**CONSTRAINTS ON ACCESS TO THE CAPITAL MARKET**

**BY MICRO, SMALL AND MEDIUM ENTERPRISES**

**IN THE PHILIPPINES**

By: Raul J. Palabrica

Commissioner

Philippine Securities & Exchange Commission

\* \* \*

 As principal regulator of private companies in the Philippines, the Securities and Exchange Commission (SEC) has laid down certain criteria, for accounting purposes, in the treatment of micro, small and medium enterprises in the Philippines.

 Under existing rules, micro enterprises are entities that have total assets and liabilities below US$70,000 (using an exchange rate of US$1:PhP43.00). On the other hand, small and medium enterprises have total assets between US$70,000 and US$8 Million, or total liabilities between US$70,000 and US$6 Million.

 Micro enterprises usually operate in fresh and dry goods markets and in the personal service sector, and employ members of a family or their immediate relatives.

**Principal Financing Sources of MSMEs**

 On account of their limited operation, micro enterprises source their funds principally from lending companies whose minimum paid-up capital under existing regulations is US$23,000.

 The average maximum amount of financing that lending companies usually make available to micro enterprises at any one time is US$2,300. Since the operation of lending companies is grassroots in character, there is minimal paperwork involved in the lending process. It’s akin to a door-to-door or personal lending and collection system.

 The area for capital solicitation is wider for small and medium enterprises. Depending on the size of their operation and business track record, they have access to capital through banks, financial institutions and, if interested and qualified, the Philippine Stock Exchange.

**Financing constraints of Micro Enterprises**

 The ability of lending companies to make available to micro enterprises additional capital is constrained by existing regulations that relate to the nationality or citizenship of the stockholders of lending companies, and their source of funds.

 Philippine law provides that the majority (or 51%) of the voting stocks of lending companies should be owned by Filipino citizens. Thus, the amount of investments that foreigners can put in lending companies cannot exceed the equivalent of 49% of the voting stocks.

 The investment cap restricts the capability of foreigners in the Philippines, whether permanent residents or engaged in lawful business, to increase their investments in lending companies.

 In addition to the citizenship requirement, it is essential that the country to which the foreign stockholders belong grants reciprocal rights on similar lending activities to Filipino citizens in their country.

 With regard to sourcing of funds, SEC regulations require that lending companies should obtain their funds from or issue debt papers to not more than 19 non-institutional persons (meaning, other than banks, investment houses, insurance companies, pension funds and mutual funds), inclusive of their stockholders.

 If these criteria are not met, the debt papers issued by the lending company have to be registered with the SEC.

This requirement is in consonance with Philippine securities law which exempts from registration, among others, private placement or securities issued to not more than 19 persons.

Once the 19-person ceiling is breached, the offering or issuance of debt papers or securities is considered public in nature and therefore required to go through the registration process.

The overriding effect of this restriction on sources of funds is, it limits the ability of the lending companies to raise more funds that it can lend to micro enterprises and puts pressure on them to increase the interest rates on their loans to maximize their profits.

**Financing constraints of Small and Medium Enterprisesp**

**A**. The Philippine Stock Exchange has put up the Small and Medium Enterprises Board (SME Board) to encourage SMEs to tap the capital market for their funding needs. Compared to the First and Second Boards, the requirements for listing on the SME Board, i.e., authorized capital stock, net tangible assets and track record, are more liberal.

 At present, only two SMEs – a financing company and a software company -- are listed on the SME Board.

 The dearth in listing on the SME Board may be attributed to the following causes:

1. Lack of incentives to underwriters to promote the SME Board because the efforts in equity raising activities for companies applying for listing on the First and Second Boards are the same as in the SME Board;
2. The funds sought to be gained from listing on the SME Board, which averages at US$2 Million, can be raised through loans from banks and other financial institutions;
3. The financial viability and lack of track records of SMEs discourages investors or venture capitalists from investing in SMEs;
4. The pre- and post-listing requirements of the stock exchange, including the regulatory requirements that accompany a listing on the SME Board, deter SMEs from listing.

**B**. SMEs have been unable to tap the domestic bond market for its capital requirements due to poor underwriter interest and strict registration requirements.

\* \* \* \*

Best Practice Regulatory Principles

Supporting MSME Access to Finance

June 27 and 28, 2011

Manila, Philippines