



How Small Banks Can Achieve Higher Level of Competitiveness

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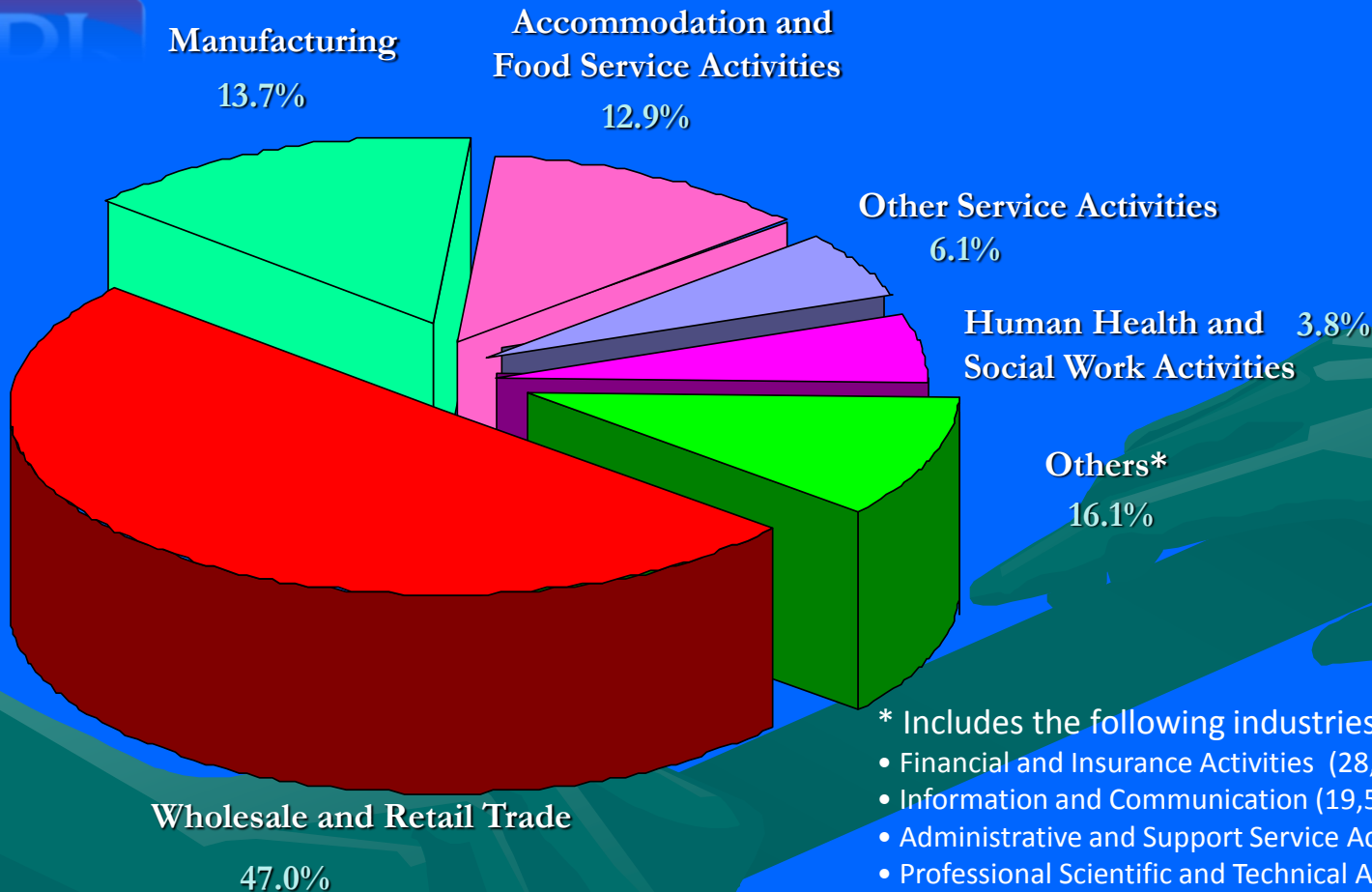


Outline of Presentation

1. SMEs a Key Untapped Market
2. Why is it Difficult for SMEs to Get Financing?
3. What Banks Need to Do to Service SMEs
 - Challenges
 - Response
4. DBP and its Partnership Advocacy
5. Conclusions



Overview of Philippine MSMEs



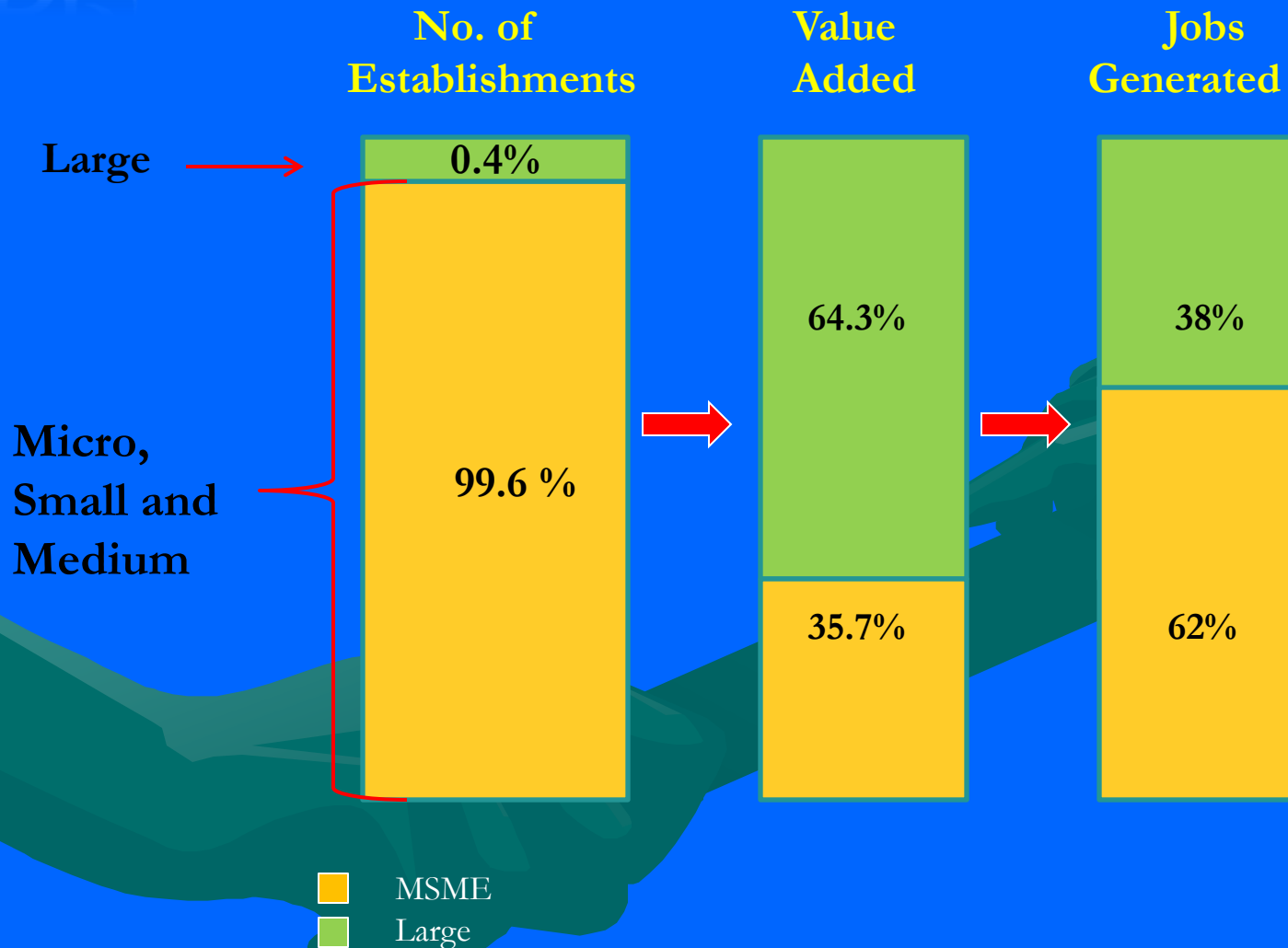
* Includes the following industries:

- Financial and Insurance Activities (28,578 MSMEs)
- Information and Communication (19,528 MSMEs)
- Administrative and Support Service Activities (18,468 MSMEs)
- Professional Scientific and Technical Activities (18,277 MSMEs)
- Education (14,999 MSMEs)
- Arts Entertainment and Recreation (13,190 MSMEs)
- Real Estate Activities (6,447 MSMEs)
- Transportation and Storage (6,130 MSMEs)
- Agriculture, Forestry and Fishing (4,976 MSMEs)
- Construction (2,861 MSMEs)
- Mining and Quarrying (536 MSMEs)

Source: 2011 List of Establishments, NSO



MSMEs' Contribution to the Economy





Mainstream SME Finance Needs Support

Estimates of Unmet Demand :

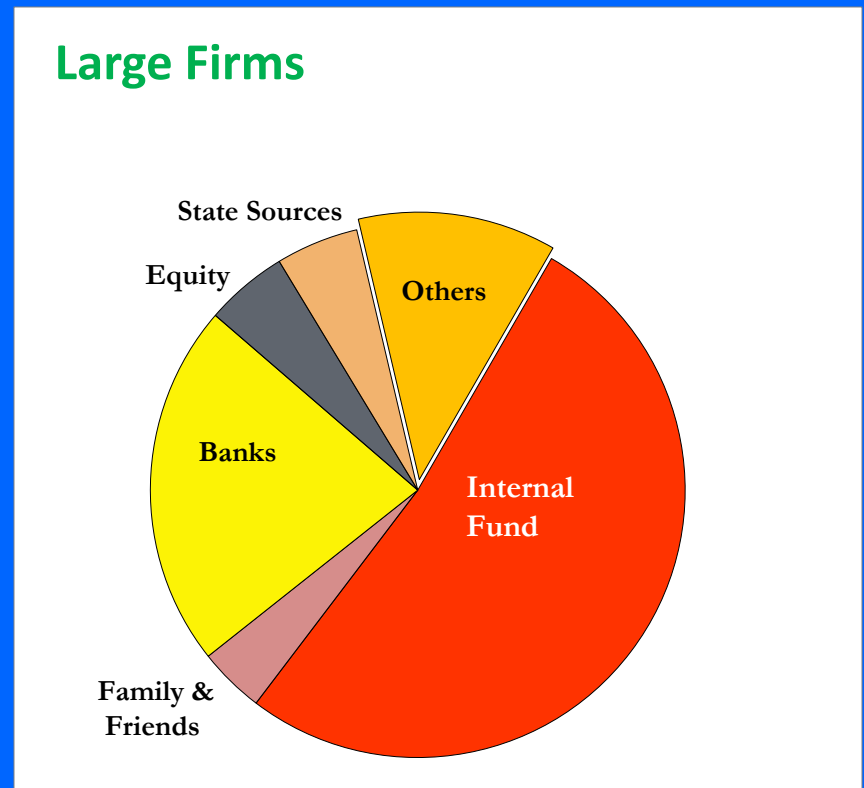
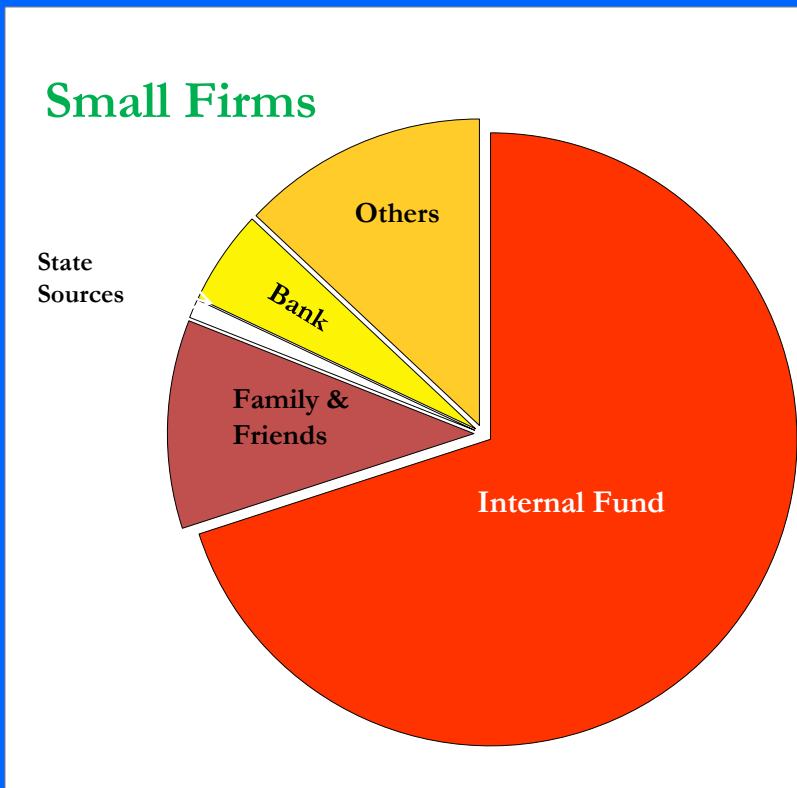
- IFC Scoping Study in 2006 - US \$2.5 billion, Philexport -Php67B, Nangia and Vaillar (2006) Php76B-Php270B, Aldaba Php130B;
- Overall compliance of banking sector with Mandatory Credit under Magna Carta for MSMEs is 5.34% for micro/small and 6.07% for medium (2012);
- Bank sector loan portfolio increased by 254.9% from 2001 to 2012;
- Micro/Small loan portfolio increased by 30.05%;
- Medium loan portfolio increased by 143.75%;
- Out of the 19 Universal Banks, 14 are uncomplined in Micro & Small Enterprise Portfolio and 6 in the Medium Enterprise Portfolio.

A decorative green 3D ribbon graphic is positioned on the left side of the slide, extending from the top left towards the bottom left. The ribbon is thick and has a slight curve, with a shadow cast beneath it. The background is a light, pale green color with a subtle gradient.

**Why is it difficult for
SMEs to Get Finance?**

❑ A universal problem : small firms are constrained than larger firms

Sources of Fixed Investment Financing for Small and Large Firms



Source : World Development Report 2005, World Bank Investment Climate Surveys, WRD Surveys of Micro and Informal Firms



❑ Higher Risks due to inadequate or lack of credit information on SMEs

- Inconsistent SME financial statements and audits
- Lack of third party information providers in the marketplace
- Higher costs of obtaining credit information on SMEs
- Lower quality of credit information



❑ Higher unit transaction costs, and therefore low profitability of lending to SMEs

- Small loan size relative to fixed transactions cost
- Higher processing costs per loan and per dollar
- Lower profitability per loan per dollar
- Traditional financial institutions not equipped with technology and skills to process SME loans





❑ Intrinsically higher risk of lending to SMEs

- Capital highly liquid – more likely to default
- More vulnerable to market changes
- Limited or inadequate management capabilities
- High “death rates” average annual closure rate is above 20% in most countries
- Imperfections in collateral markets





Challenges

1. SMEs find difficulty in accessing available funds from financial institutions because of stringent and voluminous requirements and long processing time of loan applications
2. SMEs find the minimum loan requirement and the short repayment period restrictive
3. The financial packages for SMEs in several regions are only available in urban areas
4. SMEs lack the capacity for financial management
5. SMEs have limited access to information regarding the sources of funds and on how to access these
6. Banks have not been responsive to SME needs
7. Banks need a major revisitation and retooling to meet SME needs



A Proposed Response: Risk - Based Lending, (RBL) a Paradigm Shift

- Entails knowledge and understanding of various concepts, tools and principles
- Requires appreciation of the big picture of the lending process from pre-qualification, evaluation, risk rating, loan packaging, monitoring, to managing relationship with borrower
- Requires account officers to develop a “credit culture”



A Proposed Response: Risk - Based Lending (RBL), a Paradigm Shift

- Collateral is not a determinant of loan approval, but impacts on pricing of the loan
- Focus is on the quality of the borrower and his capacity to repay the loan rather than his capacity to put up collateral to secure the loan
- With RBL, the lender is able to assess, price and manage credit risks to ensure payment



A Proposed Response: Implementing Risk - Based Lending (RBL)

- Need to strengthen capacity building function/ mandate matched by the need for increased funding
- Need to develop other services and capacity building programs tied up with RBL technology
- Need to develop skills such as FS validation and reconstruction, Early Warning Systems, etc.



Credit Risk Management System

- The heart of SME Risk-Based lending technology
- Composed of tools, practices, principles, hardware and software, and organizational structures employed by lending institution to manage credit risk
- Helps determine borrower quality, credit risk levels, areas of risks and mitigating measures, expected loss, probability of default, loan pricing, and provisioning for probable losses



Response : Components of Change

Handle MSME loans in terms of:

- Organizational structure
- Managerial Processes
- People Competencies
- Reward Systems
- Management Information System



Response : Cross Selling

- Savings, Insurance, Deposits
- Small business loans to small business households
- Relationship Banking



Response: Consider Credit Enhancements

1. Small Business Corporation (SB Corp)
2. Philippine Crop Insurance Corporation
3. Philippine Export-Import Guarantee
4. BSP's Credit Surety Fund
5. Industrial Guarantee Loan Fund (IGLF)



Development Bank of the Philippines

- ❑ Premier developmental financial institution
- ❑ 100% government owned, 92 branches as of September 2013
- ❑ Authorized capital stock of US\$19.29-M
- ❑ Remits at least 50% of net income to government annually



MANDATE:

- ❑ To influence and accelerate sustainable economic growth
- ❑ To service the financing needs of enterprises, infrastructure efficiency, livelihood and job creation.





PRIORITY SECTORS:

❑ INFRASTRUCTURE & LOGISTICS

- Infrastructure, Transport, Logistics, Tourism

❑ SOCIAL SERVICES

- Health Care, Education, Housing, Community Development

❑ ENVIRONMENT

- Water, Solid Waste Management, Pollution Control, Power including Renewable Energy

❑ MICRO + SMEs

- Loans, Technical Assistance





**DBP
Accredited
Rural
Banks under
Wholesale
Lending**

Rural Bank/ PFI	Location
Agribusiness Rural Bank, Inc.	Solano, Nueva Vizcaya
Banco Dipolog, Inc.	Dipolog
Bukidnon Gov't Employees Multi-Purpose Coop	Malaybalay
Bank of Makati	Makati
Cooperative Bank of Cotabato	Kidapawan
Cooperative Bank of Misamis Oriental	Capistrano Branch
First Consolidated Bank	Tagbilaran
First Isabela Cooperative Bank	Ilagan
Gov't . of Laoag Dev't Cooperative	Laoag
Katipunan Bank, Inc.	Dipolog
RBT Bank, A Rural Bank	Capistrano
Zamboanga del Norte Cooperative Bank	Dipolog
Bank of Florida	SF Pampanga
Cooperative Bank of Davao del sur	Digos
Cooperative Bank of Pampanga , Inc.	SF Pampanga
Enterprise Bank	Davao Branch
First Valley Bank	CDO Branch
Gateway Rural Bank	Malolos Branch
Guagua Rural Bank	SF Pampanga
Gulf Bank	Dagupan
One Network Rural Bank, Inc.	Davao City Branch
Rural Bank of Barili	Cebu
Rural Bank of Bay, Inc.	Sta. Rosa Branch
Rural Bank of Pres. M.A. Roxas	Dipolog Branch
Rural Bank of Rizal (Zamboanga del Norte)	Dipolog Branch



**Rural
Banks
w/
Releases
from
IGLF
(as of
December
2013)**

RURAL BANK/ PFI/ THRIFT /MFI	AMOUNT (P MILLION)
Agribusiness Rural Bank, Inc.	69.3
Banco Dipolog, Inc.	44.7
Bank of Makati	101.0
Cooperative Bank of Cotabato	36.3
First Isabela Cooperative Bank	32.1
First Consolidated Bank	100.2
Plantersbank	570.6
Producers Savings Bank Corp	525.9
Katipunan Bank, Inc.	98.6
Philippine Resources Savings Banking Corp	219.9
Enterprise Bank	93.5
First Maco Bank	14.5
First Valley Bank	33.3
Gateway Rural Bank	0.12
Gulf Bank	11.6
One Network Rural Bank, Inc.	49.5
Rural Bank of Rizal (Zamboanga del Norte)	13.8
Aakay ang Milamdec Foundation, Inc.	124.5
Aalay sa Kaunlaran, Inc.	50.0
Bukidnon Gov't Employees Multi-Purpose Coop	4.5
Holy Community Development Foundation, Inc.	2.7
Radiowealth Finance Corp	177.1
Zamboanga Social Welfare Development	5.0
Total	2,379.0



DBP As Your Partner





In Conclusion:

- Risk measurement, the way to be competitive
- Collateral restricts, risk measurement predicts
- Continuous learning and stress testing are the key
- Risk management is better than crisis management, Be **PRO-ACTIVE**
- Information systems are inevitable, **INVEST NOW**
- Transparency is more profitable in the long run

RISK-
BASED
LENDING
MOVEMENT



In Conclusion:

- SME lending could be more profitable and less risky than LE lending
- With the right technology (such as the BRR), Credit Appraisals are easy to conduct and therefore not so expensive for FI
- Interest rate margins in Small Business lending are high compared to Corporate Lending where commercial banks are competing

RISK-
BASED
LENDING
MOVEMENT



In Conclusion:

RISK-
BASED
LENDING
MOVEMENT

- Profitability does not derive from loans only but from a cross selling approach (sales of multiple services: saving, insurance, housing loans, car loans . . .)
- If procedures are correctly implemented, the risk management is easier with a lot of small exposure than with large exposures



In Conclusion:

- The repayment rate is very high since debt is often serviced in very short term
- Collateral has no impact on the probability of default
- Risk based lending is not a perfect science. It is better to be approximately correct than to be precisely wrong.
- Consider a partnership strategy with DBP

RISK-
BASED
LENDING
MOVEMENT



Closing:

“He who survives is not the strongest nor most intelligent But he who is more responsive to change and is flexible to adopt to situations”
– Charles Darwin

“You have the right temperament. You don’t need extraordinary intelligence to succeed. You need a philosophy. The key is not to be seduced by crazy ideas, but instead just stick to the fundamentals year after year.” - Warren Buffet

If you want to travel fast...

travel alone



...but if you want to travel far,
travel together.

**DBP in
Partnership with
Rural Banking
Sector**



Thank you.
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