveyed in the Philippines consider difficult access to funding and working capital as an obstacle to their competitiveness. Given that 99 percent of Philippine enterprises are considered micro, small and medium enterprises, an innovative lending approach to serve this vast potential market was clearly needed.

The German Technical Cooperation (GTZ) through the Private Sector Promotion Program (SMEDSEP), in partnership with the Department of Trade and Industry (DTI), offered a solution by introducing the cashflow based approach in small and medium enterprise lending.

Cashflow based lending enables loan officers and the credit committee of a bank to assess the viability of a loan applicant based on its ability to generate cashflows and income. In the interest of risk management, collateral is still required. However, cashflow based lending encourages acceptance of nontraditional collateral and movable assets such as accounts receivables, inventories, equipment and personal guarantees.

The cashflow based lending approach is also a way for financial institutions to better comply with an important amendment in the law for SMEs. Last 23 May 2008, President Gloria Macapagal-Arroyo signed into law the Republic Act No. 9501, *An Act to Promote Entrepreneurship Strengthening Development and Assistance Programs to Micro, Small and Medium Scale Enterprises*, otherwise known as the *Magna Carta for Small Enterprises*. The *Magna Carta* requires all banks to lend 10 percent of their credit portfolio to MSMEs for a period of ten years.

In 2003, the GTZ piloted its program to develop capacities on cashflow-based lending in three provinces in the Visayas. A series of consultations with bank associations was conducted to build consensus on the approach and on the selection process of the banks that would participate in the training program. Some 48 rural banks and two thrift banks participated in five SME training programs which culminated in August 2006. Nine rural banks further received onsite training and coaching in building and strengthening their respective units dedicated to providing loans for small and

medium enterprises, developing an SME credit manual and implementation of cashflow-based credit appraisal.

Taking a closer look at the monitoring data generously shared by two of the banks supported by the GTZ Private Sector Promotion Program, FAIRBank Cebu and Bank Victorias in Bacolod, it can be seen that their loan portfolios have increased at a rate way above the industry level while maintaining very good quality. The increase in the number of loans results in increased employment generation in the sector. The increase in loan sizes of repeat small and medium entrepreneur clients, especially the medium and long term loans, also indicates a buildup of assets of business owners. This enhances their capacity to acquire instruments of social protection for their families such as insurance protection and health coverage.

In the interest of making the approach sustainable, the GTZ has capacitated SME finance training providers to regularly market and organize fee-based trainings. One such training provider would be the University of the Philippines-Institute of Small-Scale Industries, which currently has eight certified trainers, with five more to be certified by September 2008.

To date, there is a high willingness for more participation in trainings on cashflow-based lending. In fact, 12 batches are currently undergoing trainings on SME finance, as well as on SME credit appraisal and monitoring training, which are expected to conclude this October 2008. These trainings are being implemented country-wide, and will benefit various rural financial institutions (RFIs) accredited by the Landbank of the Philippines, a state-owned commercial bank. The present challenge continues to be rolling out the lending approach to reach even more banks in the country.

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