The Philippines[1]

Industrial and Support Services Expansion Program (Phase II) (ISSEP II))

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Field Survey: January 2008

1. Project Profile and Japan's ODA Loan

Map of project area: Entire area of the Philippines

Feed production equipment financed by this project

1.1 Background

The Philippines' manufacturing industry achieved an average growth rate of 5.4% during 1994 to 1997 due to trade and investment liberalization, the surmounting of the electric power crisis and the stability of the inflation rate and interest rates. Manufacturing played a definite role in the economic growth (real GDP growth rate: 5.0%) during the same period. However, prior to the implementation of this ODA loan, the manufacturing industry accounted for 22.3% of the GDP in 1997, a figure which was little changed from the 1980s, and so it did not become a driving force of economic development. Moreover, the percentage of manufacturing in employment had fluctuated around 10% since the end of the 1980s, and so its contribution to employment creation was small. Consequently, to further promote economic development in the Philippines, industrial promotion that focused on the manufacturing industry became indispensable, and a long-term goal of the Estrada Administration which held office at the time were prepared was to raise the manufacturing growth

[1] For this project, the ex-post evaluation was implemented jointly with the Philippine government's National Economic and Development Authority (NEDA).

rate to 10% annually.

The manufacturing growth rate of the Philippines, which was also affected by the Asian economic crisis, was minus 1.1% in 1998, and although the overall condition of the economy improved in 1999, there was continued stagnation in manufacturing, which posted a growth rate of minus 1.0% in the first quarter of 1999. Employment also declined by 2% during the one-year period from July 1997 to July 1998. To return the Philippine economy to the growth track, revitalization of the manufacturing industry became indispensable in the short term as well.

For this reason, the Philippine government was providing support for small and medium enterprises (SMEs) in the fields of finance, technology, and marketing. However, there were restrictions in terms of staff and budget (funds), etc., and assistance from foreign countries became necessary. With regard to the financial aspect in particular, because the supply of funds to SMEs especially became tight due to the Asian financial crisis and credit crunch in private funds and because of the particularly striking deficiency of medium- and long-term funds, there was a heightened need for provision of medium- and long-term funds to the private sector.

Meanwhile, for the promotion of SMEs and supporting industries in particular, it was necessary to provide assistance not only fund-wise but also to include support for marketing, technology, and management. In collaboration with existing technological support by the Philippine government and other donors, provision of support combined with funding assistance was required.

1.2 Objective

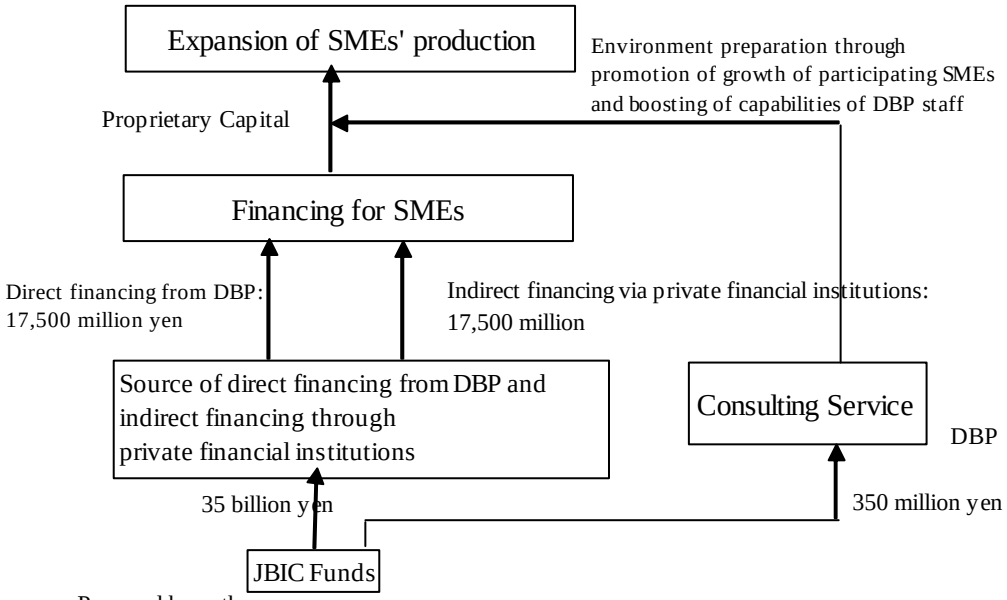
This program's objective was to provide medium- and long-term financing mainly to small and medium enterprises in the manufacturing and related industries of the Philippines through DBP and also to provide technical assistance including technical/management guidance and marketing support to companies in supporting industries for the purpose of promoting the manufacturing industries and developing the supporting industries, thereby creating employment and contributing to the economic development of the Philippines.[2]

1.3 Borrower/Executing Agency

The Development Bank of the Philippines (DBP) (guaranteed by the Government of the Philippines)

[2] As assistance for SMEs through policy finance projects prior to this project, the Japanese government has provided loans to the ASEAN Japan Development Fund (AJDF), Industrial and Support Services Expansion Program I (the first phase of this program) (ISSEP I), Export Industry Modernization Project I and II, and the Agro-industrial Technology Transfer Program.

Figure 1: Project Scheme



source: Prepared by author.

1.4 Outline of Loan Agreement

Loan Amount/Loan Disbursed Amount	35,350 million yen/35,260 million yen
Exchange of Notes/Loan Agreement	December 1999/December 1999
Terms and Conditions -Interest Rate -Repayment Period (Grace Period) -Procurement	0.75% 40 years (10 years) General untied (Consultant services: Bilateral tied)
Final Disbursement Date	March 2006
Main Contractors	—
Consulting Services	Small Enterprises Research & Development Foundation of Philippines (Philippines), Unico International Corporation (Japan)

2. Evaluation Result (Overall Rating: A)

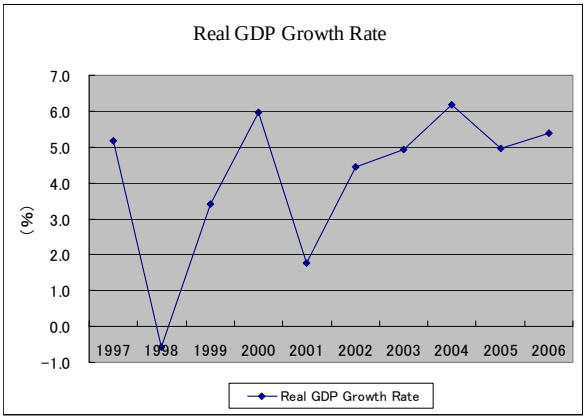
2.1 Relevance (rating: a)

The implementation of this project is wholly consistent with the national policy, etc., both at the time of the appraisal and at the time of the ex-post evaluation, and so the relevance of the project implementation is extremely high.

2.1.1 Relevance at the time of appraisal

Starting in the latter half of the 1980s in ASEAN member countries, financial deregulation in trade and investments progressed, leading to high economic growth rates achieved by actively utilizing foreign investment. However in the Philippines, unlike other Southeast Asian countries, there was little increase in foreign investment because the country was unable to allocate funds intensively to the export industry, which was the potential key to economic development. Thus unlike Thailand and Malaysia, the Philippines did not create a powerful export sector.[3]

Figure 2: Real GDP Growth Rate of the Philippines (%)



source: World Development Indicators 2007

Looking at the percentage of added value in the GDP accounted for by the Philippine manufacturing industry, it declined by minus 0.01% annually during 1980 to 1999, which means that it remained basically unchanged. Given this, it may be said that the manufacturing industry did not become a driving force for the economic development. Meanwhile in Malaysia and Thailand, the annual percentage during the same period increased by 1.9% and 2.2%, respectively. Moreover, the percentage of employment accounted for by the Philippine manufacturing industry increased by 0.1% annually during 1980 to 1999, and so the contribution by manufacturing to employment creation was slight. On the other hand, in Malaysia and Thailand, the annual percentage during the same period increased by 1.2% and 2.0%, respectively, and so manufacturing made a major contribution to employment creation in those countries, in contrast to the Philippines.

[3] Refer to Okuda (2008) "*Daiyonsho Firipin no kinyu seido kaikaku*" (Chapter 4: Financial system reorganization in the Philippines) and Teranishi et al. "*Ajia no keizai hatten to kinyu shisutemu tonan Ajia hen*" (Economic development and the financial system in Asia: Southeast Asia edition), Toyo Keizai Inc.

Figure 3: Percentage of GDP Added Value due to Manufacturing

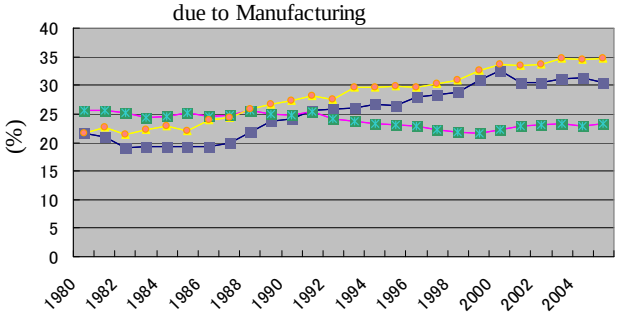
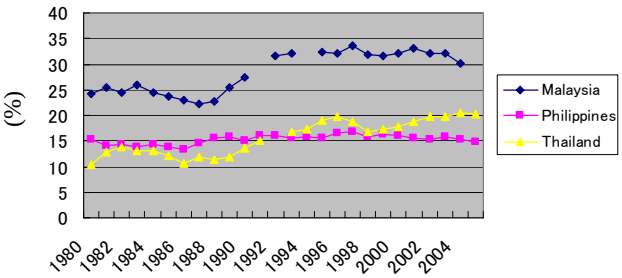


Figure 4: Percentage of Employment due to Manufacturing



source: World Development Indicators 2007

In the Philippines, the real GDP growth rate turned negative due to the impact of the Asian currency crisis in 1998, but it was in a recovery trend, toward its 1997 level, from the end of 1999 when this project began up to the first half of 2000. During this period, the important issues were industrial development which focused on the manufacturing industry and the employment creation which accompanies that. A long-term goal of the Estrada Administration in office at that time was to raise the manufacturing industry growth rate by 10% annually.

The policy planned by the Philippines mandated “promoting internationally competitive industries” as a goal of the industrial sector in the Medium-Term Philippine Development Plan (MTPDP) 1999-2004. There were six policy objectives, as follow: (1) promotion of science and technology, (2) increase of productivity, (3) securing of sustainable development, (4) facilitation of decentralization, (5) employment creation, and (6) promotion of SMEs. As measures for the development of SMEs, the government carried out the following in accordance with the Magna Carta for Small Enterprises (enacted 1991, Republic Act (RA) 6977 as amended by RA 8289): (i) Establishment of the Small and Medium Enterprise Development Council (SMEDC) and SME development strategy planning , (ii) Establishment of the minimum allocation of financing by banks for SMEs, and (iii) Establishment of the Small Business Guarantee and Finance Corporation (SBGFC). In 1998, the SME Development Strategy was established and consisted of the following five pillars: (1) identifying priority sectors, (2) strengthening cooperation with large enterprises, (3) promoting technical development and R&D activities, (4) developing human resources and providing training, and (5) improving access to financial services.

Moreover, demand for funds from SMEs during 1999-2004 was estimated to increase by an additional 5 billion pesos, aside from the existing programs.

Given the above, this project, which is a two-step loan provided through DBP, had high relevance because, together with alleviating the inadequacy of investment funds by providing medium- and

long-term funds primarily to SMEs, technological support was provided by consultants in accordance with the policies and measures of the Philippine government at the time of appraisal.

2.1.2 Relevance at the time of the evaluation

Promotion of SMEs and micro enterprises was placed at the top of the 10-Point Agenda announced by President Arroyo in her inauguration speech in June 2004 and has been considered, up to the time of this evaluation, one of the most important issues for the Philippine government as a measure which directly creates employment at SMEs and micro enterprises.[4] In the Medium-Term Philippine Development Plan (MTPDP) 2004–2010 prepared in November 2004 mainly by the National Economic and Development Authority (NEDA), economic growth and employment creation are mentioned as top priority issues. The plan specifies "promotion of SMEs through financial support, technical guidance, and marketing support" and "a three-fold increase in financing for SMEs" as the targets for the trade and investment sector. Its strategic measures include "creation of employment for 10 million people through the promotion of SMEs, etc." The following two measures are set forth in a specific action plan for the promotion of SMEs:

- Provision of financial support, technical guidance, and marketing support to 3 million SMEs
- Empowering existing SMEs by increasing lending and creating new employment opportunities through various programs

Moreover, as a strategy for the development of SMEs, in July 2004 the Department of Trade and Industry (DTI) formulated the SME Development Plan 2004–2010 with the support of JICA's development study "Support Program for SME Development Plan" (completed March 2004). The top level vision of the plan is "to nurture and create Philippine SMEs that are competitive in the globalized economy," and the plan sets forth specific support strategies for SMEs.

Thus at the time of this evaluation, the project remained consistent with the top policies affecting SMEs promotion, and the relevance of project implementation was extremely high.

Assistance by Other Donors in the SME Financing Sector

During the implementation of ISSEP II, there was a second-generation loan by the IGLF (Industrial Guarantee and Loan Fund) and a CLSME (Credit Line for Small and Medium Enterprises) by KfW as financing programs for SMEs using aid funds.

The IGLF is a financing program for SMEs that was jointly financing by the US, the World Bank, and the Asian Development Bank from 1952 to 1989. Currently, second-generation loans are

[4] According to the latest statistics on the Philippine establishments (2001) published by the National Statistics Office (NSO), the total number of business establishments in the Philippines is 811,589. Among them, SMEs account for 99.6% of the total number and 69.1% of the employees. They contribute approximately 30% of the total production (in terms of GVA) and account for approximately 60% of exporting enterprises.

extended using a revolving fund based on that.

Until 2004, KfW also provided DBP with a Credit Line for Small and Medium Enterprises (CLSME) for fixed asset purchases only and for micro enterprises to acquire fixed assets and to use as working capital.

2.2 Efficiency (rating: a)

2.2.1 Output

(1) Method of Financing: In this project, two financing methods were adopted, indirect financing (wholesale) through private financial institutions (PFIs) and direct financing (retail) from DBP. Of the 312 sub-projects loans for which data was available, there were 151 wholesale loans made through PFIs and 161 retail loans from DBP. In ISSEP I implemented prior to this project, only the wholesale method was adopted. According to the ex-ante appraisal, the retail method was added anew to this project from the standpoint of expanding fund supply windows, in reflection of the fact that the financial condition of private banks had deteriorated and the number of PFIs had decreased following the Asian economic crisis.

(2) Eligible End Users: Enterprises with total assets below 200 million pesos before receiving financing and at least 70% Philippine capital (excluding subsidiaries of enterprises with total assets over 200 million pesos before receiving financing)

(3) Use of Funds: Use of funds was originally prescribed as follows.

- Construction, expansion, modernization of production facilities and equipment and related consulting services
- Procurement and introduction of machinery, equipment and new technology
- Investment for the promotion of research and development (including training)
- Initial and additional working capital (loans only for working capital are available)
- Interest during construction may be covered by the loaned funds if necessary

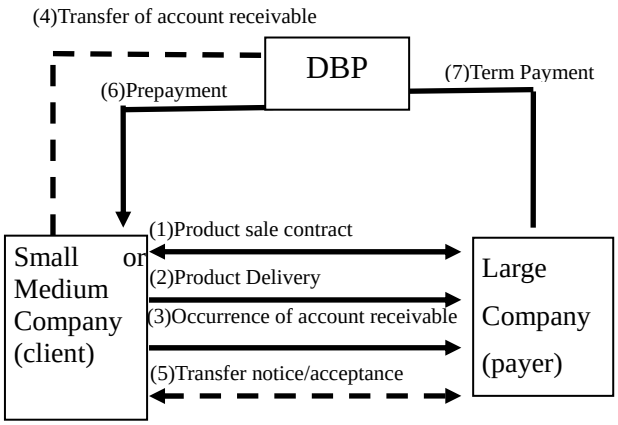
In addition, the following five uses were added during implementation.

- Factoring (sale of accounts receivable at a discount) transactions included in Instant Working Capital Agreements with a term of one year or longer
- Credit Line covered by Credit Line Agreements for working capital with a term of one year or longer[5]
- Working capital through direct loans without an established credit line[6]
- Lending to microfinance institutions
- Refinancing of other SME loans

[5] A credit line is credit extension with an established upper limit. The borrower company can borrow within that limit.

[6] A direct loan to small companies without an adequate accounting system to prepare for a credit line transaction.

Figure 5: DBP's Factoring Scheme and Its Implications



In the event that an SME delivers products to a large company but has a sales contract for payment 30 days later, the SME must wait until the due date to receive payment. However, if the SME experience a cash-flow problem during that period, DBP will buy an account receivable at a discount, give the SME a prepayment, and receive the payment from the large company on the due date. This is called factoring. When DBP conducts factoring, one condition is that the SME have a subcontract with the large company. Factoring has been adopted as a loan scheme to strengthen the relationship of large companies and supporting industries.

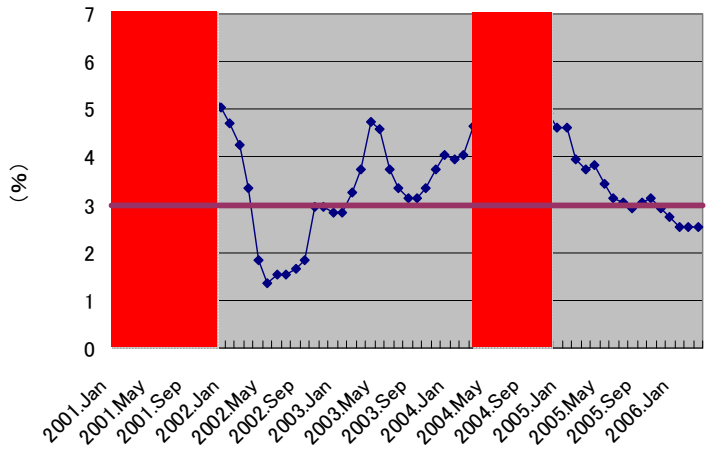
(4) Interest Rate Terms and Conditions: In this project, WAIR (Weighted Average Interest Rate)[7] is used as the base for calculation of sub-loan interest rates for reflecting the trends of the market interest rate in the sub-loan interest rates while preserving the concessional nature of interest rates on sub-loans.

When deciding the interest rate on wholesale sub-loans, together with the sub-loan interest rate, the PFIs' spread is another matter of importance. The PFIs determine the PFI spread for each sub-loan, and if the interest rate consisting of this project's sub-loan interest rate plus a spread is not lower than the prime rate,[8] then the PFIs have no incentive to use this project's funds to assist SMEs.[9] The figure below shows the amount of difference between the prime rate and the sub-loan interest rate during the project period, from 2001 to March 2006. However, as can be seen in the figure, from the first quarter of 2002 through the first quarter of 2003 as well as in the first quarter of 2006, the interest rate consisting of this project's sub-loan interest rate plus a spread (assumed to be 3%) was higher than the prime rate. For this reason, around these times, there were not many new loans undertaken in this project using the wholesale method.

In this project, a spread is necessary because the PFIs bear 100% of the risk of end-user default and the spread is an incentive for PFIs to participate in the policy lending program. However, under conditions where the market lending rate is decreasing, end users select a low-interest program for new loans, and PFIs also select low market loan interest rates instead of this project's funds. This issue was also pointed out in the ex-post evaluation of ISSEP I, and it remains as an issue.

[7] 91-day TB interest rate (weighted-average interest rate of first three weeks of previous month).
[8] The prime rate is the interest rate (most preferred interest rate) that banks charge on loans to corporate customers which are top-ranking companies with the highest creditworthiness.
[9] There was a PFI which stated that, in special cases, a minimum spread of 1.75% is applied.

Figure 6: Difference between the Prime Rate and the Sub-Loan Interest Rate



source: Bangko Sentral ng Pilipinas statistics website (http://www.bsp.gov.ph/statistics/statistics_online.asp), DBP data.

Furthermore, the periods shaded in red in the above figure were the periods when the sub-loan interest rate was WAIR minus 2% based on the agreement with JBIC at the time. When the spread between the prime rate and the sub-loan interest rate is large, thereby giving PFIs incentive to grant new loans, this method of determining interest rates is utilized. On the other hand, because the difference between the prime rate and the sub-loan interest rate is small given a sub-loan interest rate of WAIR minus 2% when the market loan interest rate is low, provision of new loans through PFIs was promoted by revising the sub-loan interest rate six times and setting the spread at less than WAIR minus 2%.

(5) Repayment period: From the initially suggested repayment period of 3 to 15 years, the minimum term of 3 years was removed, i.e., it was changed to up to 15 years. This was because factoring over 1 year was added as a new fund use, and moreover, a credit line for working capital was set. The grace period (up to 5 years) remains unchanged.

Table 1: Comparison of number of loans and amount by loan period

Category	Number of loans		Loan amount	
	Number	%	(million pesos)	%
Loan period				
Long-term (3 years up to 15 years)	406	78	11,022	70
Medium term (1 to 3 years)	116	22	4,818	30

source: PCR

It can be seen that, because of the addition of this new fund use, the amounts of loans became

relatively larger compared to the number of loans among the loans of medium-length terms.

(6) Asset Size of Borrowers

Table 2: Asset Size of Enterprises Receiving Loans[10]

Category	Number of loans		Loan Amount	
	Number	%	(million pesos)	%
Asset size of borrower				
Over 100 million pesos (large enterprise)	100	19	6,079	38
Over 15 million pesos, less than 100 million pesos (medium enterprise)	295	57	8,345	53
15 million pesos or less (small and micro enterprises)	127	24	1,415	9

source: PCR

Looking at the loan results by asset size of the borrowers, loans to medium enterprises constituted the bulk of the loans, both in terms of number and loaned amount, as shown on the above table. Moreover, approximately 20% of loans were made to large enterprises, but in terms of loan amount, large enterprises received nearly 40%.

This project aims to provide support mainly to small and medium-sized companies in manufacturing and related industries, but it is also designed to meet the financial needs of companies with total pre-loan assets of up to 200 million pesos.

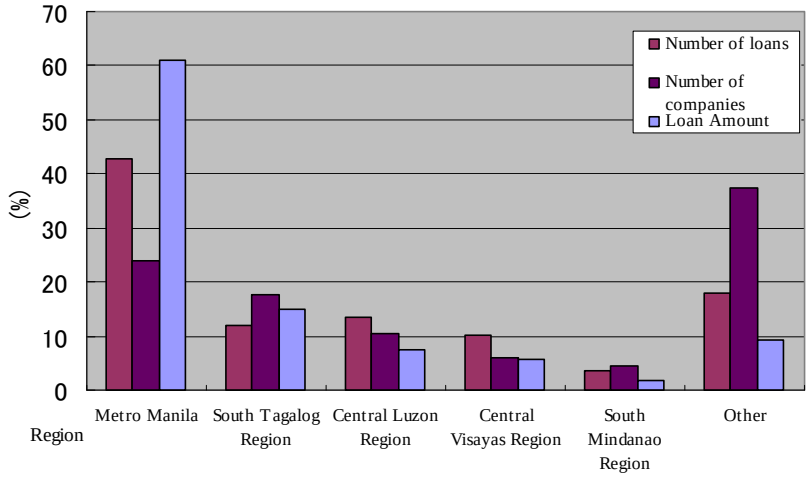
(7) Target Area: 522 companies received financing. Of the loans, 43% were in Metro Manila, and 57% were in other regions.

[10] Definition of SME: The definition of SME in the Philippines was as follows when the project began. (1) micro enterprise: total assets 1.5 million pesos or less, (2) small enterprise: total assets over 1.5 million pesos up to 15 million pesos, (3) medium enterprise: total assets over 15 million pesos up to 60 million pesos (asset size excluding land where the company's offices, plants, and facilities are located). Furthermore, it was noted in the documents that review of this definition was planned. As a result of the review, the figures were revised as follows in the SME Development Plan 2004-2010 (January 2003), with the upper limit of asset size of medium enterprises being raised from 60 million pesos to 100 million pesos. (1) micro enterprise: total assets (excluding real estate) below 3 million pesos or 1–9 employees, (2) small enterprise: Total assets of 3 million pesos or more and below 15 million pesos, or 10–99 employees, (3) medium enterprise: Total assets of 15 million pesos or more and below 100 million pesos, or 100–199 employees. However, the number of employees is included in consideration of the ILO definition, and basically the total assets excluding real estate are used as a standard for classification.

Table 3: Number of Loans and Loan Amount by Loan Region

Category / Loan Region	Number of Loan		Loan Amount (million pesos)	
	Number	%		%
Metro Manila (NCR)	223	43	9,657	61
South Tagalog Region （Region 4）	63	12	2,353	15
Central Luzon Region （Region 3）	71	14	1,181	7
Central Visayas Region （Region 7）	53	10	903	6
South Mindanao Region （Region 11）	18	3	284	2
Other	94	18	1,462	9

Figure 7: Comparison of Number of Companies by Region and Number of Loans in this Project



Note: The number of loans and loan amount are from PCR. The number of companies is from the SME Development Plan 2004-2010.

The region with the largest loan amount is Metro Manila. While 23.9% of all companies in the Philippines are located in this region, 43% of all loans provided by this project are to companies in Metro Manila, and so the number of loans in Metro Manila is relatively large considering the regional distribution of companies in the Philippines. However, given that the number of workers in Metro Manila constitutes 40.1% of all workers and the high percentage of large companies located in this area, concentration of loans here is unavoidable.

(8) Consulting Service: Consultants held seminars for SMEs, provided technological advice, supported supporting industries which connect large enterprises with SMEs, and made services from DBP to SMEs available through the Internet, etc.

2.2.2 Project period

According to the appraisal report, this project was planned to be started in December 1999 and finished by March 2004. However, it was agreed in the L/A that the project should start in March 2000 and the project period should be from March 2000 to March 2006. Therefore, the project period was 63 months, or 100% of the planned period

As a percentage of the total loan amount, the amount of the consultant service is small; whereas the planned implementation period was 60 months, the actual period was completed in 48 months, during March 2001 to March 2005.

2.2.3 Project cost

Whereas the projected project cost was 35 billion yen in fund assistance mainly for SMEs' investment in plant and equipment and for working capital and 350 million yen in fund assistance for consulting services (making a total of 35,350 million yen), the actual project cost was 35,001million yen (99%) for investment in plant and equipment and working capital and 259 million yen (1%) for consulting service (making a total of 35,260 million yen), which was within the planned amount.

Both project period and costs were almost as planned, therefore, efficiency od the project is high.

2.3 Effectiveness (rating: a)

The objective of the project was to promote the quantitative and qualitative expansion of loans to the manufacturing industry and related industries, focusing on SMEs, through the DBP. Specifically, the objectives were to 1) use the two-step loan framework to supply the necessary medium- and long-term funds to SMEs and to boost the profitability of the end users and 2) supply funds and technological support for development of supporting industries. In both objectives, the contribution made by this project is recognized, as stated in the text below. Moreover, as a result of the addition of the retail method by DBP, the percentage of the loan amount provided to SMEs increased.

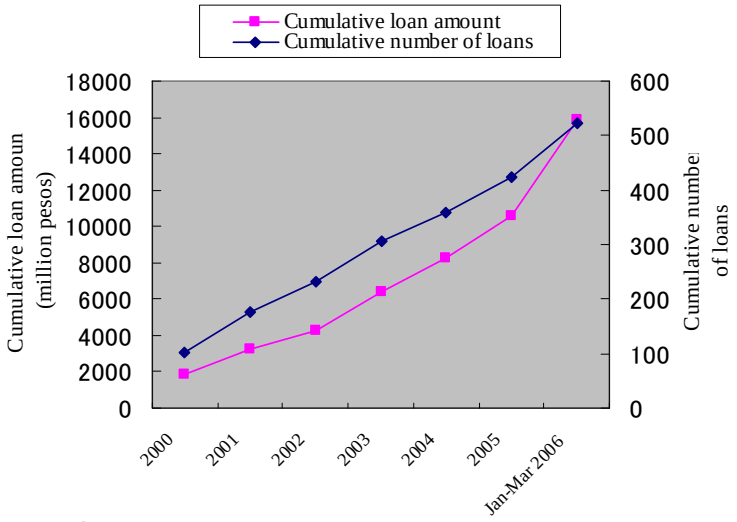
Given the above, the effects of project implementation appear to have been realized basically as planned, and so the efficiency was high.

2.3.1 Fund supply needed to develop small and medium companies

The number of sub-projects was 522, and the total loan amount from DBP was 15,856 million pesos. The achievement of quantitative fund supply for SMEs was confirmed in "2.2.1 Output" and is also clear looking at the figure on the right. Furthermore, the pace of disbursement was continually slightly behind schedule, but the amount of disbursement suddenly grew during January to March 2006, which was the final quarter of disbursement, thereby achieving the planned disbarment amount. The entire planned amount of fund loans from JBIC to DBP was carried out, and loans to

SMEs using those funds are underway.

Figure 8: Trend in Loan Amount



source: PCR

2.3.2 Boosting the profitability of end users

Comparing the business condition of end users before and after the project, increases were seen in gross income (up 18.4%), net profit (up 31.1%), and total assets of end-users (up 49.2%). Furthermore, comparing the effect of the retail method used for loans by DBP and the wholesale method used for loans through PFIs, gross income displayed a higher rate of increase in the case of the retail method rather than the wholesale method; however, net profit and total assets of end-users displayed a higher rate of increase in the case of the wholesale method.

Table 4: Gross Income by Lending Method (before and after) (unit: peso)

		Gross Income		
		Before	After	Growth (%)
Retail by DBP	Total	9,159,125	11,489,462	25.4
	Average	56,889	71,363	
Wholesale to PFI	Total	12,589,973	14,258,121	13.2
	Average	91,898	104,074	
Total	Total	21,749,098	25,747,583	18.4
	Average	72,984	86,401	

source: : PCR

Table 5: Net Profit by Lending Method (before and after) (unit: peso)

		Net Profit		
		Before	After	Growth (%)
Retail by DBP	Total	707,840	799,265	12.9
	Average	4,397	4,964	
Wholesale to PFI	Total	933,523	1,352,682	44.9
	Average	6,814	9,874	
Total	Total	1,641,363	2,151,947	31.1
	Average	5,508	7,221	

source: : PCR

Table 6: Total Assets of End-users by Lending Method (before and after)
(unit: peso)

		Total Assets of End-users		
		Before	After	Growth (%)
Retail by DBP	Total	9,911,528	13,457,131	35.8
	Average	61,562	83,585	
Wholesale to PFI	Total	14,185,389	22,495,950	58.6
	Average	93,943	148,980	
Total	Total	24,096,917	35,953,081	49.2
	Average	77,234	115,234	

source: : PCR

Net profit in particular displayed an increase approximately three times greater when the wholesale method was used instead of the retail method. Given this, it may be inferred that, when loaning project funds, PFIs are selecting companies which can be expected to produce higher profit. Conversely, it is likely that DBP's standards for screening repayment ability are more lenient than PFIs' standards and that DBP, due to its nature as a public institution, accepts more loan risk as than PFIs accept.

When a comparison is made of the size of companies to which DBP and PFIs extend loans, medium-size companies account for fifty-some percent of the loans from both DBP and PFIs. However, PFIs extend more loans to large companies, and DBP extends more loans to small companies. In other words, it may be said the DBP is contributing to the development of SMEs, which is the objective of this project, more than PFIs are.

Table 7: Asset size of the End-users by Enterprise Scale and Lending Method

	Asset size of the End-users	Number of projects	%
Retail by DBP	Large (over 100 million pesos)	29	18.0%
	Medium (15 to 100 million pesc	81	50.3%
	Small (under 15 million pesos)	51	31.7%
	Total	161	100.0%
Wholesale to PFI	Large	51	33.8%
	Medium	85	56.3%
	Small	15	9.9%
	Total	151	100.0%

source: : PCR

2.3.3 Impact on employment

According to valid data in the PCR covering both before and after loan implementation (326 companies out of 522 companies), the project resulted in a net increase in employment of 4,549 persons, which represents an 11.9% increase.[11] The number of salaried employees in the manufacturing industry across the Philippines increased by 11.2% during 2001 to 2005,[12] and this is basically consistent with the employment trend in the Philippines nationwide.

2.3.4 Technological support through consulting service

More than 350 companies are participating in seminars for SMEs or are receiving technological advice. Assistance for supporting industries and the website "dbp4sme,"[13] which provides business matching for those industries, were launched, and as of the end of 2004, 1,468 companies were registered. Furthermore, more than 150 DBP employees participated in a series of seminars with experts from the Philippines' Department of Trade and Industry to boost their technological level.

In other words, this project's consulting service was not only for companies that received ISSEP II financing; the consulting service took a more strategic approach and dealt with topics set by the SME Development Plan 2004-2010 by launching a website for assistance to supporting industries, etc.,

2.3.5 Differences compared to ISSEP I

Two differences between this project and ISSEP I, the forerunner of this project, are 1) additional fund uses (factoring, working capital, and refinancing) and 2) the addition of the retail method used

[11] At 12 companies which received loans from DBP and at 3 companies which received loans from PFIs, there was a decrease in employment.

[12] Calculated using ILO statistics (http://laborsta.ilo.org/).

[13] http://www.dbp4sme.ph To promote business matching among the registered companies, this site links companies together by compiling and releasing a corporate database and facilitating exchanges of information concerning supply and demand among the registered companies. Together with this, the site provides information which contributes to relationship-building, such as information on subcontracting, franchises, and strategic business partners.

by DBP. However, the two projects share the common objective of "providing medium- and long-term funds mainly to SMEs in the manufacturing industry and related industries." Thus, this evaluation studied whether or not there was any impact on the financing targets caused by the changes in the loan terms and conditions in the two projects.

The differences in the sub-loan terms in this project and ISSEP I were compared. According to the table below, 93.48% of the ISSEP I loans were long-term loans from 3 years to less than 15 years, and 6.52% of the ISSEP I loans were medium-term loans from 1 year to less than 3 years. On the other hand, 77.78% of this project's loans were long-term loans, and 22.22% were medium-term loans; so, medium-term loans from 1 year to less than 3 years increased substantially. This is the effect of the new addition of factoring (sale of accounts receivable at a discount) which was included in the Instant Working Capital Agreements for a period of one year or longer.

Table 8: Sub-Loans Classified by Term (comparison with ISSEP I)

	Sub-Loan Projects Financed by ISSEP II					ISSEP I	
	Number of projects	%	Loan amount (million pesos)	%	Average loan amount (million pesos)	Number of projects	%
Long-Term (3 years to less than 15 year	406	77.78%	11,021.95	69.58%	27.15	172	93.48%
Medium-Term (1 to 3 years)	116	22.22%	4,818.09	30.42%	41.54	12	6.52%
Total	522	100.00%	15,840.04	100.00%	30.34	184	100.00%

source: : PCR

Factoring was concentrated among medium-size companies in Metro Manila, according to PCR. This is probably because implementation of factoring is basically limited to SMEs that have consignment contracts with large manufacturing companies which are concentrated in Metro Manila. The objective of factoring is to support the working capital of companies which are playing a role as supporting industries. The ease of using the funds obtained through factoring was noted in interviews with end users, with credit lines being made available within approximately 5 to 10 days following approval.

Table 9: Number of Companies that Engaged in Factoring by Location and Company Size

	Company Size			
	Large	Medium	Small/Mic	Total
Metro Manila (NCR)	4	33	9	46
South Tagalog Region (Region 4)		7		7
Central Luzon Region (Region 3)		2		2
Central Visayas Region (Region 7)				0
South Mindanao Region (Region		1		1
Other				0
Total	4	43	9	56

source: : PCR

Factoring deals account for 26% of all financing (excluding T/A) in this project and 22% of all financing in Metro Manila alone. It appears that provision of funds through factoring was effective in view of the fact that fund usage was in keeping with support of supporting industries, which was a major goal of this project, since factoring played a role in sustaining the subcontracting relationships between large companies and SMEs, and in view of the fact that gross income of companies engaged in factoring rose by an average of 21%.[14]

Table 10: Factoring Amount by Location and Company Size (unit: peso)

	Company Size			Total	
	Large	Medium	Small/Micro		
Metro Manila (NCR)	751,253,000	2,154,802,282	608,052,000	3,514,107,282	(22.18%)
South Tagalog Region (Region		571,742,413		571,742,413	
Central Luzon Region (Region		88,497,000		88,497,000	
Central VisayasRegion(Region				0	
South Mindanao Region		411,000		411,000	
Other				0	
Total	751,253,000	2,815,452,695	608,052,000	4,174,757,695	(26.36%)

source: : PCR
Note: Figures in parenthesis are the percentages of the total loan amount of this project (excluding T/A).

The appraisal documents point out that the Philippines' manufacturing industry is concentrated in Metro Manila and the South Tagalog Region (Region 4), and the importance of promoting manufacturing in other regions is also highlighted. The table below compares this project and ISSEP I based on the location of companies that received sub-loans. The number of loans in both Metro Manila and the South Tagalog Region (Region 4) are lower in this project than in ISSEP I. On the other hand, although the loan amount is declined in the South Tagalog Region (Region 4), in Metro Manila it rose from 50.84% in ISSEP I to 60.97% in this project. It may be assumed that this reflects the concentration of factoring in Metro Manila.

[14] Furthermore, the net profit of companies engaged in factoring rose by 0.4%, which is far below the overall average of 31.1%. This is because factoring provides working capital through the sale of accounts receivable, and so indicators related to business expansion, such as net profit, do not increase.

Table 11: Classification by Region (comparison with ISSEP I)

Region	Sub-projects financed in ISSEP II					Projects financing in ISSEP I		
	Number of projects	%	Loan amount (million pesos)	%	Average loan amount (million pesos)	Number of projects	(%)	Percent of loan amount (%)
NCR	223	42.72%	9,657.20	60.97%	43.31	92	50.00%	50.84%
12	3	0.57%	124.00	0.78%	41.33	1	0.54%	1.72%
04	63	12.07%	2,352.98	14.85%	37.35	33	17.93%	19.96%
10	20	3.83%	398.37	2.51%	19.92	11	5.98%	1.85%
02	8	1.53%	159.18	1.00%	19.90	1	0.54%	0.34%
07	53	10.15%	903.46	5.70%	17.05	17	9.24%	6.50%
09	10	1.92%	169.11	1.07%	16.91	0	0.00%	0.00%
03	71	13.60%	1,180.95	7.46%	16.63	16	8.70%	11.89%
08	4	0.77%	64.24	0.41%	16.06	0	0.00%	0.00%
11	18	3.45%	283.57	1.79%	15.75	9	4.89%	5.51%
01	15	2.87%	219.58	1.39%	14.64	3	1.63%	0.90%
05	3	0.57%	39.28	0.25%	13.09	0	0.00%	0.00%
CAR	6	1.15%	57.20	0.36%	9.53	0	0.00%	0.00%
06	25	4.79%	230.92	1.46%	9.24	1	0.54%	0.50%
Total	522	######	15,840.04	100.00%	30.34	184	100.00%	100.00%

source: : PCR

Together with factoring, this project also carried out refinancing, as a financing target that was newly adopted in this project.[15] There were 43 loans refinanced (8% of the total 522 loans), amounting to 608.45 million pesos (3.8% of the total loan amount), and 42 of the 43 loans were refinanced by PFIs. This project's refinancing became available from mid-2002, but PFIs used the majority immediately prior to the end of the project, from the end of 2005 through the first quarter of 2006, to pay outstanding balances when the interest rate on market loans fell, worsening the terms and conditions for interest rates on new loans from PFIs to end users

2.4 Impact

2.4.1 Outline of end user sample survey

For this evaluation, a total of 12 companies including PFIs were visited, and of those, 4 companies agreed to a detailed survey. The 12 companies were selected from Metro Manila, Cebu city, and Iloilo city to avoid bias. Furthermore, the number of education institutions was increased slightly because that sector was added to the original plan. The sectors and number of companies visited are as follow.

[15] On May 20, 2002, the DBP headquarters informed all branches that JBIC had approved refinancing that utilizes this project's funds. It was also pointed out that, at the time of refinancing, not only refinancing but also additional loans could be received from this project.

Table 12: Companies Visited and Surveyed in Detail

	Sector						
	PFI (including GFI)	Food manufacture	Educational Institutions	Feed manufacture	Chemical manufacture	Clothing Manufacture	Total
Visit Survey	3	2	3	1	2	1	12
Detailed Survey	-	1		1	2		4

source: End User Survey

The visit survey consisted of interviews with managers where they were questioned mainly about the merits of the project. The detailed survey consisted of interviews with managers, employees, and area residents where they were questioned about changes in the company involved and impact on the area caused by the loan provided by the project. Furthermore, of the 9 companies excluding PFI, 7 received direct loans from DBP and 2 received loans from PFIs.

2.4.2 Project's merits recognized by sampled end users

Eight of the nine companies, excluding PFI, replied that the greatest merit of the project was the low level of interest rates. The second greatest merit which was mentioned was the length of the loan term, and third was interest rate stability due to the selection of fixed interest rates. For six of the seven companies that received loans from DBP, this project was the first occasion for them to receive financing from DBP, and all six of these companies replied that the decisive factor in selecting DBP after comparing the loan conditions of PFIs and DBP was the low level of interest rates available from DBP through this project. Moreover, the two companies that received loans from PFIs stated that one PFI was selected due to the low level of interest rates and the other PFI was selected due to the simplicity of the loan procedure, compared to other PFIs.

Two of the nine companies did not receive approval for 100% of their requested loans, but neither of the two indicated that this was a particular problem; they replied that they merely reduced the scale of their investment.

Compared to ISSEP I, services were expanded in this project to include working capital, factoring, and refinancing, etc., and one company that utilized factoring mentioned the matching service with DBP client companies as the greatest merit.[16] Moreover, a company that refinanced other debt using a loan from this project stated that the greatest merit was the lowering of its interest rate burden through refinancing.

[16] When this company utilized factoring from DBP, it was introduced to "dbp4sme" which was launched as a consulting service in ISSEP II, and it expanded the number of its business contacts through this matching service.

2.4.3 Status of management by DBP and PFIs

All companies expressed a high degree of satisfaction with the management of DBP and the PFIs. Although slight dissatisfaction was heard with the number of documents required for the loan applications, all end users stated that both DBP and the PFIs gave adequate guidance during the loan application process and advice on how to prepare the application documents. All of the companies interviewed for this evaluation were actually visited by loan officers from DBP or the PFIs at the time of the loan screening to check the end users' business need for the loans.

In this sample of end users, there were no borrower companies with overdue loan payments.

2.4.4 Awareness of project

In the interview survey, the sampled end users were asked, "Are you aware that the source of ISSEP II funds is Japanese ODA?" The result was that eight out of nine companies were aware of the Japanese ODA, and the one company which was not aware of this fact had received its loan through a PFI. In a pamphlet for end users concerning ISSEP II prepared by DBP, it was clearly stated at the beginning that the source of this financing is a yen loan. In contrast, it may be said that the explanation provided by the PFI to the end user was insufficient.

2.4.5 Detailed survey of sampled end users

Direct interviews were conducted with 30 employees at each of four companies where managers gave permission, and information was obtained concerning the impact of the financing received through this project on the company involved and the local conditions.

Increased Number of Workers: At all four companies, the number of workers increased following financing by this project. The reason for this is that the financing was used to introduce equipment and materials and to expand production capacity, sales, and plants.

Table 13: Reasons Why Workers Increased (multiple choice)

Food Manufacture	Company A
Increase in production	62.5%
Increase in sales	25.0%
Improvement in facilities	12.5%

Chemical Products	Company B
Introduction of additional machinery and equipment	76.7%
Expansion of work area	60.0%
Increase in production and sales	33.3%

Feed Manufacture	Company C
Increase in production capacity	76.9%
Increase in sales	23.1%
Expansion of plant	23.1%

Chemical Products	Company D
Increase in production and sales	69.2%
Expansion of plant	34.6%

source: : End User Survey

Increased Salary: As shown on the table below, 30% to 40% of the employees at Companies A, B, and C received salary increases of 10% or less. Meanwhile at Company D, over 90% of the employees received salary increases of 10% or less. It is likely that Company D's employees did not receive larger salary increases because Company D utilized factoring and so the funds received through this project were not allocated to plant and equipment investment.

Table 14: Percentage of Salary Increase

Food Manufacture	Company A
10% or less	45.0%
11% - 20%	20.0%
21% - 30%	5.0%
31% or over	25.0%

Chemical Products	Company B
10% or less	30.0%
11% - 20%	30.0%
21% - 30%	13.3%
31% or over	26.7%

Feed Manufacture	Company C
10% or less	34.8%
11% - 20%	17.4%
21% - 30%	21.7%
31% or over	26.0%

Chemical Products	Company D
10% or less	92.9%
11% or over	7.1%

source: : End User Survey

Reason for Wage Increases: At two of the companies, there were many employees who stated that wages increased because the companies introduced results-based wages. Meanwhile at the other two companies, there were many employees who stated that wages increased due to an increase in the minimum wage. The percentage of wage increase at Company B appears large compared to the other sampled end users, but this is due to the fact that wages were previously extremely low at Company B and many workers received wage increases when the minimum wage was raised.

Table 15: Reasons for Wage Increases (multiple choice)

Food Manufacture	Company A
Increase in results-based wages	85.0%
Increase in production or sales	40.0%
Increase in minimum wage	20.0%

Chemical Products	Company B
Increase in minimum wage	56.7%
Increase in production or sales	46.7%
Increase in results-based wages	43.3%

Feed Manufacture	Company C
Increase in results-based wages	47.8%
Increase in production or sales	30.4%
Increase in minimum wage	26.1%

Chemical Products	Company D
Increase in minimum wage	40.0%
Increase in results-based wages	30.0%
Increase in production or sales	30.0%

source: : End User Survey

Improvements in Work Areas: It can be seen that various improvements were made in work areas and that the work environment changed for the better as a result of this project.

Table 16: Improvement in Work Areas (multiple choice)

Food Manufacture	Company A
Cleaner facilities	48.0%
Expansion of production line	24.0%
Improvements in buildings	20.0%
Modernization of machinery and tools	16.0%

Chemical Products	Company B
Construction of new building and expansion of work area	66.7%
Improvement of ventilation	50.0%
Improvement in machinery and tools	30.0%
Improvement in worker performance	26.7%

Feed Manufacture	Company C
Increase in machinery and tools	55.0%
Cleaner facilities	30.0%
Improvement in production system	20.0%
Product became famous in the marketplace	20.0%

Chemical Products	Company D
Work area became easier to use	53.6%
Introduction of new machinery and tools	21.4%
Improvement in production system	21.4%
Improvement in management	17.9%

source: : End User Survey

Benefits from the Companies to the Local Communities: It is clear that these companies have produced large benefits to the local communities through the expansion of employment. Companies B and C are also conducting CSR (corporate social responsibility) in the form of fund assistance for local community activities.

Table 17: Benefits to Local Communities (multiple choice)

Food Manufacture	Company A
Employment	69.6%
Christmas present	21.7%
Maintenance and improvement of access road	8.7%

Chemical Products	Company B
Employment	52.0%
Contribution to tax revenue increase	36.0%
Fund assistance for community activities	24.0%

Feed Manufacture	Company C
Employment	88.2%
Fund assistance for community activities	5.9%
Repair of village roads	5.9%

source: : End User Survey

2.4.6 Environmental impact

The appropriateness of the sub-loan appraisal of the environmental aspects was confirmed with DBP, and it was confirmed that Environmental Compliance Certificates (ECC) were acquired in accordance with the loan manual of the Program Department. However, since the above-mentioned Company D engaged in factoring, the existence of an ECC was not confirmed in its case, although its business type, raw materials, and main business contacts were confirmed.

2.5 Sustainability (rating: a)

2.5.1 Condition of revolving fund[17]

Loans using the revolving fund have not yet begun.

2.5.2. Executing agency

2.5.2.1. Status of cash collection

The overdue situation of this program is generally acceptable and there is no concern at this moment.

2.5.2.2 Operation and maintenance system

The project's executing agency is the Development Bank of the Philippines (DBP), which has primarily provided medium- and long-term funds to Philippine industries and public corporations.

In the organizational aspect, an operation and management system for each financing program is well established with the Program Department playing a leading role under a clearly defined division of duties. Particularly in the field of lending to SMEs, DBP is experienced in the implementation of many programs by OECF, JBIC, the World Bank, KfW and other donor organizations. It has well-established procedures and systems from screening to monitoring and is highly capable of providing guidance and management to PFIs concerning wholesale lending.

However, while there are more loans that require care in the technological aspects of technological support and technological screening of end users, including in this project, the staff of the Program Department is limited, and so it remains desirable to strengthen the Program Department by increasing the number of staff.

2.5.2.3 Financial status

The projects sustainability in terms of DBP's financial status (management) is extremely high in general. In the financial aspect of the bank as a whole, both income and profit have been increasing and financial ratios, which are indicators of profitability, are favorable. DBP has been doing business on a steady basis as a bank.

[17] The revolving fund uses the liquidity resulting from the gap between the repayment period of the sub-loans and the repayment period of the JBIC loan and relends the funds to end users. This is expected to further boost the effects of the JBIC loan.

Table 18: DBP's Financial Status

	2004	2005	2006
Gross Income (billion Peso)	11,543,103	13,388,083	18,271,412
Net Income (billion Peso)	2,445,067	3,216,545	3,734,378
Debt to Equity Ratio	8.17	7.33	6.63
Net Income to Gross Income (%)	21.20%	24.02%	20.43%
ROE (%)	10.88%	12.59%	12.10%
ROA (%)	1.20%	1.50%	1.60%
Capital Adequacy (%)	11.03%	11.91%	13.22%
Interest Income to Net Loan & Receivables (%)	8.73%	8.46%	14.14%

source: : PCR

2.5.2.4 Operation and maintenance status

The Program Evaluation Section in the Program Department (the counterpart in this joint evaluation) is essentially staffed by two persons and so is understaffed. However, the employees who are assigned as loan officers have abundant experience, in addition to receiving training both inside and outside DBP, and so there are numerous outstanding employees who are well versed in operational capabilities.

In light of the above, there are no problems in the capabilities of the executing agency or in the O/M system, and so the evaluation is that high sustainability may be anticipated.

3. Conclusion, Lessons Learned, and Recommendations

3.1 Conclusion

Given the above, the evaluation of this project is extremely high.

3.2 Lessons Learned

Despite the fact that the sub-loan interest rate was revised several times because market interest rates declined significantly during the project period, the situation occurred in which the sub-loan interest rate was near or at the same level as the market interest rate. For this reason, at times the interest rate was lower on loans at market interest rates than on loans using this project's funds once the PFI's spread was added on. At such times, there was stagnation of project loans extended through PFIs. DBP lowered the wholesale interest rate as much as possible in order to continue loaning using the wholesale method while preserving DBP's own profit, but it was difficult for DBP to cope with the large decline in market interest rates. Consequently, it should be recognized that there is an inherent structural risk that loans using the wholesale method will stagnate in cases when the market interest rates decline greatly.

3.3 Recommendations

Although there are issues in the usage of the wholesale method via PFIs, DBP is a policy financing institution and should avoid proportionally pressure PFIs by expanding direct financing to private companies. Unilateral expansion of the retail method by DBP is not desirable. It is necessary to study how to best strike a balance between the wholesale method through PFIs and the retail method by DBP, considering avoiding cloud-out of PFIs and how to determine the sub-loan interest rate when market interest rates are declining, while keeping in mind what will better contribute to assistance of SMEs in the Philippines.