
# THE MISSING MIDDLE

A Market Study on SME Financing in the Housing Market System in the Visayas

Habitat for Humanity®

Terwilliger Center for Innovation in Shelter

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# ACRONYMS

| | |
|---|---|
| **BCP** | Business Continuity Plans |
| **BDO** | Banco de Oro |
| **BIR** | Bureau of Internal Revenue |
| **BMBE** | Barangay Micro Business Enterprise |
| **BSP** | *Bangko Sentral ng Pilipinas* |
| **CALABARZON** | Calamba, Laguna, Batangas, Rizal, and Quezon Provinces |
| **CAPEX** | Capital Expense |
| **CARES** | COVID-19 Assistance to Restart Enterprises |
| **CDA** | Cooperative Development Authority |
| **CITEM** | Center for International Trade Expositions and Missions |
| **COVID-19** | Coronavirus Disease 2019 |
| **DHSUD** | Department of Human Settlements and Urban Development |
| **DICT** | Department of Information and Communications Technology |
| **DOF** | Department of Finance |
| **DOST** | Department of Science and Technology |
| **DTI** | Department of Trade and Industry |
| **ECQ** | Enhanced Community Quarantine |
| **ERF** | Emergency Rehabilitation Fund |
| **GDP** | Gross Domestic Product |
| **HEROES** | Helping Economy Recover Thru OFW Enterprise Start-Ups |
| **HFHI** | Habitat for Humanity International |
| **ID** | Identification cards |
| **IMC** | Integrated Marketing Campaign |
| **ITC** | International Trade Centre |
| **ITR** | Income Tax Returns |
| **KII** | Key Informant Interviews |
| **KYC** | Know Your Customer |
| **Landbank** | Landbank of the Philippines |
| **LC** | Lines of Credit |
| **MGCP** | MSME Credit Guarantee Program |
| **MSME** | Micro, Small and Medium Enterprises |
| **NBFI** | Non-Banking Financial Institution |
| **NGO** | Non-government Organization |
| **P3** | *Pondo sa Pagbabago at Pag-asenso* |
| **PCAB** | Philippine Contractors Accreditation Board |
| **PSEFI** | Primary Structures Educational Foundation, Inc. |
| **PSIC** | Philippine Standard Industrial Classification |
| **PTTC** | Philippine Trade Training Center |
| **SEC** | Securities and Exchange Commission |
| **SBCorp** | Small Business Corporation |
| **SBGFC** | Small Business Guarantee and Finance Corporation |
| **SBL** | Small Business Loans |
| **SME** | Small and Medium Enterprises |
| **SMED** | Small and Medium Enterprise Development |
| **TESDA** | Technical Education and Skills Development Authority |
| **The Terwilliger Center** | Terwilliger Center for Innovation in Shelter |
| **UAP** | United Architects of the Philippines |

# I. INTRODUCTION

## A. Background of the Study

Habitat for Humanity's Terwilliger Center for Innovation in Shelter aims to catalyze both the demand and supply side of the affordable housing market to achieve a vibrant and resilient housing ecosystem in the Philippines. To accomplish this, Habitat focuses on improving access to products, services, and financing so that low-income households have access to improved housing. In the Philippines, the Terwilliger Center developed a market systems program that facilitated the increase in quality housing products and services for owner-driven home construction by low-income households.

Based on various research conducted by the Terwilliger Center, low-income households usually purchased construction materials from businesses that serviced the needs of low to lower middle income households. These businesses were typically micro, small and medium enterprises (MSMEs) that can sell construction materials in rural and peri-urban areas where owner-driven home construction is prevalent. As such, MSMEs ensured that there is a supply of quality materials which were continuously accessible to low-income households. However, according to an Oxford Business Group report in 2017[1], although MSMEs comprise 99.6% of all business in the Philippines, they are still challenged by a lack of access to finance. This is evidenced in a 2020 study conducted by the Terwilliger Center on the impact of COVID-19 on the low-income housing market system in the Philippines, wherein MSME owners described lacking access to working capital during the start of the pandemic to cover costs such as salaries and paying suppliers.

As MSMEs are pivotal not only in the economy of the country, but also in providing access to affordable materials and services, the Terwilliger Center decided to conduct an exploratory study to understand who are the SMEs within the housing market value chain, what are their financing needs, and what support system they need to continuously operate. However, upon initial research by the team, it was seen that microbusinesses were catered to by microfinance institutions, an industry which receives support from the Financial Inclusion and Capital Markets team of the Terwilliger Center.

As such, the Market Systems team of the Terwilliger Center decided to zero in on small and medium enterprises, which comprise what is known as the "missing middle."

[1] Oxford Business Group. (2017). *The Report: The Philippines 2017*.

## B. Objectives of the Study

The study aimed to explore the financing needs of SMEs in the Visayas Region. The Visayas region covers the following provinces: Aklan, Antique, Biliran, Bohol, Capiz, Cebu, Eastern Samar, Guimaras, Iloilo, Leyte, Negros Occidental, Negros Oriental, Siquijor, Southern Leyte, Samar, and Western Samar.

The study was done to provide an understanding of small and medium enterprises that comprise the "missing middle" in the housing market value chain. The results of the study were used to create recommendations that are appropriate and identify innovative market-based interventions to support the availability and accessibility of quality and affordable building materials for low-income households.

The specific objectives of the market study were the following:

- Determine and understand who the SME players in the housing market value chain are.
- Identify the current state of SME financing by diagnosing supply and demand and pinpointing existing market actors.
- Diagnose market constraints and opportunities in SME financing in order to improve products and services of financial providers related to owner-driven construction.

## C. Scope and Limitations of the Study

The study conducted was an exploratory study of SME financing in the Philippines. Given that, the team explored the research with as much thoroughness as they could given the time and physical constraints of the study. The conduct of data gathering was limited due to the ongoing COVID-19 pandemic, and as such, the majority of activities were conducted remotely, through online video calls, online survey deployment, and phone calls. This was especially exacerbated by the proclamation of the government on a stricter lockdown beginning August 7, 2021. In addition, there were provincial lockdowns imposed by the local government units restricting inter-island travel between provinces in the Philippines. Due to these constraints, the sampling size was limited, and although the team took due diligence in looking for and reaching out to the respondents, only a few participated in the study.

Players in key sectors were invited to participate in the study. These were identified as government agencies who are involved in governing SMEs, financial institutions that provide financial products and services to SMEs, and other development actors such as non-government organizations and associations that provide non-financial support to SMEs. The key actors identified by the team were the financial institutions, government actors, SME owners, and development actors.

The SME owners were included in the surveys while the rest were invited for a key informant interview. The team invited and reached out to private sector and government representatives but were met with negative responses, despite extensive efforts to do so. Majority of the private sector actors declined the request due to conflicts in their schedule, while those in the government were not able to participate due to the budget season, as well as restructuring within some government offices.

There were some business owners that did not want to be included in the study because they were uncomfortable with sharing their financial information. In addition, other respondents did not want to be included because they didn't think that their SME customers were included in the housing sector. Despite explaining what the research was about, these respondents still declined.

The SME respondents were registered businesses that belonged to one or more of the following industries, according to the Philippine Standard Industrial Classification (PSIC):

- Construction
- Financial and insurance activities
- Information and communication
- Manufacturing
- Mining and quarrying
- Professional, scientific, and technical activities
- Real estate activities
- Water supply, sewerage, waste management and remediation activities
- Wholesale and retail trade; repair of motor vehicles and motorcycles

As a business, the SME had to be registered with the Department of Trade and Industry (DTI) and the Bureau of Internal Revenue (BIR), as well as fall under the category of SME as defined by DTI. The definition of an SME will be discussed in the next few sections.

The study covered the main provinces in the Visayas. In this report, respondents came from the following provinces of Cebu, Aklan, Iloilo, Negros Occidental, and Negros Oriental. For actors that had a more national scope in terms of SME and SME financing, the team reached out to the heads of the agencies, and in some cases, were referred to the regional offices.

# II. RESEARCH FRAMEWORK AND METHODOLOGY

## A. Research Framework

The team utilized the market systems framework, to better understand the deeper issue of financing SMEs. In this framework, the team assumed that the main system being studied is Finance, with the supply coming from financial institutions, and the demand from the SMEs. The underlying hypothesis of the study was that there is a lack of financing coming from the supply side to the demand side, but that SMEs need financing to improve their products and services. The diagram below shows the framework that the team used:

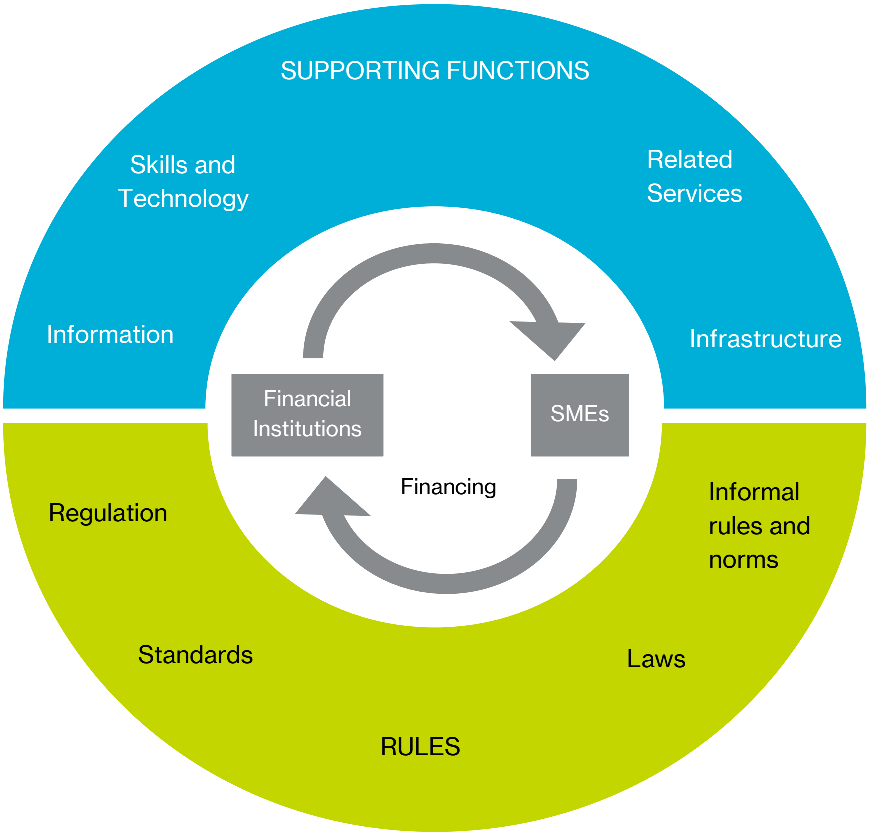



*Figure 1. SME Financing Market System*

By way of understanding the framework, the team also sought to recognize what were other factors that affected financing SMEs. This led to addition of questions on financial management, business operations, and other practices that SMEs have that might affect their need for financing. The team also sought to understand what the current support systems for SMEs are apart from access to finance, what are the regulations on SME financing, and what are other ways that SMEs acquire capitalization.

By doing so, the team was able to identify other interventions that may be able to increase access to finance, rather than simply providing financing. These findings and recommendations will be discussed further in a later part of the report.

## B. Research Methodology

The team utilized a mixed method approach for the study. The methods employed were: 1) desk review of secondary data available on SME, SME financing, and housing market value chain players; 2) remote key informant interviews (KII) through phone calls and online video conferences, and 3) online surveys through the online platform called Kobo Toolbox and phone calls from enumerators.

The consultants developed the research tools in consultation with Habitat for Humanity's Terwilliger Center for Innovation in Shelter and followed the prescribed research protocols set by the organization.

**Document review.** The consultants performed a desk review to create a baseline of the current environment surrounding the SME sector as well as the housing market value chain. The document review allowed the team to identify where the SME actors are in the housing market value chain, and what were the current trends when it comes to SME financing. Alongside this, it also helped identify who are the key actors supporting SMEs, and the current players providing financing to SMEs. This desk review utilized documents and other secondary data available from the web, public repositories, and from the Terwilliger Center.

**Key informant interviews (KII) with industry players.** The team conducted remote and virtual interviews of key informants that were helpful to the study. Key informants included were some SME actors in the housing market value chain that operate in the Visayas region; financial institutions that included commercial banks, a development bank, a fintech company, a rural bank, and a government bank; government agencies that provide assistance to SMEs, and the Department of Human Settlements and Urban Development (DHSUD); and development actors which provide support services to SMEs. The list of key informants included other key players that were also identified by the Terwilliger Center as they deemed fit.

**Online and phone survey data collection.** An online survey tool was created by the team to gather information from Visayas-based SMEs within the housing market value chain. The online survey was fielded to SME business owners through chambers of commerce, DTI regional offices, schools, and industry associations. To be able to reach more SMEs, the team reached out to individual business owners wherein the SMEs were sent the link which fill out in their own time, within the timeframe of the study.

However, although there were numerous visits to the site, only a handful answered the survey. To those that the team reached out to personally, there was a response rate of 16.8%, with only 21 out of 125 agreeing to answer the survey online or through phone interview. This led the team to begin calling SMEs to ask for their participation. Although this added to the total number, more SMEs declined to join the study due to busy schedules. All the same, the survey gathered information on the demographic and psychographic profiles of the SMEs, as well as their financial practices in their business operations and current challenges and constraints that they encountered before and during the COVID-19 pandemic. The results of the survey allowed the team to understand the typical SME actor in the housing market value chain. This activity also identified issues and challenges which can guide the Terwilliger Center in their overall program direction, especially on collaborating with these value chain stakeholders.

**Data collation and analysis.** The team collated the data obtained from documents review, KIIs, and online surveys, and summarized them accordingly. The quantitative data was used to create an over-all profile of the SMEs which included their demographics, psychographics, financial management practices, challenges, and business outlook. The analysis of the data is presented in subsequent sections of this report. With guidance from the Terwilliger Center, presented initial findings that summarized the salient points and report recommendations in relation to the conducted research.

## C. Sampling Strategies

The consultants employed different sampling strategies for the KII and online survey. The selection of informants for KII was done through purposive sampling as the key informants were chosen to represent different stakeholders from the SME housing market value chain actors, financial institutions, government agencies, as well as other development actors. The online surveys utilized a snowball sampling method wherein the current identified SME housing market value chain actors were asked to identify other potential respondents. The team also contacted chambers of commerce and industry associations that fielded the online survey. DTI provided a list of SMEs in the regions covering the Visayas area, which the enumerators used to contact the respondents directly.

## D. Respondents in the Study

The total number of respondents included in the study were 41. 21 were included in the quantitative survey, while 20 were interviewed as key informants in the study. The breakdown of types of actors are the following:

*Table 1. Classification of Respondents*

| Number | Representation | Specific Actors |
|---|---|---|
| 25 | **Small and Medium Enterprises** | Businesses in construction, retail of construction supply, manufacturing of construction supply materials, professional services for housing construction |
| 7 | **Financial institutions** | Dungganon Bank, Landbank of the Philippines, NextPay, commercial banks, such as BDO Unibank and BDO Network Bank, International Finance Corporation |
| 4 | **Government institutions** | Department of Trade and Industry, Small and Medium Development Council, Department of Human Settlements and Urban Development, Center for International Trade Expositions and Missions |
| 5 | **Non-Government Organizations and Associations** | Water.org, Bayan Academy, Primary Structures Educational Foundation, Inc., Subdivision and Housing Developers Association, Inc., United Architect of the Philippines – Cebu Chapter |

For insights on fintech companies, the team reached out to First Circle, PayMaya, Gcash, Coins, and SeekCap but were turned down or said that they would reply if their management approved the request. Other commercial banks were also invited but they turned down the team's request.

For the KII respondents, the team was declined interviews by the Department of Finance (DOF) and the Bangko Sentral ng Pilipinas (BSP) due to scheduling conflicts, as well as their offices undergoing budget season, which made it difficult for them to participate in the study. Nevertheless, the team was able to gather secondary data that covered governance of loans or financing to SMEs. Other government agencies that the team reached out to were SBCorp, the Development Bank of the Philippines, and the Philippine Guarantee Corporation.

# III. GETTING TO KNOW THE SMEs

## A. SMEs in the Philippines

Small and medium enterprises (SMEs) were classified based on two criteria: number of employees or asset size.

| Size | Asset Size (PHP Million) | Employees |
|---|---|---|
| Large | >100 | >200 |
| Medium | >15-100 | 100-199 |
| Small | >3-15 | 10-99 |
| Micro | Up to 3 | 1-9 |

***Source:*** *www.dti.gov.ph*

SMEs, or particularly MSMEs, were identified as a crucial part of the economic climate of the Philippines, with the majority of business classified under MSME. As of 2019, there were approximately 1 million enterprises registered with the DTI, with 10.5% classified as either small or medium; 89% of enterprises were microenterprises, with barely 0.5% registered as large corporations[2]. All SMEs regardless of industry were required to be registered with the DTI to acquire their business permits, registration with the Bureau of Internal Revenue (BIR), and any other license as required to them by the industry in which they were part of. In total, SMEs generated almost one-third of employment in the Philippines, which translates to 2.87 million formal workers. This is regardless of industry and type of work, while informal workers were covered by and employed by microenterprises.

In terms of geographical distribution, almost a quarter of SMEs are situated in the National Capital Region, followed by CALABARZON, Central Luzon, and Central Visayas. The Visayas region alone has more than 163,000 micro, small, and medium enterprises. Although there are some SMEs in Western and Eastern Visayas, the majority of which were still concentrated in Central Visayas – particularly in the province of Cebu.

The government has seen the importance of MSMEs in the Philippines, and created Republic Act 6977, or what was known as the Magna Carta for Micro and Small Enterprises. This Magna Carta strengthened the definition for SME classification, as well as identified support that government agencies are to provide to SMEs. One important outcome of the Magna Carta was the creation of the Small and Medium Enterprise Development (SMED) Council, which was housed under the Department of Trade and Industry.

[2] Bureau of Small and Medium Enterprise Development. (2019). *SME Industry Snapshot and Opportunities*. Department of Information and Communications Technology. https://www.dict.gov.ph/wp-content/uploads/2016/07/8.-SMEs-in-the-Philippines-_Empowering-LGUs-through-ICT-Partnership-with-SUCs.pdf

Under the SMED Council, efforts for empowering, supporting, and financing small and medium enterprises were created. In addition to this, the national government also enacted the MSME Development Plan, in which the following strategies would be employed to support MSMEs:

1. Promoting a Business Enabling Environment
2. Enhancing Access to Finance
3. Enhancing Access to Markets
4. Improving Productivity and Efficiency

The first strategy allowed for the creation of the Barangay Micro Business Enterprise (BMBE) Act and the Go Negosyo Act. These two acts provided support to microbusinesses and SMEs, respectively. The BMBE act provided incentives to micro businesses such as tax exemptions, while the Go Negosyo act gave assistance to SMEs to facilitate access to support services such as technical assistance and advisory services through Negosyo Centers set up nationwide. For access to finance, the Magna Carta led to the creation of the Small Business Guarantee and Finance Corporation, now known as Small Business Corporation (SBCorp). SBCorp was tasked to provide SMEs with access to finance through loans, venture capital, financial leasing, secondary mortgage, or rediscounting of loan papers to small businesses. In addition, the Magna Carta also mandated the BSP to allocate a portion of the banking portfolio for SME financing.

The government's strategy on access to markets was driven by their promotion of trade fairs and support to SMEs that participated in international business conferences and expositions. In terms of improving productivity and efficiency, different government agencies provided support to SMEs in the form of shared support services and facilities. Different offices under the Department of Science and Technology (DOST) provided shared access to SMEs to machinery, equipment, and tools that they needed to improve production. DTI also provided training and workshops that allowed SMEs to improve their skills and knowledge in running their businesses. They also assisted SMEs in the agriculture and tourism industries to create industry clusters that increased production efficiency and develop to export.

These strategies by the government coincided with the challenges that SMEs constantly faced, even before the pandemic started. SMEs were challenged with the lack of access to finance, lack of access to technology, and lack of availability of inputs. SMEs also suffered from a lack of access to markets. Primary obstacles to market access among SMEs were inadequate business operations, human resources constraints, difficulties complying with international standards and government regulations, inability to compete with competitors, marketing and branding constraints, inadequate infrastructure and distance to markets, lack of access to finance, lack of access to market information, and shifting consumer preferences[3]. In addition, SMEs were also plagued with constraints in terms of poor cash flow and lacked access to training programs that could enhance their business management skills.

## B. SMEs in the Housing Value Chain

The team, in consultation with Habitat for Humanity's Terwilliger Center for Innovation in Shelter, identified key industries that are related to the housing value chain. These industry classifications were based on the Philippine Standard Industrial Classification (PSIC). The chosen industries were as follows:

- Construction
- Financial and insurance activities
- Information and communication
- Manufacturing
- Mining and quarrying
- Professional, scientific, and technical activities
- Real estate activities
- Water supply, sewerage, waste management and remediation activities
- Wholesale and retail trade; repair of motor vehicles and motorcycles

These industries were chosen due to their proximity to housing activities. The majority of enterprises that fell in these industries provided crucial products and services that were needed in housing construction. However, it has to be noted that although the SMEs included in this study were part of these industries, they did not solely cater to clients with housing construction needs, but to construction in general.

The housing value chain illustrated below shows the different activities that were required to ensure that low-income families had access to decent housing. These activities began with assistance to secure land and tenure all the way to ongoing support services under community development – activities that create an enabling environment for low-income housing. In this value chain, the SMEs were situated from steps 3 through 6, which cover financing, building materials, design and building skills and services, and housing. These were the usual products and services that SMEs provide to low-income households at affordable rates.

[3] Francisco And Canare, D. J. P. T. (2019). *The Challenges to SME Market Access in the Philippines and the Role of Business Associations*. https://apfcanada-msme.ca/research/challenges-sme-market-access-philippines-and-role-business-associations

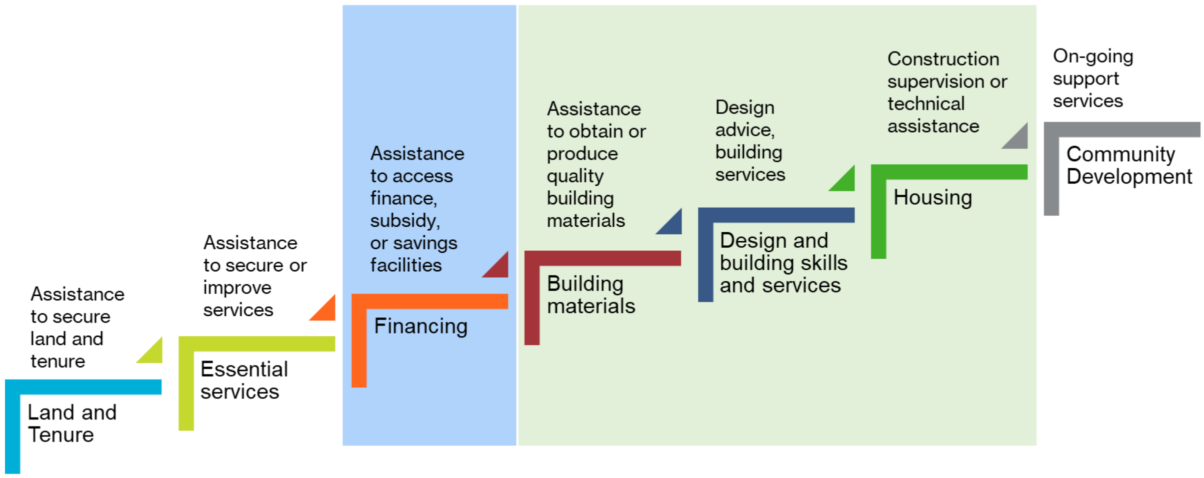



*Figure 2. Housing Value Chain and SME Actors*

In the study, DTI classified only a handful as directly related to the housing value chain. The majority of SMEs were Included in the study were SMEs under construction (38%), manufacturing (24%), retail of construction materials (33%), professional and technical services (19%), and information and communication (5%). Construction SMEs provided services that constructed houses for low-income to low-middle-income households. SMEs under manufacturing produced products such as hollow blocks and lumber, as well as other housing materials, which were bought and used by low-income households to build their houses.

Professional and technical activities included services that utilized special knowledge of professionals such as architects, surveyors, engineers, electricians, and the like. Information and communications providers such as media groups provided meaningful information to low-income households on choosing and building good quality houses. Although none were included, some SMEs also provided financing options for low-income households such as short-term housing loans. These SME players were mostly non-banking financial institutions that provided housing finance for low-income households through microfinance. In addition, some players providing financing for low-income households were catered by microfinance institutions (Terwilliger Center, 2017).

The study was able to receive results from respondents in the provinces of Cebu, Aklan, Negros Oriental, Negros Occidental, and Iloilo. Of those included, 80% were in urban areas, 10% in rural, and 10% in peri-urban areas. The respondents included in the survey were mostly the owners or proprietors (62%) of the businesses, with 57% owning multiple businesses. Some SMEs had related businesses, such as construction or manufacturing businesses also owned retail stores, while some had businesses that were not related, such as agricultural businesses or textile manufacturing. One peculiar finding of the team was that 81% of the respondents were male.

The business owners had varying lengths of entrepreneurial experience - 52% were new business owners (1 – 5 years), while 48% were experienced entrepreneurs (48%), with the majority of the SMEs registered as sole proprietorships.

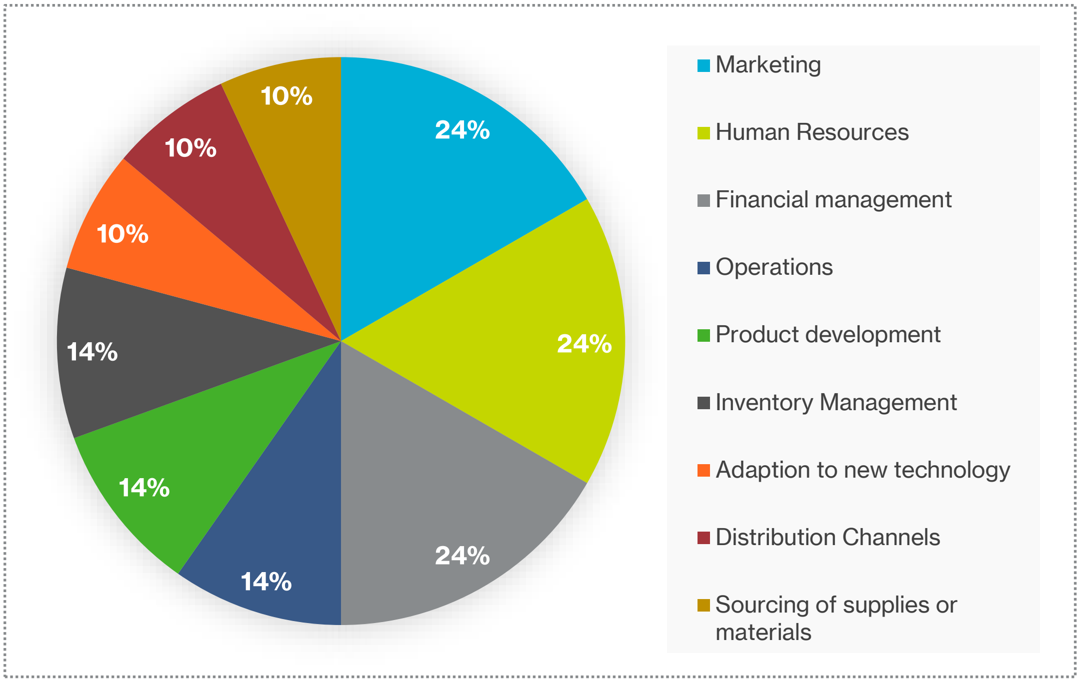
Approximately 90% of the businesses catered to retail clients, which meant that they sold their products and services to individual households; the majority of these SMEs catered to lower middle income to middle income (68%) and low-income households (21%). This proved that the SMEs in the housing value chain catered mostly to the same households that the Terwilliger Center was hoping to assist – households that participated in owner-driven construction. In addition, the respondents with low-income clients shared that their transaction size varied from anywhere between PhP5,000 to PhP200,000, with an average transaction size of PhP45,500, or roughly around USD1,000.

The average asset size of the SMEs surveyed in the study was approximately PhP55 million, with a range of PhP500,000 to PhP60 million. The SMEs reported that they averaged gross monthly sales of PhP5 million, with their individual revenues ranging from anywhere between Php5,000 to PhP10 million. These figures showed that SMEs in the housing value chain are capital intensive, with most of their assets going into business operation costs such as services and construction supply.

SMEs in the housing value chain identified product development as their key strength, as they had continuously created products and services that serviced the housing needs of their clients. Housing value chain SMEs cited design and development as their strength, such that they were keen to adopt new technologies to be able to delight customers with their products. However, they also shared that there were some challenges they faced which were not related to financing.

The figure below shows what were the self-perceived challenges of the SMEs in the housing value chain. Quite a number said that financial management and human resources were their main issues, primarily since they were not trained to handle business finances and had a difficult time with billing and payment processes. This was also validated by key informant interviews with financial institutions which said that their concern with SMEs was that the latter did not have proper financial reports, and when asked for reportorial requirements, were lacking or were not recorded properly.

*Figure 3. Main challenges of SMEs*




Human resources was another main issue, as there was a lack of skilled labor that the SMEs needed in their specific industry. Marketing was also an area that SMEs were concerned about since they experienced difficulties in acquiring new businesses and managing difficult old clients. This allowed the team to understand what SMEs were facing that not only contributed to their need for financing, but also what hindered it.

## C. SMEs and the COVID-19 Pandemic

SMEs were severely affected during the COVID-19 pandemic. According to statistics from DTI, over 73% of MSMEs closed their business after one month of the enhanced community quarantine (ECQ) in 2020. In a study conducted by the International Trade Centre[4], SMEs suffered from lower sales, difficulty in accessing inputs, reduced logistics services, and non-payment of their clients. World Bank also reported that 66 percent of SMEs reported liquidity constraints, with those who did not have enough cash to pay for business expenses beyond one month. Not only the firms were affected by liquidity pressures, but also the ability to sustain their operations was compromised because of closures or reduced availability of domestic suppliers.

[4] International Trade Center. (2020). *Promoting SME competitiveness in the Philippines: Compete, connect and change to build resilience to crises.* https://www.intracen.org/uploadedFiles/intracenorg/Content/Publications/Philippines_SME_v6.pdf

The findings of the previous studies were further validated by the SME respondents of this study, 72% of whom suffered an average loss of 52% in their net income. Half of the respondents had lost their customers altogether, as the lack of income was also experienced by their clients. Out of the total respondents, 19% expressed difficulty in the procurement of supply, citing disruptions in their supply chain as a reason for either delayed supplies or unavailability of some materials. Unfortunately, 19% of the respondents also shared that these conditions required them to close their operations temporarily.

Even before the pandemic, access to finance was already a constraint for SMEs, and continued to do so as more firms relied on their family and friends for loans. SMEs reportedly liquidated their assets to continuously fund their operations. Operational challenges were mostly felt by small enterprises, reflecting the need for liquidity. Because of these, firms reported a reduction in sales, cash shortfalls, and falling behind in payments compared to large firms.

To add to this, some financial institutions shared that their board of directors had changed directives to lessen exposure to loans, as the risk of default was high. Although some respondents shared that they needed assistance in meeting overhead costs such as rent or staffing payments, only 5% answered that they would require zero-interest loans or financial assistance to help them cope with the effects of COVID-19. Almost everyone has preferred assistance in the form of more information or training to help make business decisions in times of crisis.

This pointed to a need for SMEs to be trained on creating Business Continuity Plans (BCP) which allow business owners to install risk management practices and contingencies in case of emergencies. In addition, 38% requested that they be provided with equipment and software allowing customers or clients to change the way they engage with the business. This now proved the need to shift to innovative technology that can provide business solutions to SMEs, allowing them to use online platforms for payment or purchase of goods and services such as e-commerce platforms.

Further adding to the need for innovative technology solutions, 24% of SMEs wanted to have equipment and software that allowed their employees or workers to work remotely. Granted, there were still facets of their operations – such as construction – that still relied on face-to-face work. Lastly, 24% simply needed better access to capital or finance and not necessarily zero-interest loans or handouts. Business owners understood the need for financial institutions to charge interest rates, and they did not expect to be treated differently, as they themselves were also business enterprises. If there are any positives, 66% of firms surveyed have adopted or intensified the use of the internet, social media, specialized applications, and digital solutions in various business functions. Aggressive use of digital solutions made a substantial impact in terms of revenues: 10% of sales were reportedly derived from it.

One caveat is that small firms were less likely to utilize digital technologies compared to medium and large firms. In addition, SMEs noted that inadequate regulations on e-transactions and inadequate personal data protection hindered their transition to utilizing digital solutions[5].

[5] World Bank. 2021. *Impacts of COVID-19 on Firms in the Philippines: Results from the Philippines COVID-19 Firm Survey conducted in November 2020. World Bank, Washington, DC. © World Bank. https://openknowledge.worldbank.org/handle/10986/35430 License: CC BY 3.0 IGO.*

# IV. SME FINANCING

## A. Current State of SME Financing

This study also sought to understand the financial practices of SMEs in the context of their need for financing, as well as the current environment for SME financing. As previously mentioned, the Magna Carta for SMEs led to the creation of support machinery from the government, the majority of which were housed under DTI, and included financing from the government. Through the Magna Carta, SBCorp was created and mandated to provide financing to SMEs, whether through outright loans, wholesale loans to financial institutions offering SME loans, or even investment through venture capital. It was also under the magna carta that the BSP was mandated to set aside a total of 8% of the total loan portfolio as support to SMEs. In addition, financial institutions under the BSP that did not follow this mandate were to incur administrative sanctions and a non-compliance fine of not less than five hundred thousand pesos (PhP500,000). However, this was not enough to sway financial institutions to the business opportunity of supporting SMEs.

> “*Banks usually do not prefer the mandatory allocation. In fact, they oppose every time the Magna Carta is amended whenever the mandatory allocation lapses [after 10 years] but on the version of the house bill, the substitute bill on the Magna Carta the mandatory allocation is still there. Banks say they shouldn’t be regulated in that way, but incentivized instead and not penalized. They say they actually lend to SMEs. They are required to allocate 8% to micro and small, and 2% to medium enterprises. This is challenging for rural banks because sometimes, medium enterprises’ financing needs are larger than their portfolio. It was then revised to 10% provided that at least 1% is allocated to medium. During public hearings, banks are asked for their comments and inputs on the major provisions of the bill.*” – Maricor Bañaga, DTI-SMED

In addition to the support mandated for SMEs through the Magna Carta, the government has increased financial support to SMEs especially in light of the COVID-19 pandemic. Primarily through SBCorp, the government allocated an additional PhP1.5 billion to support businesses affected by the ECQ (Philippine Chamber of Commerce and Industry, 2020). This funding, aptly called the Enterprise Rehabilitation Fund (ERF), were made available to SMEs to assist rehabilitation after the lifting of ECQ.

The table below shows the creation of financial products through government agencies that were meant to support MSMEs to rehabilitate after the pandemic:

*Table 2. Government-funded Financial Products for MSMEs*

| Agency | SBCorp | | | MSME Credit Guarantee Program |
|---|---|---|---|---|
| **Financial Product** | Pondo sa Pagbabago at Pag-asenso (P3) Program | COVID-19 Assistance to Restart Enterprises (CARES) Program | Helping Economy Recover thru OFW Enterprise Start-Ups (HEROES) Program | Credit Guarantee for MSMEs |
| **Features** | • Enterprises not exceeding PhP3 Million in asset size are eligible<br>• Loan amount of PhP5,000 to PhP200,000 | • Enterprises not exceeding PhP3 Million in asset size can lend from PhP10,000 to PhP200,000<br>• Enterprises with asset size between PhP3-15 Million can borrow loan amount up to PhP500,000 | • Returning OFWs who want to start their own business<br>• Loan amount of PhP30,000 to PhP100,000<br>• Required to attend Philippine Trade and Training Center's online training for start-ups | • MSMEs affected by COVID-19 are eligible<br>• Maximum of PhP50 million loan amount per borrower<br>• Guarantee covers 50% for working capital loan and 80% for capital expenditure<br>• Valid until September 2021 |
| **Interest Rate and/or fees** | 2.5% per month | • Zero interest<br>• 6% service fee for loans not exceeding 18 months<br>• 8% service fee for loans exceeding 18 months | Zero interest | • 1% guarantee fee per year<br>• PhP5,000 amendment fee |

Most commercial and rural banks offered business loans prior to the pandemic without necessarily tagging them as SME specific. Retail banking rules allow for loans of PhP500,000 and above to be provided to clients for business purposes.

However, despite the existence of numerous channels for MSME financing, respondents still answered that it was not that easy to access. One SME key informant shared that he had difficulty in accessing loans due to the tedious process of application. He explains:

> "*Our experience with loans was bad. The first question [that they ask you] is what do you own? Do you have hard assets, do you have properties under your name? The banks are playing it safe and it's difficult when you have to go through that route. It all goes around the issue of funding because there's no access to capital. You can't loan, since there are no assets to collateralize and it's very difficult to go around and hope that you can actually get some funds. It also affects our human resources since our sources are limited.*" – SME owner

Unfortunately, this was not an isolated experience. Other respondents in the survey answered that the capital they used for their business came from their own savings (86%) or from the financial support of their friends and family (5%). Only a few were able to acquire loans from banks for capitalization (10%), and there were also some who shared that they reached out to non-banking financial institutions (5%) such as microfinance institutions, cooperatives, or non-government organizations (NGOs) for their start-up capital. This also proved a continued dependence of SMEs on internal sources of financing, not only during their start-up phase, but also in the day-to-day operations of their business. Thus, SMEs have been slow to grow and expand and were unable to access funds due to a limited track record, limited acceptable collateral based on banking regulations, and inadequate financial reporting and business plans.

About 50% of the respondents admitted to having experienced taking out a loan for their business. However, only 10% took out loans from a commercial bank, another 10% accessed loans from non-traditional financial institutions, and 5% applied for a loan with a private lending institution. The rest (25%) of the respondents admitted to turning to friends and family, who offered non-interest-bearing loans.

For those who were not able to apply for loans, their reasons were that: 1) they were not familiar with the financial product, 2) there were too many requirements asked by the bank, and 3) in the construction business, they needed longer-term loans, which were not available with their financial institution. In one case, the respondent shared that she did not access a loan because the financial institutions in their area would not lend to people who did not graduate college.

This should not be taken as a sign of SMEs as being financially illiterate. In fact, SME respondents reported having their own personal bank accounts (90%) in commercial banks, but only 24% had corporate accounts in commercial banks. Despite this, SMEs still found the need to open accounts in non-traditional financial institutions such as microfinance institutions, cooperatives, and NGOs, with 1 in 4 having personal accounts and only 1 in 20 with corporate accounts.

One interesting finding of the study was that there were SMEs who had begun adopting financial technology solutions – 14% of SMEs said they opened their own personal digital wallet, while 5% admitted to having a corporate digital wallet. This showed the need for innovative financial products that suit the evolving needs of SMEs, in this case, an online platform to handle payments from clients and suppliers.

When asked what other financial instruments they needed to improve their business, 38% admitted that they would benefit from business loans, and 33% were more interested in credit lines from banks. Interestingly, another 38% wanted to learn more about investment products that can help them manage their funds. When it came to loans, however, SMEs had an average loan size of approximately PhP900,000, although they admitted that they desired an average loan amount of PhP3 million.

This evidenced the disparity between what were the present loan products available in the market with what was needed by the SMEs. This disparity often led to a mismatch between supply and demand, thereby adding to the concern of lack of financing for SMEs. As business owners, the SME respondents understood that business loans work better when invested back into their operations, which was why, when asked about their need for financing, they would use it for the following:

- Additional equipment – using the funds to acquire equipment that they could not afford given their cash flow constraints
- Business development – investing in skills training for their staff, streamlining services
- Capitalization for expansion – addition of new products, product diversification
- Additional capital for business – covering overhead expenses, being able to front expenses for construction business wherein clients ask for lower down payments and repayment takes a longer turnaround period, purchasing additional inventory

Given this scenario, SMEs still consider financial access as a major constraint to survival and growth. When compared to its' neighbors, SME loans in the Philippines only accounts for 3.1% of the gross domestic product (GDP) in 2014, which was much lower compared to Thailand, Malaysia, and Indonesia. As of 2018, BSP reported that SME loans from various financial institutions constituted around 6.6% of the total portfolio in the banking system – which was still lower than what was mandated in the Magna Carta for SMEs.

## B. SME Financing Market System

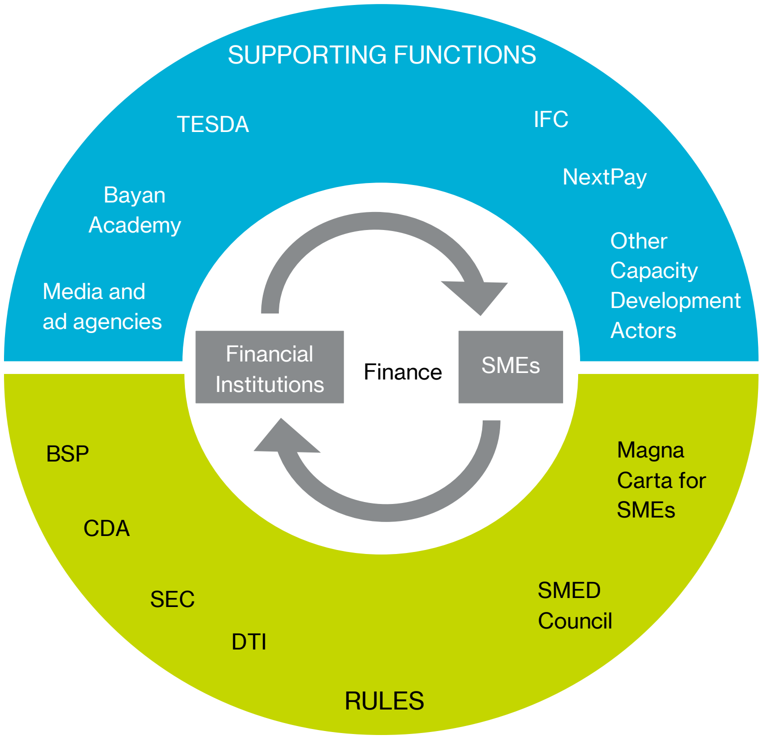



*Figure 4. SME Financing Market System*

The study allowed the team to identify the actors that contributed to the market system surrounding SME finance. On the supply side, there were the financial institutions which provided financial products and services that SMEs can use to finance operations. On the demand side, there were the SMEs which required financial access for a myriad of reasons.

There were also other market actors such as non-government organizations and government agencies that provide support to SMEs.

This support came in the form of technical assistance, advisory services, training and workshops, and skills enhancement. These were also the same actors that provided information and access to innovative technology that SMEs could use to improve their product and service offerings. Rules governing finance for SMEs were primarily governed by the central bank or Bangko Sentral ng Pilipinas, tasked to regulate banking and finance in the Philippines.

As such, BSP has provided some guidance to formal financial institutions when it came to SME financing. Although the Cooperative Development Authority (CDA) and the Securities and Exchange Commission (SEC) governed informal financial institutions, these two government agencies did not have specific rulings when it came to SME lending. This was primarily because their mandate did not provide for shepherding financial services that were provided by the institutions within their jurisdiction.

This section will discuss the intricacies of the supply and demand side of SME financing.

## C. Supply Side: Financial Institutions

Financial institutions, whether formal or informal, were the main supplier of financing to SMEs. It was important to note, however, that majority of non-banking financial institutions (NBFI) such as microfinance institutions, cooperatives, and NGOs fundamentally provide financial services that cater to microenterprises. This meant that the financial products would not be able to cater to large loan amounts that SMEs generally required for their business operations. Given this, it was the formal financial institutions that were poised to have the financial muscle to be able to address financial needs of SMEs.

However, banks that were interviewed echoed the same sentiment: SMEs were difficult to finance and were usually shunned due to poor credit history, insufficient collateral, insufficient proof of sales or income, poor cash flow management practices, unstable business types, and poorly made business plans. In addition, banks admitted that there were large transaction costs faced by both the bank and SMEs when processing loans. Banks are sensitive to risks in lending to SMEs, especially when proposed projects do not quality as bankable or viable. Larger commercial banks are also averse to processing numerous small transactions, as this increases transaction and labor costs.

As if this wasn't difficult enough, banks themselves also faced constraints in providing SME financing. BSP regulations provide stringent rules on loan amounts, types of loan, and collateral requirements for lending facilities. One commercial bank representative explained, saying:

> "*We require collateral, real estate inclusive of residential and commercial properties. The loan we require should be fully secured. Basic requirements are: application form, two valid IDs, marriage contract, two years ITR with financial statements, photocopy of the title on the property offered as collateral, sketch plan of the property, business permit, DTI permit or business registration papers and latest one year bank statement. Most of these requirements are easily available since these are mandatory requirements for you to qualify because we will also have a difficult time getting your loan approved if you do not comply with those requirements. The ones who experience challenges in acquiring these requirements are the newly established or start-up businesses because one of the qualifications is that your business should be operational for at least two years. So, for those start-ups, they really don't qualify. Another option is, let's say you have a start-up business, and you have another existing business that has been operational for at least two years, then that can qualify.*" – BDO Unibank

These loan policies did not allow for flexibility when offering lending facilities to SMEs. Inasmuch as some banks are open to supporting SMEs, they were also required to report to BSP and had to follow regulations.

Another constraint mentioned were asset liability management risks. Although SMEs require short-term loans for business capitalization, some SMEs require financial instruments that allow them to tide over their cash flow requirements – which is even shorter than usual loan terms. Bridge financing – or a loan that allows SMEs to cover for costs or obligations requiring immediate cash flow – was still not practiced in the Philippines but would provide for a more suitable financial product for SMEs.

This type of loan was not yet offered by commercial banks that were included in the interviews, predominantly because of stringent banking regulations. Hard assets such as real estate and chattel mortgage were still required from SMEs, who usually did not have business assets in real estate or chattel. Majority of SMEs shared that their assets were tied up in their inventory, and in the case of construction businesses, their assets were poured into their current construction project.

To be able to cope with the growing demand of financing from SMEs, some banks have experimented on innovative ways that they can provide financing for SMEs. One banker included in the interview stated that they provide the following:

> "*We have SBL or small business loans, commercial loans and others. Specific products or services that we do provide for SMEs, including owner-driven construction, are loan lines which help them bridge the liquidity gap, term loans which is mainly for CAPEX acquisition, building construction or permanent capital, and trade related transactions like bank guarantees and LCs. We have other products, but these are the basic ones, it all depends on their needs.*" – Commercial Bank

Offering other products to SMEs have been the strategies of other banks as well, in order to create credit history with SMEs which will allow them to lower financial risks in offering business loans. This allowed some banks to be innovative and provide financing to SMEs that were their depositors. Some banks also resorted to providing unofficial non-financial services such as providing technical advice to their SME clients. This, however, was not standardized and heavily depended on the strategy of the bank officer, as well as the directive of top management. In one case, the bank head was instructed by their board of directors to slow loan releases to businesses in their area, but instead, he increased releases to SMEs in the construction sector as he observed the trend of continuation of operations for construction businesses in line with the government's increased spending on the Build, Build, Build Program.

These innovations in providing SME financing gave these banks an opportunity to support SME but at the same time, manage their financial risk and support economic rehabilitation especially in the time of the pandemic.

However, it should also be noted that financial support needed to go hand in hand with support services for SMEs. Landbank shared during the interview that their biggest concern with financing SMEs is the lack of accurate financial reporting. To them, financial reporting was crucial as it is their sole basis on what is the financial need of the SME as well as capacity to be able to repay the loan. They further shared that:

> **"***I'm not an expert on [housing] although, I do see that there is really a need for banks to help, for us to be responsive to the client's needs. But there is also a need for clients to exert effort and to be transparent. Every information should be disclosed because banks are only dependent on the information we will get based on the checking and the disclosure of the client.*
>
> *More than ever, the banks should work together and be transparent. Our attitude as a bank is that we are not in the business of real estate. It doesn't matter to us if you're fully covered or not, what matters to us is that you have a good business, your business will be able to pay for the loan that you contracted and that you will be able to grow from the financing you got. Because if you don't, there is no point of having a bank loan. If you're not willing to risk [personal] assets that you have, it means you don't trust your business. Then why will the bank risk as well*?" – Landbank of the Philippines

Landbank also pointed out the risk of funding mismatch – such that the loan provided to the SME may not cover their financial needs, thus leading to the SME to end up with cash flow problems or becoming over-indebted. It was reiterated that this can only be observed if there are accurate and timely financial reports provided by the SMEs. However, it is to be noted that not all SMEs are able to provide financial reports due to lack of skills in financial management. To this, majority of the key informants highlighted the importance of technical assistance when it came to improving SMEs' business skills.

As such, some support services that go hand in hand with financing were the training and workshops provided by government agencies such as the Go Negosyo Centers, CITEM, and the Philippine Trade Training Center. There were also some development actors which shared that they provided skills enhancement training programs for SMEs, such as Bayan Academy and PSEFI.

Despite that, these support service providers admitted that most of their training programs supported SMEs that were in agriculture, food manufacturing, and other cottage industries, and that they were not equipped to support SMEs that were specifically participating in the housing value chain.

## D. Demand Side: SMEs

At the demand side of the financing market system were the small and medium enterprises that supported the housing value chain. The research showed that SMEs intended to expand the size and scope of their businesses and that internal funds alone were not sufficient to finance this expansion, thus the need for financing. In a report by the World Bank, SMEs in the construction sector expressed desire to improve their liquidity through preferential access to new loans, regulatory relief (suspended, reduced, or waived fees and payments for licensing, registration, permits, and inspection), deferral of loan payments or rent, mortgage, and utilities, and tax reductions or deferrals.

> "*It was all personal funds. It's either you borrow from friends and family or whatever we saved up when I was working for another firm all served as my starting capital to set up the projects. And as projects come along, we set aside money to invest in equipment, grow our assets in terms of machinery, equipment, vehicles. Eventually, that's what the banks should look at, but it all comes down to your financial statements. It's all listed in our assets and liabilities. It's what PCAB looks at when you apply, that you have so much equipment. What I learned from the banks is what they look at more is what your cash flow was and if you have actual physical assets like land to be able for you to get any kind of credit line.*" – Ar. Ian Bautista

Access to finance was tricky due to documentation requirements from banks. Across the board, banks asked for the following:

1. Financial statements, preferably audited financial statements from 2 – 3 years of operations
2. Collateral, preferably real estate or chattel, but in some cases, deed of assignments and receivables would be accepted, along with the deed of deposits
3. Credit history, usually in the form of deposit relationship with the bank, with high average daily balances that need to be maintained

When the SMEs were asked about the bank requirements, the majority expressed that these documentation requirements were difficult to complete. Firstly, they admitted to underreporting net income to lower tax expenses. This then led to a skewed valuation of the financial need of the SMEs, with the outcome being that the loan amount was much less than what the SMEs needed. Second, SMEs shared that they were averse about having to put all their personal assets at stake for the business, with a risk of losing their personal property. In their understanding, business loans needed to be tied to business assets and used for business operations and were not interchangeable with their personal assets. Thirdly, SMEs agreed that having to keep high minimum balances in commercial banks also affected their cash flow.

Due to the requirement of minimum balances for a corporate account, there was a source of capital or cash that they could not use which made it more difficult to manage cash flow. On average, commercial banks require a minimum deposit and maintaining balance of PhP50,000 or USD1,000.

When asked about what areas of their business they would like to receive assistance in, access to finance (30%) topped the list. However, other than finance, there were other kinds of assistance which they identified, such as: marketing, human resources, and financial management. Some areas they identified were the following:

*Table 3. What Areas Would You Need Assistance for your SME?*

| AREAS OF ASSISTANCE NEEDED | |
|---|---|
| **Access to finance** | 30% |
| **Marketing** | 25% |
| **Human resource** | 20% |
| **Financial management** | 20% |
| **Adaption to new technology** | 10% |
| **Sourcing of supply or materials** | 10% |
| **Operations** | 5% |
| **Inventory management** | 5% |

SMEs identified difficulty in getting new clients and struggling with customer service whenever clients were not satisfied – all aspects of marketing. Human resource concerns revolved around the lack of skilled labor, admitting that they needed to invest in training their human resource to increase operations efficiency.

SME owners themselves felt that they did not receive the proper training as business owners and so, training them in improving their skills was crucial. Another SME shared that, “it is a challenge to look for skilled workers especially during the pandemic,” which added to the strain on their human resources. Some of their staff were also not trained on providing good customer service, which led to a loss of clients.

Financial management was another area of difficulty for SMEs. For most of the SMEs which had construction businesses, cash flow was challenging due to the nature of their business. They answered that for them to be able to begin a construction project, they already had to front the cost of acquiring the land, not to mention the cost of labor and materials to commence the project. These were all costs that the SME carried, and if they were lucky, they could either be financed or the client paid the down payment.

The pandemic added a layer of challenges as it created price fluctuations and supply chain disruptions to imported construction materials. Financial management issues were also discussed in the context of receivables. The SMEs reported that their receivables were increasing, and in some cases, would have to extend terms especially if their clients were not able to pay. This again added burden to cash flow management. SMEs admitted having trouble accessing finance from formal financial institutions because of stringent requirements. This then hindered their capacity to purchase needed upgrades for equipment and technology, and in some cases, also caused a delay in acquiring inventory and supply. The business owners understood that it was important to invest in emerging technologies that could help make operations efficient and lessen production costs, but the absence of financial support made it hard to purchase these technologies. Another difficulty in their supply was that suppliers discontinued credit lines that they used to avail of. SMEs were able to prevent the constraint of lack of access to finance by enjoying credit lines with suppliers. However, the pandemic also caused cash crunches with suppliers, who then had to impose purchasing supplies on cash-basis.

When asked then what kind of assistance they required and would prioritize, the SMEs stated the following:

1. Capacity building such as training or workshops on the topics of financial management, business development, and customer service;
2. Support from associations or chambers of commerce when it comes to professional development, exposure to potential clients, and networking;
3. Access to finance, such as low interest rates, preferably for receivables financing or bridge financing;
4. Credit lines from financial institutions, such as banks, which would allow for some breathing room for SMEs whenever they need additional capital or purchase of equipment; and
5. Assistance on marketing and new technology for materials innovation.

These priority items identified by SMEs were important in setting the context around their need to access finance. The study showed that the issue was not that there were no providers of finance to SMEs, but that there was a mismatch of what the SMEs were able to provide and what the banks, as well as the regulatory agencies, required from them. There are also nuances, such as lack of skills in financial management on the part of business owners, which made it challenging for them to properly assess and produce the appropriate reports to support their need for finance.

The research team was also able to reach out to development actors such as DTI and Bayan Academy, who shared that they provided technical assistance to SMEs year-round. They also added that TESDA, CITEM, Go Negosyo, and other government agencies, constantly provided support to SMEs for professional and skills development. The gap indentified, however, was that the SMEs were not aware of the existence of such development actors. In the case of DTI, SMEs assumed that they were required to register with DTI but did know that there were support services like training and mentoring, which they could avail of. To be able to address the needs of SMEs for financing, it is important to have a more holistic and well-rounded approach, rather than simply providing more lending facilities.

# V. CONSTRAINTS AND OPPORTUNITIES

Evidence gathered shows that the market system of SME financing is a complex one. It was key to understanding the enabling environment that surrounded the factors which affected the demand and supply of SME financing. Although there seem to be sources of SME finance, the World Bank cited that it is lack of awareness that is driving low engagement from the SME sector to avail of financial and support programs from the government[6].

This is also one main finding that can be seen in the study – that there are actors providing SME finance, but this is not known to SMEs and, for those that do know about, there is a difficulty in access to finance. Although there are various ways in which the government has provided support, along with private sector actors which can give out financing and technical assistance, SMEs are still unaware of these types of support and the actors behind them. Here are some potential solutions and opportunities that can address constraints to SME financing:

1. **Loan Application Process.** The loan application process, along with the document requirements, was a recurring constraint identified by SMEs. Some banks also expressed that the process is tedious and costly for them as well. One potential solution is improving the application process by integrating it into an online or tech-based system. Some of the commercial banks included in the study shared that during the pandemic, their shift was to make loan applications online – SMEs could take photos of their document requirements, take videos of their business operations, and submit all these through email. This not only made the process faster for both the client and the bank, but it also decreased exposure to COVID-19. Some fintech platforms such as GCash, Coins.ph, and NextPay have all transferred their Know Your Customer (KYC) procedures online, which made it much quicker to open accounts and use their services. These platforms can be used as a model for improving the loan application process.

2. **Lack of collateral for SMEs.** Requirements for hard assets were another constraint that disincentivized SMEs to access finance from formal financial institutions, even if their interest rates were lower than informal financial service providers. Moreover, prudent financial practices also dictate that personal and business assets should be separated. One way to address this issue is to create a guarantee fund which serves as innovative collateral for the SMEs. The MSME Credit Guarantee Program (MCGP) has begun offering this and as of February 2021, a total of 8,839 SMEs were assisted by this credit guarantee. However, as previously mentioned, this is only for a limited time and can only be used in

[6] World Bank. 2021. *Impacts of COVID-19 on Firms in the Philippines : Results from the Philippines COVID-19 Firm Survey conducted in November 2020. World Bank, Washington, DC. © World Bank. https://openknowledge.worldbank.org/handle/10986/35430 License: CC BY 3.0 IGO.*

conjunction with 10 identified banks and financial institution partners of MGCP. This arrangement can be expanded to either lengthen the life span of MGCP, increase the guarantee fund, or partner with more banks and financial institutions to address the needs of more SMEs nationwide. An additional feature can be added such that the SME will need a “big brother, little brother” arrangement with a large firm as a guarantor wherein the big brother is not only the client of the SME, but also vouches to provide technical assistance to the SME. This arrangement creates a win-win approach, where the banks’ financial risks are managed, the SME is provided with support by the large corporation, and the large corporation ensures that they have an SME partner that allows them to stabilize their supply chain.

In the absence of MGCP, Habitat’s Terwilliger Center can also provide or create a guarantee fund or even partner with MCGP to grow the guarantee fund. Similar actors such as Water.org or BuildChange, which also cater to owner-driven construction of low-income households, can also add funds, with the assumption that the pooled funds can cater to more SMEs.

3. **Requirement for credit history, including savings account.** This is one potential solution which can benefit from a partnership with a fintech company. Instead of requiring costly credit history with one bank thereby limiting access to other funds, a transfer of risk could be employed. For this, we can look to the business model of NextPay, a fintech company in the Philippines. As a pay-per-use service for SMEs for administrative and financial services, NextPay consolidates the funds of their SME clients into one account. Since the NextPay platform does not require a minimum balance from the SMEs, this frees up whatever cash the SMEs currently have to plow back into their operations. This intervention may work assuming a partnership with NextPay can be managed, wherein the SMEs are encouraged to join the platform, given technical assistance on how this can assist their financial management practices and improve credit history by creating documentation on the platform in terms of their financial transactions. Another potential solution is the creation of a credit history scoring specifically for SMEs. This service is currently being provided by another fintech company called Ayannah, which has credit scoring services for microfinance clients.

4. **Need for bridge financing.** Bridge financing is a loan product that is crucial for SMEs that need a quick cash flow to replenish their stocks. As such, the availability of other funding sources to SMEs, not necessarily through banks, can help SMEs manage their cash flow and build up their credit history through debt and repayment. In addition, SMEs can be assisted to transition into inclusive businesses that have access to different forms of funding such as equity investments, which come with technical assistance.

Inclusive businesses (businesses which are larger forms of social enterprises) also have access to funding sources from convertible notes and public equity. A potential solution provider for this can be rural banks who are keen on pilot testing bridge financing products and fintech companies such as First Circle that provide access to finance to SMEs. PayMaya and Gcash, as well as HomeCredit, can be beneficial partners for SMEs such that these platforms can front the cash needed by the end-user to the SME so that the latter can purchase the inventory needed for the end-user.

5. **Improvement of regulation.** This pertains to regulations governing financing, and even ceiling prices to housing developers. This is a tricky constraint, as only the government can create and amend laws. The Terwilliger Center, however, can constantly dialogue with the government as an advocate or coordinator with multi-stakeholder coalitions which can push for enabling laws that will allow conducive business environments both in the housing and finance sectors. Some key shelter agencies that the Terwilliger Center can dialogue with are the Creative Housing Action, Shelter Cluster, to advocate for the importance of supporting SMEs within the housing value chain.

6. **Enhancement of business and financial management skills.** SMEs repeatedly shared their lack of skills and understanding of the importance of professional development. However, some SMEs were still risk-averse when it came to loans due to their experience of difficulty in accessing finance. Technical assistance and mentorship on business management is important to address the areas of concern which SMEs have, but these will not be beneficial unless they also have a module that allows the SMEs to have a mindset of a business owner – one who takes calculated risks while seizing opportunities for growth and expansion. Some key partners in this intervention can be Bayan Academy, TESDA, DTI-SMED, and other capacity development providers that can enhance the business skills of the SME.

7. **Low adaptation to technology.** Due to the onslaught of the COVID-19 pandemic, more and more businesses learned the benefits of switching to a more tech-friendly way of doing business. As it is, although there were one in ten SMEs that were open to digital platforms, there needs to be an increased awareness of the benefits of shifting to an online platform when doing business. In addition, there needs to be capacity building for SMEs on how to transition into new technologies. There is also a need to consolidate the different platforms and software that SMEs can maximize to improve their business operations. This intervention calls for partnerships with fintech companies, that can explain and guide SMEs through the transition, but at the same time, capacity development providers that are adept at providing learning experiences for business owners.

8. **Asymmetrical information from service providers to SMEs.** This constraint was a recurring theme throughout the study. The team found out that there were no shortages of financial service providers that offered loans and other financial products to SMEs, and that there were numerous government agencies and development actors that gave training, technical assistance, and mentoring to SMEs. The problem was not the lack of such services, but rather the lack of information dissemination which led to asymmetrical information.

   Development actors were keen on working with the SMEs, yet SMEs were not aware of their existence. This potential solution is the lowest hanging fruit – there needs to be a consolidator of information to increase awareness in terms of the different kinds of funding and financial support from financial service providers, as well as support services and grants from the government. Information dissemination is key for this intervention, and as such, partnerships with media outlets and advertising agencies can help create awareness campaigns on SME support that is currently available. The team and the partner can create an integrated marketing campaign (IMC) that targets SMEs which would benefit from the financial and technical support.

Based on the information that was gathered for this study, the table below summarizes a list of main constraints for SMEs when accessing finance, what are potential solutions and opportunities, and who can be potential solutions providers.

*Table 4. Constraints and Recommended Solutions*

| Constraints | Potential Solutions / Description of Opportunities | Actors / Providers |
|---|---|---|
| **Loan Application Process** | Creative solutions for business application; integration into tech; development of a system with piloted by banking providers | IT solutions providers |
| **Lack of collateral for SMEs** | Guarantee fund as innovative collateral; big-brother and big-sister arrangements with large companies; build a pool of funds with similar players; Habitat's Terwilliger Center as creator/provider of guarantee fund or partner with MGCP | Terwilliger Center, MGCP, Water.Org, Build Change |
| **Requirement for credit history, including savings accounts** | Transferring the risk to a coordinator, i.e. business model of NextPay; innovative collaterals in lieu of savings; credit scoring or background | Fintech companies NextPay and Ayannah |

| | | |
|---|---|---|
| | investigation to build business reputation | |
| **Bridge financing** | Availability of other funding sources available to SMEs; helping SMEs transition into inclusive businesses so they have access to more funding - i.e. equity investments that come with technical assistance; convertible notes; access to public equity; creation of new loan products; credit lines for end-users in purchasing materials to generate financing to SMEs | Financial service providers such as rural banks; FinTech companies such as First Circle that provide loans to SMEs, PayMaya, GCash, Home Credit |
| **Regulatory improvements (financing and home construction)** | Dialogue with government; leverage the active role of Habitat for Humanity as an advocate; multi-stakeholder coalition; push for enabling laws in the housing and finance sectors | Creative Housing Action, Shelter Cluster |
| **Enhancement of business and financial management skills** | Creation of training programs that can guide SME in improving business skills, change general mindset of SMEs around businesses and their risk aversion | Bayan Academy, TESDA, DTI-SMED Council, PSEFI and other Capacity Development providers |
| **Low adaptation of technology** | Increase awareness, and training; support link to actors; integrated information hub; awareness campaigns for adoption of technology into business operations | Bayan Academy, TESDA, DTI-SMED Council, other Capacity Development providers, FinTechs (i.e., NextPay) |
| **Asymmetrical information from service providers (gov't, dev't actors)** | Increase awareness of different forms of funding, financing, and support; consolidator and disseminator of information; awareness campaigns on support currently available to SMEs | Media, Ad agencies |

# VI. RECOMMENDATIONS

Given the opportunities identified in the previous section, this section lists some recommendations that the Terwilliger Center for Innovation in Shelter can take into consideration for future interventions. These recommendations are written with the understanding of the constraints of the mandate of the housing market systems team of the Terwilliger Center, and their limitation as an organization. It can also maximize the partnerships they currently have as well as the work that they have previously done.

**Influencing Policy**

One key element in financing SMEs is policy. As previously discussed, there are policies that hinder the adoption of innovative ways to finance SMEs. These are not necessarily directly related to the creation of new loan products but may also be in the form of guarantees or collateral, or even credit and background investigation of businesses. Constraints under loan application are also governed by BSP policies, which need to be amended for financial institutions to not only address financial needs of SMEs, but also to evolve with the growing need for supporting SMEs.

As such, the Terwilliger Center, can drive conversations and roundtable discussions to support SMEs within the housing value chain. These SMEs are crucial to the continuation of owner-driven construction and need to be provided with support. By shedding light on their constraints, not only does it would gain awareness from other organizations and even the government, but more inclusive solutions can be ideated from a multi-stakeholder approach.

**Consolidation and Dissemination of Information**

Another constraint that repeatedly showed up during the research is asymmetrical information. The research team found that there was several financial and non-financial support provided by government, private sector, and other development actors such as associations and non-government organizations. However, the problem was the lack of knowledge from the SMEs and the difficulty of these organizations to reach out to the SMEs.

In addition, these support organizations admitted that they also lacked the technical skills and knowledge to be able to properly support technical needs of SMEs within the housing sector. As such, the Terwilliger Center can function as a consolidator of information on support provided for SMEs, especially for those in the housing sector, and given their work with the media sector, can be able to better disseminate the information.

**Guarantee Fund**

A difficulty that SMEs face when accessing finance is the lack of collaterals or guarantees. These proved difficult such that banks look to their personal assets rather than their business assets. Rather than support them in their enterprises, banks penalize them for not putting their own assets at stake. When looking at business practices of large corporations, owners do not use their personal assets when growing their companies – they leverage on business assets as well as banking relationships with financial institutions.

This, however, is not available for SMEs. As such, a guarantee fund can assist SMEs by standing as a co-guarantor of their loan. Similar to other guarantee funds, the Terwilliger Center for Innovation in Shelter can either partner with MGCP or create their own. In the latter arrangement, The Terwilliger Center can pool funds with other similar NGOs such as Water.org, BuildChange, and Gawad Kalinga – all organizations that support owner-driven construction and also interphase with SMEs for providing products and services to low-income households.

In addition, the fund can also partner with other development actors that provide technical assistance to SMEs, such as PSEFI and TESDA, to ensure the success of the latter's business operations. This creates a virtuous cycle wherein SMEs are provided holistic support to succeed and pay back their loan, but the guarantee fund also secures that more SMEs can be supported and grow through financial and non-financial support.

# ANNEXES

## Annex 1. The Research Team

***Romeo Arahan, Jr.***

Romeo "Meong" Arahan, Jr. is a research consultant who recently received his master's degree in Global Human Development from Georgetown University in Washington, DC. He graduated with honorable mention from the Ateneo de Manila University with a bachelor's degree in Economics and has had work experience both in the corporate world and in the development sector. Meong has a long-standing career of research and capacity building in the areas of microfinance socially responsible investments. Meong was also the founding partner and finance manager of Praxis Associates, PH, a consulting firm that provided training, development, and technical consultancy, as well as integrated digital marketing and digitization services to development organizations and SMEs all over Asia.

He earned his development work experience as a Program Officer in SEDPI where he led colleagues in providing research, consulting and training. He has conducted several researches with various institutions and has experience in Philippine, Asian, and the Pacific Island geographies. Previously the Chief Executive Officer of SEDPI Development Finance, Inc., Meong has worked with micro, small, and medium enterprises from the standpoints of capacity builder, researcher, and investor. His more than a decade experience in research and development work allows him to provide advisory services to various non-government organizations. Meong has worked with organizations such as The World Bank, Pan-American Development Foundation, and Social Enterprise Development Partnerships, Inc.

***Lilibeth L. Leh-Arcena***

Lilibeth L. Leh-Arcena is an Assistant Professor of the Economics Department of the Social Science Cluster of the School of Arts and Sciences of the Ateneo de Davao University. She is appointed as the Director of the Arrupe Office of Social Formation at the Ateneo de Davao University, where she oversees the administration of the office and eight major programs responsible for the formation of students and alumni, faculty and non-teaching personnel to be agents of social transformation.

She also served as the Director of the Ateneo Center for Leadership for five significant years. This center which is under the University President is in charge of developing leaders, AdDU sui generis: leaders who will work for social justice and the common good for Mindanao and by engaging the globe for the transformation of society according to the vision and mission of the Ateneo de Davao University. After five years of her leadership, she, together with her colleagues, has fulfilled and accomplished the goals set for the center where has successfully institutionalized its programs.

She has also led multiple academic research for economic education and community development on top of giving lectures and training on Public Health Leadership and Governance, Bridging Leadership, Ignatian Leadership to government and private sector leaders, among others.

Lilibeth graduated from the Ateneo de Davao University with a degree in Economics, and has pursued further studies with a Masters Degree in Economics in the Ateneo de Davao University, as well as a Masters Degree in Economics and Entrepreneurship for Educators in the University of Delaware, Delaware, USA where she garnered the distinction of the Harry Hutchinson Leadership Award.

***Denise Subido***

Denise Subido graduated cum laude from Ateneo de Davao University (ADDU) with a degree in International Studies, major in Asian Studies. She has worked as a research assistant to some sociology professors in ADDU and has interned with United Nations Development Program – Action for Conflict Transformation (UNDP-ACT for Peace Programme) and the Philippine Overseas Employment Agency (POEA).

After graduation, she became a volunteer for Jesuit Volunteers Philippines (JVP) and was assigned to Iloilo City, where she drafted and conducted various trainings to college youth in Central Visayas. After her JVP year, she worked as Associate Program Staff for Philam Foundation, Inc., where she was acquainted with microfinance and social entrepreneurship. Denise screened, appraised and validated various livelihood projects nationwide that the foundation funded, such as agriculture and aquaculture projects and microfinance institutions. Apart from project appraisals, she also conducted research, trainings and attended several seminars on Social Entrepreneurship, strengthening her training skills, which prove to be valuable in SEDPI. As part of the SEDPI team, Denise crafted research tools and collected data on-site from different segments including local pottery artisans, Overseas Filipino Workers (OFW), low-income households, and farmers. Denise was also part of the Financial Inclusion team of the Terwilliger Center.

Denise is a consultant for social enterprises and non-profit organizations. She has conducted various trainings nationwide, particularly in the areas of microfinance and social entrepreneurship. Apart from that, she has also been part of the research team on housing microfinance and domestic payments in the Philippines, as well as various researches to MFIs and social enterprises in the Philippines. She has also conducted research on financial products, impact assessment, market research, and market expansion. She has more than a decade of experience in the development sector, primarily in the areas of social enterprise, financial literacy, and microfinance.

## Annex 2. Key Informants

| Organization | Respondent |
|---|---|
| **Bayan Academy** | Arthur Aguinaldo, Community Organizer<br>Sherrylyn Caigas, Trainer |
| **BDO Unibank** | Jade Tumadiang, Account Officer – SME Loan |
| **BDO Network Bank, Inc.** | Franco Jay Montejo, Area Sales Head – MSME Group |
| **Center for International Trade Expositions and Missions** | Romina Aurea Magno, Chief TIDS and Officer-in-Charge |
| **Department of Housing Settlements and Urban Development** | Mark Diamante, Strategic Planner |
| **Department of Trade and Industry** | Maricor Bañaga, Supervising Trade-Industry Development Specialist |
| **Dungganon Bank, Inc.** | Raymond Serios, General Manager |
| **International Finance Corporation** | Angelo Tan, Country Lead for the Philippines |
| **Landbank of the Philippines** | Elsie Tagupa, Senior Vice President – Visayas Lending Group |
| **NextPay** | Mex Talan, Growth Manager |
| **Primary Structures Educational Foundation, Inc.** | Jessie Cubijano, Executive Director |
| **SME Owner** | Arch. Ian Bautista, Architect |
| **Subdivision and Housing Developers Association** | Sonny Ducay, Executive Director<br>Rafael Felix, Board Adviser<br>Mayi Rodriguez,<br>Rosie Tsai, Chairperson |
| **United Architects of the Philippines Cebu Chapter and SME Owner** | Ar. Robert Malayao, President and Architect |
| **Water.Org** | Gay Santos, Regional Director – Southeast Asia |