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Philippine Institute for Development Studies
Surian sa mga Pag-aaral Pangkaunlaran ng Pilipinas

Growing Inclusive Businesses in the Philippines: The Role of Government Policies and Programs

Roehlano M. Briones

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Growing Inclusive Businesses in the Philippines: The Role of Government Policies and Programs

Roehlano M. Briones¹

Abstract

Inclusive business (IB) is a private sector approach to providing goods, services, and livelihoods on a commercially viable basis, either at scale or scalable, to people at the base of the pyramid by making them part of the value chain of companies' core business as suppliers, distributors, retailers, or customers. There is keen interest in IBs, both in the public and private spheres, as a strategy for inclusive growth. The Department of Trade and Industry is setting up an accreditation system to certify business models as IB, based on an evaluation tool, initially for three priority sectors: agribusiness, housing, and tourism. This paper analyzes the economic and development potential of IBs, and describes existing programs and policies of the government in terms of openness to IB. It then makes several recommendations for short-term IB promotion, as well as long-term measures to support IB in the Philippines.

Keywords: Inclusive growth, inclusive business, micro, small, and medium enterprises, small farmers and fishers, base of the pyramid, industry promotion

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Executive Summary

Scope of the Report. The private sector can make a profound contribution to inclusive growth by providing more and better paid jobs as well as relevant affordable social services (and goods) for the poor and low income people at the “base of the pyramid”. The Philippine government, led by DTI, is keen on growing inclusive business (IB) as a base for sustained inclusive growth. The DTI is introducing an accreditation system to certify IB projects or models in three priority sectors, namely agribusiness, housing, and tourism.

In support of this, this Report aims to: prepare a short overview of existing government support programs for SME promotion, agricultural support, tourism and other employment programs on their relevance for IB; review DTI programs on their suitability for IB support, and recommend how such programs can be used; and make proposals to integrate IB in the Industrial Priority Plan of the country, and in the various sector road maps.

Characterizing inclusive business and the BoP. Inclusive business is a private sector approach to providing goods, services, and livelihoods on a commercially viable basis, either at scale or scalable, to people at the base of the pyramid by making them part of the value chain of companies’ core business as suppliers, distributors, retailers, or customers. More specifically, it covers business models implemented by profit making commercial entities that bring systemic impact in scale to the poor and vulnerable people under the \$3 international poverty line by engaging the poor as suppliers, consumers, employees, and distributors. The design of priority sector strategies for reaching the poor should start with characterizing the socio-economic conditions of the poor in the Philippines, summarized as follows:

- The base of the pyramid (BoP) accounts for a large majority (more than 60%) of the population.
- Though poverty has been falling, the rate of decline has been very slow, motivating the search for measures to accelerate growth, and increase the social impact of growth.
- Poverty is primarily a rural phenomenon.
- Being poor is positively related with being underemployed, and more so being visibly underemployed.
- Agriculture plays a dominant role in the livelihoods of the poor.
- Being an underemployed agricultural worker is strongly associated with being poor.
- The agricultural worker earns less than half the average daily basic pay.
- Depressed levels of agricultural wages have persisted over the decade.
- Increased labor income at scale, including labor income of farmer-operators, is less likely to be realized in traditional farming activities.
- BoP households suffer much lower quality of housing compared average household.
- BoP households are incrementally building up their homes, but in a slow and costly process for both themselves and society as a whole.

Abundant labor resources available at affordable wages are the main economic advantages from employing the poor, whether directly as workers or indirectly as suppliers. However, high coordination cost, unfavorable business environment, and inadequate human and financial resources, are major challenges replicating and sustaining inclusive business. BoP

households face greater obstacles to overcoming these challenges. Similarly, market failure prevents BoP households from gaining sufficient access to quality housing.

To promote IB, a typology of three policy approaches is adopted, namely: *enabling companies* to enter IB activities; *encouraging companies*, including social enterprises, to invest in IB activities; and *empowering BoP households* to engage with companies. Each of these provide several types of benefits, namely: improved information; a clear set of rules; access to financial resources; and improved structure and capacity.

These policy approaches presupposes a method of distinguishing IB from other types of business or developmental effort. A practical way to do this is to apply an evaluation tool (based on scoring) to measure the qualification of a business model for IB accreditation, based on criteria of financial viability, social impact, and innovations. Accreditation is applied only to specific projects or business models of companies already operating legally in the Philippines, whether foreign or local. Finally, accreditation presupposes a monitoring process, in which models that cease to meet IB criteria will lose their accreditation.

The criterion of “social impact” requires a minimum scale, hence the accreditation criteria will likely favor companies able to to implement large-scale projects, though these projects will benefit the BoP by engaging them as suppliers, workers, or consumers. Engagement of the BoP will likely require support from the IB company, the specific form of which (finance, technical assistance, favorable pricing, etc.) will depend on the particulars of the IB model being proposed.

Given BOI’s mandate to encourage investments which provide significant employment opportunities relative to the amount of capital investment, provide a fountain for the future development of the economy, and accelerate development of less developed regions of the country, the BOI is the logical agency to handle IB accreditation, though independently of its incentive registration process.

Government programs relevant to IB. The country’s national development plan expresses a strong commitment empowering BoP households. However the national strategy is weak in terms of encouraging and enabling companies to realize benefits from IB. Marketing, technology, and production management, are functions at which the private sector has comparative advantage in the supply chain. An alternative approach therefore is to take the private sector rather than grassroots enterprises or poor households themselves as the entry point for intervention. Social impact is ensured by a rigorous accreditation process that distinguishes IB from conventional commerce.

Various other government programs are related to inclusive business. The following observations are relevant for integrating IB into these programs:

- The government’s initiatives with respect to industry roadmaps and clusters provide an important opportunity to nurture business alliances, including IB or networks promoting IB. Likewise, the clusters and roadmaps, being multi-sector initiatives, are excellent opportunities to introduce IBs to a broad group of stakeholders.
- As for investment promotion based on fiscal incentives, problems have been noted in the country’s investment incentives regime, underscoring the need for reforms. These reform initiatives create an opportunity to integrate IB in the country’s investment promotion regime.
- On paper there is a strong commitment towards an agribusiness and value chain approach towards developing the small farmer and fishers (SFF). However the policy pronouncements contrast sharply with budget priorities and implementation. An

agribusiness-based approach to agricultural development will benefit greatly from an IB accreditation scheme. Based on initial meetings, the multi-stakeholder mechanism within DA, namely the Philippine Council for Agriculture and Fisheries (PCAF), has welcomed further discussion to explain and disseminate IB models to the various stakeholders.

- Lack of finance is a major obstacle to MSME and agri-enterprise development. Instead, government financial programs can phase in value chain participation of IBs as part of its strategy for an inclusive financial sector. Government can support this by providing guarantees.
- Mandatory allocation for BoP sectors is unlikely to be acceptable to financial institutions. The disadvantage to mandatory allocation is that they contribute to raising the cost of financial intermediation across-the-board.
- Tourism policies and programs are not specifically designed to engage the base of the pyramid.
- The government imposes a mandatory allocation for socialized housing, and offers generous subsidies for homeowners. Subsidy schemes are provided at huge fiscal cost by providing implicit and explicit subsidies that do not meet their target clientele, the low-income households, while crowding out private sector financing.

Integrating IB in government programs: an IB policy proposal. The following recommendations pertain to an IB policy proposal that involve no major legislative changes.

1) To address the need for information on specific firms which meet IB standards among CSOs, SFFs, SMES, and LGUs , BOI should establish and scale up IB accreditation.

Accreditation will become meaningful only after a strong **communication campaign** that will explain to stakeholders the nature and scope of IB, and the specific features of IB accreditation, and how a typical IB scheme works. The list of companies with accredited IB projects can be kept on a public database to be disseminated nationwide, i.e. through the newly established Negosyo centers. The list should also be incorporated into the Philippine Business Registry Databank. Dissemination and promotion by DTI through BOI and the Negosyo Centers can provide a valuable information service to LGUs, producer organizations, farmer's groups, and other stakeholders, e.g. private banks, GFIs, donor agencies, etc.

2) Regarding the roadmaps, targets should go beyond revenue or output, and adopt aswell social impact such as jobs generated among the BoP.

The roadmaps offer an opportunity to incorporate IB in the country's coordination and industrial promotion strategies. The current set of roadmaps require an industry appraisal (including problem analysis), objectives and targets, a flexible set of strategies and roles, and a monitoring system, to inform stakeholder dialogue and implementation. The targets are typically cast in terms of output (or value added) growth. Inclusive growth can be more explicitly incorporated into roadmaps by specifying social impact targets, e.g. employment generated among the poor, number of small farmers engaged as contract growers, number of companies with IB-accredited projects, and so on.

A related opportunity is the industry cluster (IC) program, which will be a good jump off point; DTI – Regional Operations Group (DTI-ROG) help drawing up the value chains for the 6 priority clusters (Processed Food (Fruits and Nuts), Cacao, Coco coir, Coffee, Processed

Rubber, and Tourism Support Industries). The IB accreditation can have far reaching consequences for these ICs especially in the areas of RM sourcing, production/technology, financing and marketing.

3) BOI should institute a Services and Monitoring Lane for IB-accredited projects.

IB projects that are also registering for incentives with BOI should be prioritized in receiving advisory services in dealing with other government agencies in the paper trail, as well as after-sales service in complying with registration and accreditation requirements. These services will also serve as a monitoring for compliance with the parameters of its IB model.

4) Lending institutions financing IB-accredited agribusiness and tourism projects should qualify for enhanced guarantee cover.

Financing can be coursed through the IB, or directly to BoP households or enterprises in the IB value chain. The enhancement can take the form of change in treatment of subrogated loans in the case of agri-agra credit; and increased principal cover in the case of MSME credit.

5) IB can be further integrated in MSME and SFF development interventions by granting preferential treatment to IB-linked BoP households and their enterprises.

Government programs such as Shared Service Facilities (SSF) target support to micro and small enterprises, as well as small farmers and fishers. Such support may be designed so as to prioritize MSMEs already linked to IBs. Moreover, the IB may be tasked with providing technical and other services so as to optimize government support for MSMEs; the recommendation however falls short of actually extending program benefits to the IB itself (e.g. in terms of the SSF, the IB need not qualify as a co-operator). Other assistance from IB buyers should be considered in the value chain, so long as this is agreeable to both all parties, such as: technical assistance in operating and maintaining specialized equipment; or even management and maintenance services for specialized equipment.

IB Policy Plus

A more radical approach to integrating IB in government programs entail major legislative changes in the area of fiscal incentives, mandatory allocation, and subsidies. For fiscal incentives, reforms are divided into two scenarios. The first scenario is **EO-226-amended**. The second scenario is **new fiscal incentive regime**.

1) Under an EO226-amended scenario, IB-accredited projects should qualify as pioneer status in the fiscal incentive scheme.

For domestic firms, pioneer status extends the ITH by two years; for foreign investors, pioneer status entitles them to register at the BOI for both fiscal and non-fiscal incentives (subject to other conditions, e.g. exporting 70% of its production, divesting to Filipino ownership after 30 years, etc.) Note that classifying IB as pioneer investment is potentially controversial given the DOF thrust towards limiting tax expenditure. To justify this, incentives should be conditional on tax expenditure being less than additional employment income due to the registered investment.

2) Under a new fiscal incentive regime, grant of fiscal incentives should be reserved exclusive for firms with IB accreditation.

There are discussions on-going within the Economic Cluster, together with both Houses of Congress, for a radical overhaul of fiscal incentives through law. Should such radical reform push through, the new incentive regime should generate social benefits in a cost-effective manner, i.e. with least tax expenditures foregone. One option is that sectoral fiscal incentives

be abolished, whether for IPP industries, housing, tourism, and agribusiness. Rather, fiscal incentives (in the form of lower corporate tax rates) should be granted only to IB-accredited projects. Accreditation validates that the investment will likely benefit BoP households, and therefore meriting special treatment (i.e. subsidy) from the government.

3) Mandatory allocations of credit or housing for target groups, or subsidized credit schemes, should be replaced by targeted cash transfers for the base of the pyramid.

Mandatory allocations or credit or housing facilities (MSMEs, agriculture, ARBs, and socialized housing) raise the cost of doing business. Abolition of these mandates will increase the total supply of credit and housing. Directing credit and housing services to the base of the pyramid can be done using targeted transfers, designed as “smart subsidies”. Targeting shall be supported by the government database on BoP households and even individuals, i.e. the National Household Targeting System (NHTS), and the Registry System of Basic Sectors in Agriculture (RSBSA).

4) To promote IB and social impact, BoP households/suppliers within an IB-accredited value chain shall be prioritized to receive the transfers.

Capital financing for MSMEs shall be provided using matching grants for enterprise development; capital financing for socialized housing shall be provided as co-payment grants to BoP households. Such grants can be designed to avoid distorting incentives, e.g. by following best practices from the CCT, i.e. relying on prior means testing (the NHTS) and providing cash transfers with calibrated conditionalities.

I. Introduction

1. The Philippine economy has continued to grow robustly, averaging 6.6% since 2012. However, the government's Philippine Development Plan (PDP) admits this achievement is prone to the criticism that the benefits of growth have not been broadly shared. Two thirds of output is produced in just three out of seventeen regions of the country; the official poverty incidence remains high at 25.2% in 2012, hardly changed from its 2009 level. The unemployed account for nearly 7% of the labor force; and nearly a fifth of those employed want additional work to make ends meet.

2. There is also growing interest from the government to partner more with the private sector for job creation and services delivery for the poor. The private sector can make a profound contribution greatly to inclusive growth by providing more and better paid jobs as well as relevant affordable social services (and goods) for the poor and low income people at the "base of the pyramid". For instance, a processing company may contract smallholders as contract growers; a private commercial bank may establish a microfinance service department; a housing developer may set aside a portion of its housing project for vertical resettlement of displaced informal dwellers. Private sector entities performing this role yet maintaining a for-profit orientation are referred to as *inclusive business* (IB).

3. Inclusive business is a private sector approach to providing goods, services, and livelihoods on a commercially viable basis, either at scale or scalable, to people at the base of the pyramid by making them part of the value chain of companies' core business as suppliers, distributors, retailers, or customers. According to ADB (2013), IB activities are at nascent stage of development in the Philippines; in the period 2010 – 2013, only 2 dedicated impact investments worth \$3 million were undertaken in the last three years. The International Finance Corporation (IFC) in addition invested \$75 million in an IB model of Manila Water from 2003 to 2005. Nonetheless, about 70 companies with IB models in 11 industries. The IB market in the Philippines is rapidly growing. The major industry associations, such as the Philippine Chamber of Commerce and Industry (PCCI), the Joint Foreign Chambers (JFC), have issued official statements and economic assessments in support of inclusive growth. Beyond inclusive growth, IB as a key thrust has been adopted by the Philippine Business for Social Progress (PBSP), the largest private foundation devoted to corporate social responsibility (CSR).

4. The Philippine government, led by the Board of Investments (BOI) of the Department of Trade and Industry (DTI), is keen on growing IB as a base for sustained inclusive growth. IB is explicitly encouraged in the 2014 Investment Priority Plan (IPP). The BOI is establishing an accreditation system to certify as IB proposed or on-going investments (whether or not registered for fiscal incentives), in three priority sectors, namely agribusiness, housing, and tourism. The government seeks deploy its resources and programs in support of IB.

5. The Philippines is at the forefront of a growing movement worldwide towards IB. The APEC Government Panel, during the High Level Dialogue on Inclusive Business hosted by the Philippines, agreed that Inclusive Business is the most important private sector approach towards addressing social problems such as income inequality; food security; lack of access to quality healthcare, education, housing etc., in a sustainable way and governments in APEC should support this innovative way of doing business (APEC CSOM, 2015). The G20 Leaders have affirmed that IB has a particularly important role for sustainable development (G20 Summit Communique, 2015) The Business Call to Action (BctA) is an alliance of donor governments and United Nations Development Program (UNDP), which serves to link members to a global community dedicated to improving the lives and livelihoods of those

living at the bottom of the economic pyramid. Various multilateral agencies such as World Bank Group, ADB, and Inter-American Development Bank (IDB) have also thrown their support behind IBs.

6. This study seeks to identify IB interfaces with government policy and programs, and make the appropriate recommendations towards promoting IB. The emphasis is on “low hanging fruit”, namely DTI policies and programs such as MSME development, industry roadmaps, and the investment priority plan; nonetheless the study will cover the spectrum of inclusive development strategies. The specific objectives are:

- i) Prepare a short overview of existing government support programs for SME promotion, agricultural support, tourism and other employment programs on their relevance for IB;
- ii) Review DTI programs on their suitability for IB support, and recommend how such programs can be used;
- iii) Make proposals to integrate IB in the Industrial priority Plan of the country, and in the various sector roadmaps.

7. The remainder of this report is organized as follows: Section II provides additional background and rationale for IB. Section III describes government strategies and programs relevant to IB. The concluding Section offers a proposal for integrating IB in government programs.

II. Inclusive Business in the Philippines

A. Concept of IB

8. **Inclusive business refers to business models of commercial entities that bring systemic impact in scale or scalable to the poor and vulnerable people under the \$3 international poverty line by engaging the poor as suppliers, consumers, employees, and distributors.** Based on the definition of IB and case studies from ADB (2013), we make the following distinctions:

- (a) **Commercial viability:** IB must be distinguished from corporate philanthropy, which tend to be treated by companies as an expense item. Profit offers a greater likelihood of sustainability as long as a shared value proposition is in place; it is less prone to shareholder whims about how much to budget for CSR. IB may be contrasted with *social enterprise*, which has been defined as *organizations with an explicit aim to benefit the community, initiated by a group of citizens and in which the material interest of capital investors is subject to limits*. Social enterprises therefore include organizations such as cooperatives and nonprofits, including a subset of nongovernmental organizations or NGOs (Defourney and Nyssens, 2006). Not all social enterprises are financially viable, and some rely on external financing (G20 Development Working Group, 2015). Social enterprises are not ruled out as IB; however, their business model must meet the market test to qualify as IB.
- (b) **BoP households as suppliers, consumers, employees, distributors:** as part of the value proposition, BoP households must receive value within an exchange relation, in the form of income, goods, or services, in return for providing labor/land (as supplier, employee, distributor), or cash (consumer).
- (c) **Systemic impact:** Business models should be able to address root causes of poverty in areas of strategic importance. For instance, a grower scheme can have systemic impact

if it can be expanded over large clusters of smallholders in Mindanao, in conflict-prone areas not reached by traditional business, and where farmers develop long term relationships for sustained growth of incomes and access to modern technologies. Alternatively, a microfinance project charging market rates and targeting rural communities of a poor region where economic activity is severely constrained by availability of cash, may be said to have systemic impact. However a company selling small retail packs of consumer goods, even if targeted towards the urban poor, is unlikely to have a systemic impact.

- (d) **Scale:** the IB should target a significant group of BoP households, i.e. 15,000 Indigenous People (IP) households in Mindanao (in the case of Coffee for Peace); seaweed farming for 7,000 and up to 20,000 fishery households in the Visayas (the case of MCPI Corporation); and 2,000 to 6,000 coconut farmers producing coco fiber (case of Coco Technologies). Note that many social enterprises also have smaller initiatives that may not meet the criterion of scale; nonetheless some of these are potentially scalable. BCtA, an alliance of IBs, have a significant membership drawn from SMEs, many of which style themselves as social enterprises, classified as “emerging and maturing companies” with viable business models approaching scale (Ashley et al, 2014)

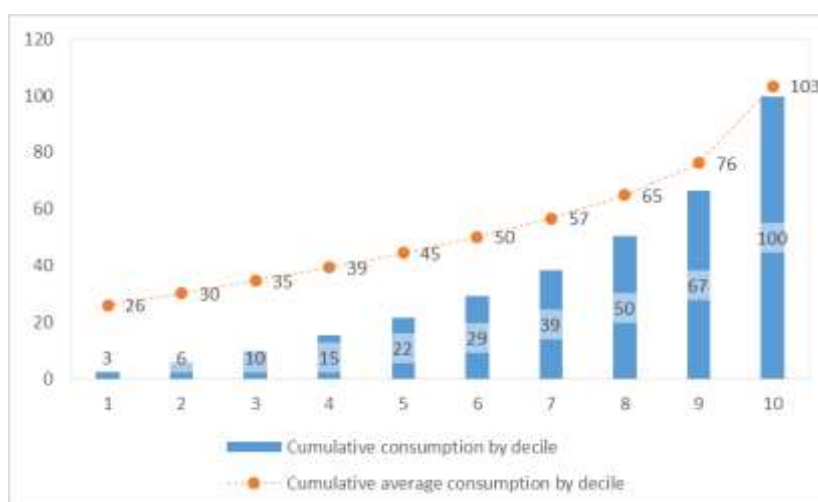
B. Characterizing base of the pyramid

To understand the economic and development potential of IB, it is necessary to characterize the socio-economic conditions of the BoP. Such characterization is done in the following, in relation to the priority sectors (particularly agribusiness and housing).

1. Income and employment

9. The impact group, i.e. the target for inclusion in inclusive growth, is referred to as the *base of the pyramid* (BoP). Initially introduced by Prahalad and Hart (2002) to highlight the market potential of the low income segment, BoP provides a convenient way to define the target population for IB. Based on a survey of 80 companies (ASEI, 2013), 78% of companies in agriculture and 100% in tourism engage the BoP as suppliers; another 17% of companies in agriculture engage them as employees. Meanwhile housing engages 100% of the BoP as consumers. This report focuses on engaging the BoP as suppliers of agribusiness and tourism, as well as of consumers of housing.

10. **The base of the pyramid accounts for a sizable proportion of the population.** The size distribution of income in the Philippines is shown in Figure 1. The lowest 30% of the population accounts for just one-tenth of total expenditure; the bottom 60%, only 29% of total expenditure. Alternative expenditure thresholds can be set at the official line, and various international lines for daily income in PPP dollars, namely: \$1.25 (subsistence), \$2 (poverty line), and \$3 (vulnerable), and \$4 (low income). Based on the international subsistence line, the poor account for just under a fifth of the population (Table 1). The proportions go up rapidly; at the BoP cut-off, about 62% of the population are poor; this closely matches the bottom sixty percent of Figure 1.

Figure 1: Expenditure indicators by decile, in PPP dollars (year 2005)

Source: World Bank. <http://iresearch.worldbank.org/PovcalNet/index.htm?3#>

11. **Poverty has been falling but at a glacial pace; this motivates the search for measures to accelerate growth, and increase the social impact of growth.** Table 2 looks at changes in poverty over time. Based on the alternative international lines, poverty has been falling, though the rate of change has been slow (an average of 0.8 percentage points per year); there was in fact an episode of poverty increase (2009 – 2012). The country will likely miss its Millennium Development Goal (MDG) target of halving poverty from 1990 – 2015. This highlights the necessity of accelerating the pace of poverty reduction, not only by increasing the rate of overall growth, but by spreading out that growth to the base of the pyramid. Within the BoP is the subset of households who count as poor based on the official line; according to Table 1, this line is about 9% above the international subsistence line. Households under the official line account for a little more than a quarter of the population.

Table 1: Poverty profile based on alternative expenditure thresholds, Philippines

	Expenditure per capita per day (PPP dollars)	Poverty incidence of the population (%)	Number of poor people (millions)	Monthly family income (pesos), 5 members
National poverty line	1.36	26.6	27.0	8,250
Very poor	1.25	19.0	19.2	7,583
Poor	2.00	41.7	42.3	12,132
Vulnerable	3.00	62.5	63.4	18,199
Low income	4.00	75.1	76.2	24,265

Source: PovcalNet (World Bank).

Table 2: Poverty incidence of the population under alternative poverty lines Philippines, 1985 – 2012, in 2005 PPP dollars

	\$ 1.25 per day	\$2 per day	\$3 per day
1985	39.06	65.16	82.73
1988	33.67	59.42	78.45

1991	33.15	57.21	75.73
1994	30.51	54.48	73.83
1997	23.71	45.61	65.50
2000	24.59	46.60	66.15
2003	22.88	44.15	63.91
2006	22.58	44.31	64.00
2009	18.10	40.42	61.52
2012	18.96	41.00	61.88

Source: World Bank. <http://iresearch.worldbank.org/PovcalNet/index.htm?3#>

12. The profile of the poor with respect to location, sector of employment, and status of employment, are summarized in Table 3. The first column pertains to sets, while the second column to proper subsets. The second row implies that the rural population accounts for 55% of the entire population; 35% of the rural population are poor (much higher than the national poverty incidence of 24.8%, based on the first row); and close to four-fifths (78%) of the poor reside in rural areas. This underscores the common observation that **poverty is primarily a rural phenomenon** (ADB, 2009).

13. Employment is a concept relevant to the labor force. The unemployment rate figures prominently in discussions of jobless growth; however, **being unemployed is not correlated with being poor**. Only 2.1% of the poor in the labor force are unemployed. The share of the unemployed who are poor is only 20%, compared to the share of the poor in the labor force, equal to 24%, confirming the oft-cited adage that the poor cannot afford to be unemployed.

14. Rather, **being poor is positively related to being underemployed, and more so being visibly underemployed**. The underemployed in 2013 accounted for 21% of workers; poverty incidence among underemployed workers is 34%, much higher than poverty incidence among workers, equal to 23%. About 12% of workers (a subset of underemployed workers) are visibly underemployed; among the visibly underemployed, 40% are poor, and of all poor workers, 22% are visibly underemployed.

Table 3: Profile of the poor by groups and subgroups according to location, employment status, and sector of work, 2013

Group	Subgroup	Shares (%)		
		In group	Of poor, in subgroup	Of poor, in group
Population (2012)	Population	100	24.8	100
	Rural	55.3	35.0	78.0
	Urban	44.7	12.2	22.0
Labor Force	Labor force	100	23.3	100
	Unemployed	7.1	19.5	2.1
Workers	Workers	100	23.4	100.0
	Underemployed	20.9	34.2	35.5
	Visibly underemployed	11.9	39.5	22.5
	Agricultural workers	30.9	42.2	66.2
Agricultural workers	Rice	20.4	30.2	14.5

Group	Subgroup	Shares (%)		
		In group	Of poor, in subgroup	Of poor, in group
	Corn	12.6	56.6	16.8
	Coconut	8.8	40.0	8.3
	Vegetables	4.0	35.3	3.4
	Other crops	7.5	44.0	7.8
	Farm workers	28.8	49.6	33.7
	Other subsectors	18.0	36.3	15.5
	Underemployed	27.9	50.0	35.7
	Visibly underemployed	20.4	50.4	25.1

Notes:

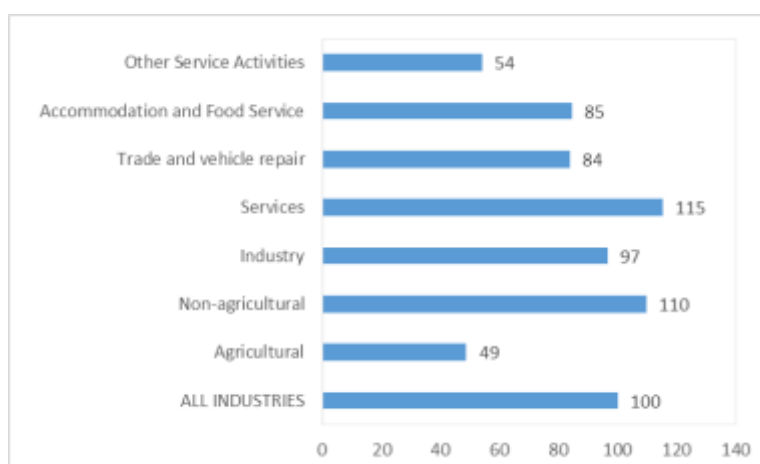
- a. Based on January 2013 Labor Force Survey (LFS), merged with 2012 FIES (Family Income and Expenditures Survey).
- b. A household is classified as poor based comparison of household per capita income with the official provincial threshold (urban and rural).
- c. An **underemployed worker** is one who expresses the desire to have additional hours of work in his or her present job, have an additional job, or have a new job with longer working hours. A **visibly underemployed worker** is one who is underemployed and is working less than forty hours a week.

Source of basic data: PSA – NSCB (2012a, 2012b).

15. **Agriculture plays a dominant role in the livelihoods of the poor.** The importance of agriculture in the livelihoods of the poor is consistent with poverty being primarily a rural phenomenon. Only 31% of all workers are in agriculture, but as many as two-thirds of all poor workers are in agriculture. Poverty incidence among agricultural workers is 42%, nineteen percentage points higher than poverty incidence among workers. Within agriculture, the worst off workers (based on group poverty incidence) are farmhands and laborers, corn workers, and workers in other crops. Poor agricultural workers are most often working as farmhands and laborers, followed by working in corn farming.

16. **Being an underemployed agricultural worker is strongly associated with being poor.** The underemployment rate of agricultural workers is 28%, rising to 36% among poor agricultural workers. Remarkably, half of agricultural workers who are underemployed are poor. Among agricultural workers, the rate of visible underemployment is 20.4%, much higher than visible underemployment among all workers. Equivalently, about 73% of the underemployed are visibly underemployed. Surplus labor continues to be a huge problem in the countryside. However, the visibly underemployed in agriculture has practically the same poverty incidence as the underemployed; it appears that quantity of working hours is not an especially important correlate of poverty, compared to being underemployed *per se*.

17. Daily wages or its equivalent, i.e. daily basic pay, must play an important role in setting agricultural incomes. **The agricultural worker earns less than half the average daily basic pay.** In 2013, daily basic pay averaged 349 pesos for all workers; however the average agricultural worker 49% of that (Figure 2).

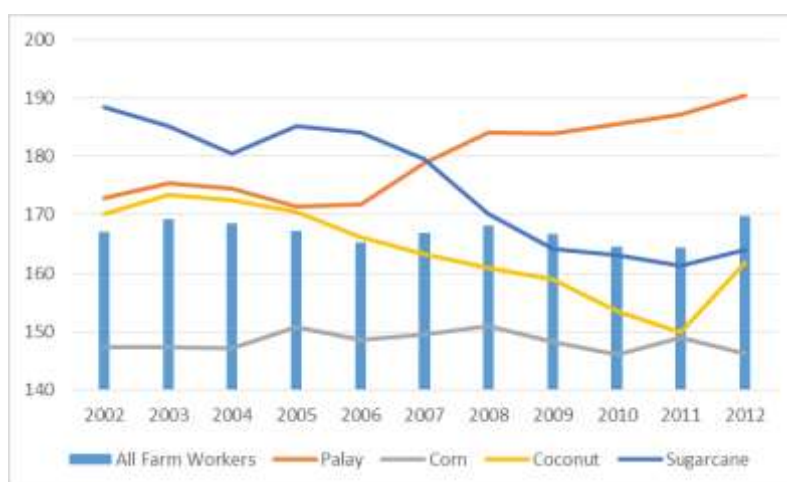
Figure 2: Average daily basic pay index (all workers = 100), 2013

Source: PSA – BLES (2015).

18. The average service worker earned 15% more; among service workers, only a few subsectors, namely accommodation and food service activities, wholesale and retail trade and repair of motor vehicles, and other service activities, earned lower than average wages; even in these low-wage service sub-sectors, average daily pay still exceeds that of agriculture.

Moreover, **depressed levels of agricultural wages have persisted over the decade** (Figure 3). In fact for all major crops, except rice, agricultural wages have fallen in real terms. The steepest decline was for sugarcane at 13%, followed by coconut at 5%. The challenge is to stimulate demand for labor in the countryside, thereby reducing surplus labor, eventually raising average wages, especially in agriculture.

19. **Increased labor income at scale, including labor income of farmer-operators, is less likely to be realized in traditional farming activities.** Labor input, value added, and net returns from rice and corn farming is quite modest on a per ha basis (Table 4). Compare this with vegetable and fruit farming, which offer fourfold or more net returns, along with greater output and employment intensity (as measured by value added and labor cost per ha).

Figure 3: Real wages in agriculture (2000 prices)

Source: PSA-BAS (2014).

Table 4: Cost and returns from various crop farming activities, pesos per ha, 2012

	Gross Returns	Net Returns	Labor Cost	Value Added
Rice	62,366	19,891	11,328	36,801
Corn	36,271	10,725	9,618	24,406
Vegetables	288,864	149,207	45,876	212,309
Fruits	150,095	78,559	20,280	115,003
Coffee	48,750	19,225	16,546	39,688

Source of basic data: PSA – BAS (2014).

2. *Housing*

20. Magtulis and Ramos (2013) estimated a housing backlog of 1.2 million units nationwide in 2011. Much of the unmet housing need is in urban areas, where the problems of informal settlement, substandard/makeshift housing, sharing of single dwellings, and outright homelessness of families, is most acute. To characterize the housing needs of the BoP, the more relevant population segment is the set of vulnerable and poor households under the \$3/day cut-off. Based on the 2012 FIES, the BoP devotes less than a fifth of its expenditure on housing (18%), lower than the housing expenditure share of the average household (21%).

21. **BoP households suffer much lower quality of housing compared average household** (Table 4). For type of roof, the BoP shows an eight percentage point disadvantage in terms of use of strong materials; instead they exhibit higher shares of use of salvaged, makeshift, and mixed materials. A similar pattern holds for type of wall; in fact usage of strong materials is twelve percentage points lower for the BoP compared to the total. Differences are noticeable but not as sharp for tenure, and electrical connection. However for toilet facilities, the BoP population has much lower access to water-sealed, exclusive use facility (ten percentage points), as well as own-use faucet or water system (fifteen percentage points).

22. The Table makes clear that BoP households are making investments; in 2012 their spending for housing (including imputed rent) is about P20,000 per household per year. However, **BoP households are incrementally building up their homes in a slow and costly process for both themselves and society as a whole.** Housing improvement is based on individual, piecemeal effort, rather than from realizing benefits from linked products and services in a value chain. Unfortunately this is typically the only route available for this population segment (Stickney, 2014).

Table 5: Shares in total, BoP versus population, by housing category (%)

	<i>All households</i>	<i>BoP households</i>
Type of roof	100.0	100.0
Strong materials	80.6	73.0
Light, salvaged, makeshift materials	12.5	18.4
Mixed materials	6.9	8.6
Not applicable	0.0	0.0
Type of wall	100.0	100.0
Strong materials	67.8	55.6
Light, salvaged, makeshift materials	19.5	28.6

	<i>All households</i>	<i>BoP households</i>
Mixed materials	12.6	15.8
Not applicable	0.0	0.0
Tenure	100.0	100.0
Owner or owner-like	69.1	65.2
Rented or rent-free with consent	27.2	30.8
Rent-free without consent	3.6	3.9
Not applicable	0.1	0.1
Toilet facilities	100.0	100.0
Water-sealed, exclusive use	76.3	66.9
Water-sealed, shared	10.2	12.9
Pit and others	9.0	13.5
None	4.4	6.8
Electricity	100.0	100.0
With electricity	88.8	83.0
Without electricity	11.2	17.0
Water source	100.0	100.0
Own-use, faucet or system	42.1	27.2
Shared water system	10.8	13.3
Own-use, deep well	11.3	10.9
Shared, deep well	15.0	20.3
Others	20.8	28.3

Source of basic data: PSA-NSCB.

C. Rationale for IB

1. *Inclusive growth and IB*

23. In the name of inclusive growth, significant resources have been expended on poverty alleviation programs that attempt to redistribute the benefit of economic growth to the poor in the form social welfare programs (most notably, the government's conditional cash transfer scheme). **However inclusive growth must transcend welfare programs and social safety nets, moving to a strategy in which low-income households contribute actively to the growth process**, from the supply side as entrepreneurs and workers, or on the demand side as buyers of goods and services that enable them to continue to add value. This is precisely the premise of the IB strategy.

24. As the private investments drive economic growth, the IB strategy closely engages the private sector in the pursuit of socio-economic transformation. Such an engagement recognizes that barriers to inclusion, or unfavorable conditions in the business environment, will need to be overcome to realize IB as a self-sustaining commercial proposition.

2. *Employment generation and IB*

25. **Abundant labor resources at affordable wages are the main economic advantages from employing the poor.** This is especially the case for rural areas, where wages in agriculture remain low and surplus labor widespread. The challenge facing IB is to share

incremental value with the BoP, by providing employment and especially self-employment income significantly higher than current levels, without undermining the value proposition from engaging the poor.

26. For tourism, firmed-up estimates of the impact on the BoP is difficult to provide as tourism is not a single sector, but cuts across various service establishments (food, accommodations, events hosting, travel, sightseeing, entertainment, etc.) Nonetheless some indicators reported by Department of Tourism (DOT) do indicate a significant potential: from January to October, monthly earnings from tourism activities grew by 8.24%, reaching P187 billion over the period January to October 2015 (DOT, 2016). Much of the expenditure may be in rural areas, e.g. tourism establishments and activities in and among island and coastal communities, mountain villages, agri-eco tourism areas, and so forth, Under IB, tourism investors may become more attuned towards hiring as well as sourcing locally, thereby engaging the BoP as workers in service establishments or as suppliers (food, travel services, etc.)

27. Engagement of the BoP household as supplier or worker presupposes a *value chain* in which inputs and intermediate goods are transformed in sequence through stages of production. In agribusiness and tourism value chains, a final service or product that meets stringent quality standards commands a high price premium. The retail price premium propagating up the chain enables BoP suppliers generate higher incomes. In the case of agribusiness, these price premia are most likely to be found in nontraditional crops, such as horticulture and commercial crops, as in Table 4. The exception in the Table appears to be coffee. This highlights the importance of modern varieties and practices in transforming traditional crop farming activities, which is precisely the model contemplated by Nestle in its IB for sourcing raw materials (Dietrich, 2014a).

28. Quality standards along some value chains obviate coordination of supply and demand based on impersonal market forces. In such chains, coordination entails a governance structure between buyer and seller. The form of governance can range from hierarchy imposed by vertically integrated ownership of assets, to more flexible forms such as supply contract, technical and other support from buyer to seller, organization of buying stations, and so forth.

29. Such coordination arrangements may themselves constrain the integration of BoP households into the value chain. **Coordination cost, business environment, and supplier/worker capacity are the major challenges facing replication and sustainability of inclusive business opportunities. BoP households face greater obstacles to overcoming these challenges.** Reasons for this include the following:

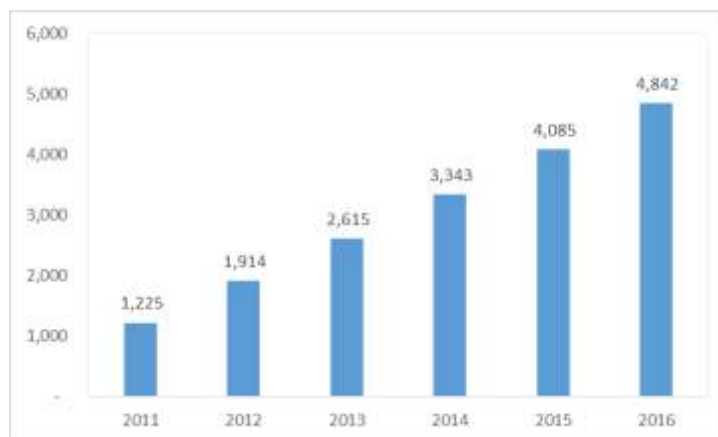
- i) Barriers to entry into the formal sector, which are favored by the economic mainstream due to better information, standardization of business form, protection of assets and contracts, and so forth;
- ii) Barriers to entry into formal finance, due to transaction cost (i.e. formal identification, filling up forms), as well as bank requirements for documented property as collateral;
- iii) Greater vulnerability to economic and natural risks, and lower access to risk mitigation instruments such as insurance;
- iv) Lower levels of education, skills, health, and participation in business social networks, preventing them realizing the business opportunities and adopting innovation.

3. *Housing services and IB*

30. **Market failure prevents BoP households from gaining sufficient access to quality housing.** The housing markets literature suggests that a number of externalities lead to undersupply of quality housing in general, with BoP households specifically at a disadvantage. These externalities include the following (Malpezzi, 1996): i) A well-functioning housing market will benefit labor markets as well by facilitating labor mobility; ii) Quality housing confers health benefits through reduced crowding and improved sanitation; iii) Homeownership is associated with desirable social outcomes, such as better maintained housing stock, and political stability. Moreover, credit market imperfections, policy distortions, and other market failures, may drive the equilibrium price of land above the capitalized value of land income, due to use of land as inflation hedge, lower taxes on agricultural use of land, etc. (Deininger and Feder, 2001).

31. In the Philippines, 78% of households own or are amortizing their homes (PSA-NSO, 2014). Twenty percent are renting, or enjoying rent-free housing with owner's consent. Presumably a large proportion of households in this group desire home ownership, but confront excess housing and land values, and exclusion from formal housing finance. Not that the BoP lacks purchasing power in the medium to long term; worldwide housing for the BoP can reach up to \$785 billion investments over the period 2010 – 2020, making housing the most promising market for BoP compared to water, health, education, and microfinance (JP Morgan, 2010). In the Philippines the market potential is also sizable. Housing and Urban Development Coordinating Council (HUDCC) estimates show that the housing backlog, already at 1.2 million units in 2011, may shoot up to 4.8 million units by 2016 (Figure 4).

Figure 4: Estimated housing backlog, in number of units, Philippines, 2011 - 2016



Source: HUDCC, cited in NEDA (2014).

32. BoP families adapt in the face of this backlog, typically compromising on housing quality, as seen in Section II.A.2. The actual process of housing investment has been described as follows for the case of Latin America, but applies equally in the Philippines (Stickney, 2014, p. 19): “While formal housing markets have generally left out the BOP, clearly the low-income majority is solving its housing needs on its own, even if through informal means. This means that construction is undertaken without technical designs, does not necessarily adhere to formal codes and regulations, and involves local builders who tend to lack formal training in construction methods.” IB offers an opportunity to BoP households to finally obtain quality home improvements or even complete housing solutions.

D. Policy approaches to IB

33. Tewes-Gradl et al (2013) offers a typology of policy approaches to IB, summarized in matrix format (Table 6). These policy approaches will be applied to the assessment of government programs relevant to IB. According to the matrix, the three policy approaches are read down the rows: i) **enabling companies** to enter IB activities; ii) **encouraging companies** to invest in IB activities; and iii) **empowering poor** people to engage with companies. Approach ii) may be augmented by interpreting “companies” broadly as including social enterprises with business models that are commercially viable and are conducted at scale or potentially at scale. The role of social enterprises in IB has been recognized by

34. Benefits from IB policies include:

- i) *Improved information*: involves raising awareness on IB, providing public recognition (i.e. awards) for IB practices, and providing research and data support.
- ii) *Conducive rules*: involves providing an overarching policy framework conducive to IB; standards or accreditation to distinguish IB from other business activity; and recognizing IB in sector regulation, perhaps relaxing existing regulations. Legal forms need to new categories to accommodate hybrid nature of IB as a for-profit institution with a social mission, or alternatively a social enterprise with commercial objectives, when conferring legal recognition, tax benefits, preferential rules, etc. Finally, as market participation of BoP households tends to be less formal, policies can lower barriers to formalization, or adjust regulations for transacting with informal enterprises or workers.
- iii) *Financial resources*: covers various instruments for financial support, ranging from outright grants, subsidies, and tax exemptions, to more market-oriented schemes such as investment guarantees, access to developmental loans by public and nonprofit financial institutions, and impact investment.²

The fact that IB is defined in terms of profit rules out activities that are sustained solely by public subsidy. However a well-designed and temporary subsidy or tax incentive scheme may be part of strategic support to IB. This is especially the case in a setting where such schemes are already provided by government as a matter of policy to attain economic development objectives, e.g. BOI and tourism incentives in the Philippines.

- iv) *Structure and capacity*: refers to the direct provision of public goods and services by the state or public enterprises. Examples include education, health care, physical infrastructure and utility services. Infrastructure linking poor rural communities to the economic mainstream are needed to enable companies to engage in IB. Companies may be encouraged to invest in IB through development partnerships with government, i.e. public-private partnership arrangements. Finally, structure and capacity interventions can work directly with BoP households in the form of microbusiness support and capacity-building.

²*Impact investment* refers to investments made into companies, organizations, and funds with the intention to generate measurable social and environmental impact alongside a financial return (<http://www.thegiin.org/cgi-bin/iowa/investing/index.html>).

Table 6: Summary matrix of IB policies

	Information	Rules	Financial resources	Structure and capacity
Enable companies	Data and research Peer learning	Sector regulation Standards Policy frameworks	Access to finance, access to loans (market-rate)	Infrastructure
Encourage companies	Awards	Obligatory inclusion Legal forms for business with social mission	Financial support Public procurement	Development partnerships
Empower BoP households	Awareness-raising	Legal framework for market participation	End-user subsidies Insurance schemes	Microbusiness support Capacity-building

Source: Tewes-Grادل et al (2013).

E. Identification of IB

35. Crafting policies and strategies for IB presupposes a clear concept of IB and its delimitation from other related activities, discussed Section II.A.B. Identification of IB can be operationalized by way of an accreditation scheme as being pursued by BOI in cooperation with ADB Box 1 presents a summary of the criteria, and accompanying weights, in the case of large companies applying for IB accreditation. Accreditation applies to projects, i.e. a set of related business activities, rather than to companies; this is consistent with BOI practice. In fact, IB accreditation can be integrated into the existing BOI registration process, though the two procedures can run separately (i.e. a company can apply for IB accreditation without having to qualify or even apply for BOI registration). Accreditation relies on an IB evaluation tool, the result of which is a classification in terms of the following: a) not-IB; b) potential IB; c) accredited IB.

36. The evaluation tool scores the company based on the following sets of criteria, namely *financial viability*, *social impact*, and *innovations*. The detailed scoring methodology is described in detail in an ASEI document; we provide only an overview here (Table 7). **Financial viability** examines the business case for the project, i.e. addressing the profit side of IB. **Social impact** covers the engagement of the BoP within the project. Social impact refers to reach, depth, and systemic solution. *Reach* is measured by number of beneficiaries. *Depth* pertains to the size of the benefit. *Systemic solution* focuses on the relevance of the business model in addressing income or human development gaps in a specific area, as well as the commitment towards disseminating the model to other key players. Lastly, **innovations** refer to innovative approaches to poverty reduction, environmental sustainability, and social inclusion.

Table 7: Evaluation criteria for IB accreditation, case of large company

Financial viability (30)	Agribusiness, tourism, housing
	<ul style="list-style-type: none"> • Financial strength of the company undertaking the project: <ul style="list-style-type: none"> - Profitability (Return on Equity, Return on Assets) - Solvency (Debt-to-Assets ratio, Assets-to-Equity ratio) - Balance sheet indicators: Assets, Debt, Equity • Total investment in the project • Relevance of the IB model for the company (IB model a core business) • Projected internal rate of return from the project
Social impact (50)	Agribusiness, tourism
	<ul style="list-style-type: none"> • Reach: <ul style="list-style-type: none"> - number of new income opportunities created - additional weight: income opportunities for the poorest households; Income opportunities for women • Depth: <ul style="list-style-type: none"> - real income increase of suppliers (pre-project versus full-scale of project) - duration and security of new income opportunities (in years) • Systemic impact: <ul style="list-style-type: none"> - relevance of business model in addressing income generation in poor areas with few income opportunities - commitment to share business model to others - technical assistance to farmers (agribusiness); training and capacity building to BoP participants in supply chain (tourism)
	Housing
	<ul style="list-style-type: none"> • Reach <ul style="list-style-type: none"> - Number of households from the BoP availing Low-cost houses - Final housing clients by income group - Final housing client by sex (% of women owner) • Depth <ul style="list-style-type: none"> - Financial (final price of the unit in PhP thousand) - Security of tenure - Quality of house, common space, infrastructure - Employment Impact (% workers hired from the community) • Systemic <ul style="list-style-type: none"> - Located in places with high density of informal settlers - Commitment to share model, replicate it, or build up the sector
Innovations (20)	Agribusiness
	<ul style="list-style-type: none"> • Business innovations (profitability and governance) (examples) <ul style="list-style-type: none"> - Measures to increase profitability for company and farmers and promote good governance - Strategy to avoid pole vaulting - Access to finance for farmers - Access to information for farmers • Social innovation

	<ul style="list-style-type: none"> - Measures to increase positive social impact - Land titling - Indigenous people inclusion - Social impact measurement system in place • Environmental innovation <ul style="list-style-type: none"> - Measures to reduce negative environmental impact - Water – dripping system/water catchment system - Sustainable reforestation – carbon storage - Environmental impact measurement system in place
	Tourism
	<ul style="list-style-type: none"> • Business innovation <ul style="list-style-type: none"> - Measures to increase profitability for company and promotion of good governance • Social innovation <ul style="list-style-type: none"> - Measures to increase positive social impact - Social impact measurement system in place • Environmental innovation <ul style="list-style-type: none"> - Measures to reduce negative environmental impact - Environmental impact measurement system in place
	Housing
	<ul style="list-style-type: none"> • Business innovations (profitability and governance) (examples) <ul style="list-style-type: none"> - Measures to increase profitability for company and promote good governance - Reducing the price for the final client (poor) through public-private partnership arrangements - Linking repayment structures to financing instruments of banks - Brokering affordable insurance, e.g. Asset insurance, life insurance as part of mortgage, etc. • Social innovation <ul style="list-style-type: none"> - Measures to increase positive social impact - Additional social facilities in the community (health, community hall, kindergarden) - Providing opportunities for sustainable income generation through housing (not only during building phase) - Facilitating construction material jobs in the community - Improvements in the community governance (organizing home owner associations, etc.) • Environmental innovation <ul style="list-style-type: none"> - Measures to reduce negative environmental impact - Features in the community (e.g. Elevated roads, wider canals, small dams around the housing group, etc.) - Construction features of the house (rainwater collection, quality of roof construction, etc.) - Others (specify)

Note: In the case of agribusiness, the weight of Social Impact is 55%, while that of Innovation is 15%.

37. Accreditation is applied only to specific projects or business models of companies already operating legally in the Philippines, whether foreign or local. Finally, accreditation presupposes a monitoring process, in which models that cease to meet IB criteria will lose their accreditation.

38. For large private companies, the criterion of “social impact” requires a minimum scale, hence the accreditation criteria will likely favor companies able to implement large-scale projects, though these projects will benefit the BoP by engaging them as suppliers, workers, or consumers. Such engagement will likely require support from the IB company, the specific form of which (finance, technical assistance, favorable pricing, etc.) will depend on the specific IB model being proposed.

39. In line with the discussion in II.A the IB accreditation tool has been extended to accommodate the business models of social enterprises and SMEs. In the tool, SE are defined as business models of SMEs with sales of under P20 million, and/or assets of under P100 million. The evaluation tool for IBs involve the same criteria, and identical weights: for Agribusiness, the weight of Social Impact and Innovation is kept at 50% and 20% respectively, as stated in the first column of Table 7.

40. Given BOI’s mandate to encourage investments which provide significant employment opportunities relative to the amount of capital investment, provide a fountain for the future development of the economy, and accelerate development of less developed regions of the country, the BOI is the logical agency to handle IB accreditation, though independently of its incentive registration process.

Box 1: Collaboration between BOI and ADB on Inclusive Business

In line with government policy on IB, the BOI approached the ADB to help set up an IB accreditation system that would help IB companies - due to their social impact - get priority access to existing government services and industry incentives. In 2014, for the first time, BoI has also included IB in the new Investment Priorities Plan (IPP).

Between 2011 and 2013, ADB promoted market scoping studies for inclusive business - one of them also in the Philippines - as part of its regional knowledge sharing work. From 2014 onwards with co-financing from the government of Sweden and Credit Suisse, ADB is implementing a new regional technical assistance program on IB, which provides due diligence studies and impact assessments of IB deals financed by ADB's private sector department, supports policy work for improving the ecosystem for IB in selected Asian countries (apart from the Philippines also in Viet Nam, Myanmar, Indonesia, and Bangladesh), and promotes knowledge sharing and partnerships.

Initial policy work on IB in the Philippines needs upscaling: ADB has supported BOI with initial work on IB accreditation in the agribusiness sector. This needs to be rolled out, and extended to other sectors also. In addition, the government wishes to screen its incentive programs (in DTI and other departments) and rationalize it for priority access for IB projects. To this end the government requested ADB for additional technical support, and ADB agreed on a consultancy assignment to promote IB accreditation in BOI and develop recommendations for a better business environment for IB through existing government programs.

III. Government programs relevant to IB

A. The national development strategy and IB

1. The national development plan

41. The Philippine Development Plan (Midterm Update) 2011 – 2016 posits three goals towards a Competitive Industry and Services Sectors:

- i) Create a better business environment;
- ii) Increase productivity and efficiency;
- iii) Enhanced consumer welfare.

42. Sub-goals under increased productivity and efficiency are as follows:

- i) Intensify the culture of competitiveness:
 - Develop human capital; support market-driven education and training;
 - Promote mutually-agreed upon work arrangements;
 - Strengthen tripartite councils.
- ii) Focus interventions in key industry areas:
 - Implement investment promotion, industry development and incentives in job-generating areas;
 - Implement export development activities in competitive industries with high-growth potential.
- iii) Enhance firm-level support to micro, small, and medium enterprises (MSMEs)
 - Provide business development services;
 - Provide access to financing;
 - Develop livelihood programs into sustainable micro-enterprises;
 - Promote entrepreneurship among overseas Filipinos;
 - Strengthen science, technology, and innovation for local competitiveness.
- iv) Expand industry cluster development;
- v) Increase market access.

43. The national development plan most directly relates to IB in sub-goal iii), on MSMEs. The legal framework for MSME development was established by the Magna Carta for Small Enterprises (RA 6977 of 1991, as amended by RA 8289 and 9501). A year later came the 1992 National Economic Research and Business Center (NERBAC) Act (RA 7470). The next milestone was the Barangay Micro Business Enterprises (BMBE) Act of 2002 (RA 9178). Most recently was the Go Negosyo Act of 2013 (RA 10644).

44. The Magna Carta defines MSMEs based on assets or number of workers, as follows:

- Micro : not more than P3,000,000; or 1 – 9 employees
- Small : P3,000,001 - P 15,000,000; or 10 to 99 employees
- Medium : P15,000,001 - P100,000,000; or 100 to 199 employees

45. The Magna Carta gives the aforementioned official definition of MSMEs based on asset size. It strengthens the Small and Medium Enterprise Development Council (previously established in RA 6977) as the MSME Development Council, attached to the DTI. The Act also tasks the DTI to prepare a six-year MSME Development Plan, which shall include a micro credit financing scheme, incorporated into the Philippine Development Plan, and approved by the President. The Act also establishes the Small Business Guarantee and Finance Corporation (SBC), which is charged with the responsibility for implementing comprehensive policies and programs to assist MSMEs, covering finance, information, training, and marketing.

46. The NERBAC Act establishes a Center that shall provide prospective investors with a one-stop action center to facilitate processing and documentation for the establishment of a business enterprise, as well as basic information on business options available in accordance with government investment priorities. The Center, as its name implies, is a national office, establishing regional branch offices as need and resources permit.

47. Business incentives for microenterprises are introduced by the BMBE Act. The Act exempts barangay microenterprises from income tax and the minimum wage law; it opens access to dedicated credit windows in government financial institutions (GFIs). The LGU, specifically the Office of the Municipal or City Treasurer, shall register BMBEs and issue the authorization to avail of these incentives.

48. The Go Negosyo Act amends the previous laws by establishing Negosyo Centers. These Centers are primarily responsible for promoting ease of doing business and facilitating access to services for MSMEs, under the supervision of the MSMED Council. It will make available a unified and simplified business registration form, containing all necessary information for the business application process. It shall accept and expedite business application process of MSMEs in coordination with the LGU. Unlike the BMBE Act, the Go Negosyo Act assigns the DTI, through the Negosyo Centers, to register BMBEs and authorize them to avail of the microenterprise incentives of RA 9178. Unlike the NERBAC, Negosyo Centers are established at the municipal, city, and provincial levels. Under the DTI's Implementing Rules and Regulations (IRR), existing SME Centers and NERBAC may be converted to Negosyo Centers. The Negosyo Act furthermore requires the establishment of a Philippine Business Registry Databank to serve as repository of information of all business enterprises of the Philippines.

49. The Negosyo Centers will serve as the core of DTI's thrust towards MSME promotion. Already, 20 pilot centers were launched in 2014 (respectively in the Cities of Cagayan de Oro and Iloilo.) Two others (Batangas City and NCR) will be launched in early 2015; the target is 100 Negosyo Centers in cities and capital towns by late 2015. By end-2016, a total of 302 Negosyo Centers are expected to be in place in every city and province nationwide.³

2. *Assessment*

50. Returning to the categories of Table 6, the PDP expresses a strong commitment to the third policy approach, namely **empowering BoP households targeting benefits in terms of improved structure and capacity**. Empowering households involves micro-business support, including finance, as well as other business services such as technical assistance,

³ <http://www.dti.gov.ph/dti/index.php/negosyo-center/about-negosyo-center>.

market linkages, and expedited business registration. Even investments in infrastructure are more closely aligned with the perceived needs of low income communities.

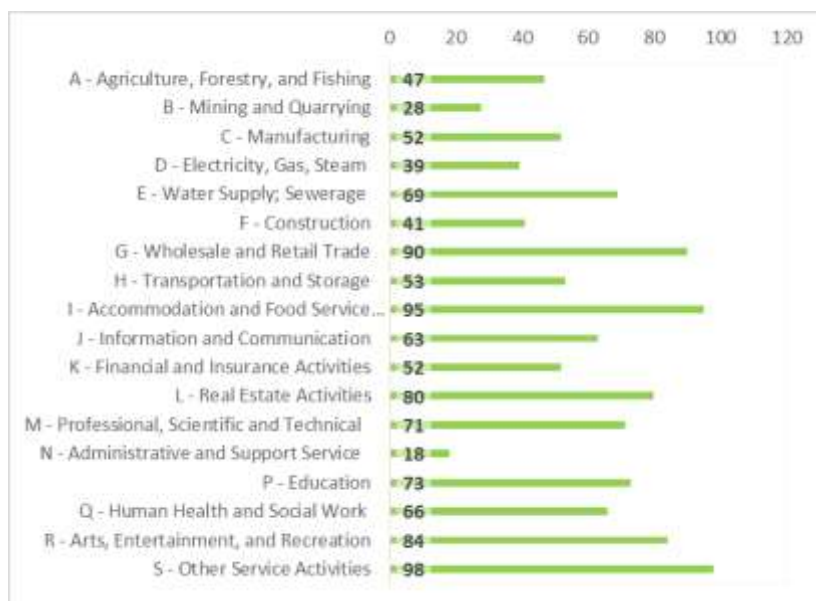
51. However the **national strategy is weak in terms of encouraging and enabling companies to realize benefits from IB**, i.e. the first two policy approaches of Table 6. There is engagement of private business, but seldom linked to value realization for the base of the pyramid. One hindrance to IB approaches is the impression that assistance for large enterprises are deemed unnecessary given their superior access and capacity for technology, finance, market networks, and human resources. This perspective however fails to see the benefits accruing to low income farm households from support to IB activities. The initiatives launched by BOI in terms of investment incentives and accreditation for IB are an excellent beginning; however IB will still need to work its way into the national development strategy and the welter of government programs.

B. MSME Development

1. Profile of MSMEs

52. Establishment data for 2012 report a total employment of 7.59 million workers. Of these, 65% are reported as employed in MSMEs. Among the latter, employment is sparsest among Medium enterprises, accounting for just 7% (compare with the 35% share of large enterprises). Among the industries, MSMEs dominate Trade and Accommodation and food service industries based on employment share (Figure 5). The cluster of community and personal services are also characterized by high MSME share in employment. In contrast, Manufacturing and other services have MSME employment shares lower than average.

Figure 5: MSME share of industry employment, 2012 (%)



Source: SME Council.

2. DTI Programs for MSME

53. The MSME Development Plan (2011 – 2016) aims at four outcomes for MSMEs, namely improving: i) business environment; ii) access to finance; iii) access to markets; and iv) productivity and efficiency. Implementation is based on three approaches, namely: local and regional competitiveness; sector competitiveness; and market system development.

Local and regional competitiveness highlights the role of LGUs, and of the private sector in local development. *Sector competitiveness* encompasses whole value chains, aiming at upgrading based on participatory development. Lastly, *market system development* develops the capacities of market actor, i.e. including the private sector, business organizations, and informal networks; allows stakeholders to address market failures; and refocuses government resources away from duplicating business development services already provided by the private sector, towards creating an enabling environment for investment, thereby promoting efficiency.

54. The DTI banner program for inclusive growth is its “Big Push” for MSME Development, spearheaded by the **Shared Service Facilities (SSF) Project**. The Project was initiated in 2013 with a 700 million budget. It involves funding (for the acquisition of specialized equipment or facilities to upgrade the business activities of MSMEs. By end-2013, there were 475 SSFs and 32,540 beneficiaries. Activities include: abaca production, processing of bamboo, banana chips, coffee, and bangus; food packaging; vegetable flour production; muscovado production; mushroom drying; soap making; pottery; indigenous crafts; and loom-making.

55. The SSF Operational guidelines (DO 13-1627) impose the following requirements:

- i) Each SSF must be accompanied by a cooperator, which will provide counterpart support in the form of a building to house the equipment or machinery, support personnel, and working capital. Cooperators can be NGOs, POs, cooperatives, business or industry associations, local government units, state universities and colleges and other similar government or academic institutions, operating a minimum of three years.
- ii) Proposed facility must address processing and manufacturing gaps in priority industry cluster (identified in NICCEP), by boosting productivity through observed product improvement, marketability, price competitiveness, and conformity to standards.
- iii) Approval is based on technical proposal, endorsed by the provincial DTI, evaluated according to the following criteria: high impact/investment ratio (30%); expansion of a ready market (25%); within 609 focused towns/cities of priority clusters (20%); and targets identified clusters with greatest need (20%).

56. Proposals below P50,000 may be approved by the provincial DTI; up to 1 million pesos, are approved by a Regional Technical Working Group (RTWG); up to 2.5 million pesos, are approved by the National Technical Working Group; and above 2.5 million pesos, are approved by the Executive Committee.

57. The Rural Micro-Enterprise Promotion Program (RuMEPP) of DTI was an IFAD-supported project (2006 – 2013) which provides technical and financial support for microenterprises, covering 19 poorest provinces in CAR, Bicol, Eastern Visayas, SOCCSKSARGEN, and Caraga. The Project focuses on formation and expansion of microenterprises at the lower and poorer end of the scale, towards profitable and sustainable operations. Interventions include microfinance and credit, microenterprise promotion, and program and policy coordination. Upon termination it tallied 56,875 microenterprises provided financial assistance (163% of target); through SB Corp, \$14.33 million worth of funds were allocated for credit through 89 microfinance institutions. Business development services were provided to 33,873 microenterprises (226% of target).

3. *MSME programs of other agencies*

58. The Department of Science and Technology (DOST) launched the Small Enterprise Technology Upgrading Program (SETUP) as its focus intervention for SMEs. It is a strategy to encourage and assist SMEs adopt technological innovations by technology transfer, acquisition of equipment, human resource development, and other activities.

59. The Department of Social Welfare and Development (DSWD) is implementing a Self-Employment Assistance – Kaunlaran (SEA-K) program, aimed at improved livelihood and capacity building program, SEA – K seeks to enable the poor to have access to finance and promote entrepreneurship. Funds provided are interest-free and intended as seed capital for livelihood projects. The Department is also implementing a Sustainable Livelihood Program, which includes a microenterprise development component; selection of beneficiaries is based on the National Household Targeting System (NHTS).

60. Another program using the NHTS for livelihood intervention is the KABUHAYAN program under the Department of Labor and Employment (DOLE) Integrated Livelihood Employment Enhancement Program (DILEEP). The KABUHAYAN provides working capital grants to purchase equipment, tools and jigs, raw materials, for livelihood undertakings.

4. *Assessment of MSME programs*

61. **Despite the strong empowerment approach in government programs, MSMEs in the country remain underdeveloped.** The constraints mentioned in the MSME Development Plan persist, i.e. the high cost of doing business, lack of access to finance and market information, and low productivity and competitiveness. In finance, a survey of SMEs shows that only 31% have attempted to borrow in the last 12 months; 41% have never borrowed at all. This is consistent with an earlier survey which shows that funds from the banking sector accounts for just 11% – 21% of the capital requirements of SMEs. This is lower than the 30% benchmark observed in other developing countries, such as India and Thailand (Aldaba, 2011).

62. Much progress has been made to streamline registration procedures for SMEs, especially for establishing and operating small proprietorships. However for partnerships and corporations, business registration and licensing remains cumbersome (Aldaba and Aldaba, 2012). As for programs to access technology, implementation problems have been noted. The SSF program has contended with slow procurement, lack of appropriate suppliers, delays in delivery of equipment, and in some cases inappropriate equipment procured (Medalla et al, 2015).

63. Sustainability has also been highlighted as an issue. In the case of RuMEPP, an internal Supervision Report states that MEs assisted have experienced an increase in profits, assets, and employment generated. However, larger and more mature MEs have shown improvements in business stability; the smallest microenterprises (70% of RuMEPP enterprises) have yet to demonstrate financial sustainability, as they struggle with rising costs, stiff competition, and eroding margins (IFAD, 2013).

64. The grassroots approach adopted by government for MSME promotion is inadequate. **An alternative approach therefore is to take the private sector as the entry point for intervention.** This approach relaxes a number of constraints facing MSMEs at the outset. Marketing, technology, and production management, are functions for which the private sector has comparative advantage in the supply chain.

65. The approach though may be deemed too indirect, relative to the target group, which is the BoP. To address this, an instrument for distinguishing regular commercial business transactions from those that are truly inclusive is essential. IB accreditation, combined with a credible M&E system, is precisely that instrument.

66. **Once IBs are properly identified, the full weight of government support can be brought to bear at both sides of an inclusive value chain.** On the grassroots side, the government programs supporting MSME development can advocate for IB linkages; IB-linked MSMEs and BoP households can be provided preferential access to government programs. IBs themselves may be afforded special treatment in existing industry promotion programs.

67. **Finally, government should devote resources towards ensuring IB accreditation is credible, and information about IB disseminated to various stakeholders in the roadmaps and clusters.** Here the Negosyo Centers can play the key role. Understandably, the Negosyo Centers are still in the process of being formed, as the IRRs were finalized on December 2014. Nonetheless once in place, the Centers can act as a lynchpin in dissemination and advocacy for IB and inclusive value chains, among stakeholders in regions and down to the provinces.

C. Other DTI programs

1. Industry promotion and clustering

68. **Investment incentives.** Annually the government determines an Investment Priority Plan (IPP); private companies with projects falling under the IPP can register with BOI and qualify for fiscal and other incentives (Box 2). Non-fiscal incentives cover: permission to employ foreign nationals (pioneer status); simplified customs procedures; and operation of a bonded manufacturing/trading warehouse. The current list of priorities includes agribusiness, tourism, and housing.

Box 2: Fiscal incentives for BOI-registered enterprises

- Income Tax Holiday (ITH): project exempted from payment of income taxes for four years (non-pioneer status) or six years (pioneer status).
- Exemption from taxes and duties on imported spare parts – exempted from customs duties and national internal revenue taxes on its importation of required supplies/spare parts for consigned equipment or those imported with incentives (requires bonded manufacturing warehouse).
- Exemption from wharfage dues and export tax, duty, impost and fees
- Reduction of the Rates of Duty on Capital Equipment, Spare parts and Accessories
- Tax Credits –equivalent to the national internal revenue taxes and duties paid on raw materials, supplies and semi-manufacture of export products and forming part thereof.
- *Additional Deductions from Taxable Income* – additional deduction equivalent to fifty percent (50%) of the wages of additional skilled and unskilled workers in the direct labor force, for projects meeting a prescribed capital to labor ratio. The additional deduction shall be doubled if the activity is located in an Less Developed Area (LDA). Not in conjunction with ITH.

69. The 2014 IPP General Policies define Inclusive Business as “those profitable core business activities that deliberately target the low-income segment (below US\$3/day) as part of their value proposition.” Note the absence of some elements of our earlier definition, namely scale and systemic impact. The IPP does not confer specific benefits to IBs; registered enterprises are simply “encouraged to adopt an inclusive business (IB) strategy”. Accreditation of registered enterprises as an IB can be done by the BOI following guidelines to be issued by the Board.

70. **Industry Roadmaps.** In 2012 the DTI initiated an Industry Roadmapping Project, to establish or reinforce strategic partnerships with industry stakeholders. A Road Map should assess the industry’s state and economic performance; identify the binding constraint to growth; recommends strategies for industry upgrading and development; and define the industry vision, goals, and targets, in the short, medium, and long term. Currently thirty sectoral road maps have been submitted, of which 32 are complete (Table 8). For each sector, a multi-stakeholder technical working group (TWG) is created, to draw up sectoral plans of action and monitor road map accomplishments. Eighteen TWGs have been convened.

71. These sector road maps are inputs to the Manufacturing Industry Road Map (MIRP). The MIRP identifies binding constraints to growth; a critical one is underdeveloped state of SMEs. They lack access to finance, technology, and capacity to meet standards. Another key constraint for some industries is the lack of skilled workers e.g. metal casting, tool and die, auto and motorcycle parts, furniture, chemical, rubber, plastic, and iron & steel.

Table 8: List of sectors with completed roadmaps

1. Aerospace	17. Manufacturing
2. Automotive	18. Mass housing
3. Automotive parts	19. Metalcasting
4. Biodiesel	20. Motorcycle
5. Book publishing	21. Natural health products
6. Cement	22. Paper
7. Ceramic tiles	23. Petrochemicals
8. Chemicals	24. Plastics
9. Copper and copper products	25. Printing
10. Electric vehicles	26. Processed Fruits-Dried Mango
11. Electronics	27. Processed Shrimp/Prawns
12. Furniture	28. Retirement
13. Health Care Services	29. Rubber products
14. IC Design	30. Seaweeds/Carrageenan
15. Iron and steel	31. Shipbuilding
16. IT-BPM	32. Tool and die

Source: DTI – IDG.

72. The MIRP calls for increasing the share of manufacturing in GDP to 30%, up from 26% in 2014, and its share in employment to 15%, up from the current 8.4%. Based on the MIRP, the DTI is spearheading the Manufacturing Resurgence Program (MRP), aimed at addressing horizontal constraints (high cost of power, high cost of transport and logistics, etc.), and resolving vertical issues (supply chain gaps, human resource gaps, etc.) The MRP also provides a coordination mechanism for inter-agency collaboration.

73. **Industry clustering.** The National Industry Cluster Capacity Enhancement Program (NICCEP) is a three-year project (2012 – 2015), supported by Japan International

Cooperation Agency (JICA). The core NICCEP provides interventions in form of technical assistance (industry cluster experts), trainings (including overseas training and benchmarking), and workshops. Complementary and support programs of the government and other donor agencies will be tapped. NICCEP links MSMEs to complementary projects under MSME Development.

74. By 2013, 24 pilot industry clusters had been mobilized. These clusters accounted for P3.7 billion in investments, P8.5 billion in domestic sales, and another \$7.4 million in exports. Within the NICCEP network over 5,000 MSMEs have been assisted, while creation of 781 new enterprises and 37,164 new jobs has been supported. In Luzon the clusters are: milkfish (R-I), dairy (R-II), bamboo (R-III), coffee (CAR), ICT (R-IVA), tourism (R-IVB), health and wellness (NCR), wearable and home-style products (R-V); in Visayas the pilot clusters are ICT, tourism, health and wellness, and gift, decors, and housewares; in Mindanao, the clusters are rubber (R-IX and ARMM), poultry (R-X), tuna (R-XII), oil palm (R-XIII), banana, mango, coconut, tourism, seaweeds, mining, wood, and ICT (R-XI).

2. *Assessment*

75. **The clusters and road maps are an important mechanism for developing business alliances.** Performance indicators, e.g. growth targets, can be identified, and obstacles to meeting targets can be discussed over a broad enough set of players that solutions can be pursued, i.e. improvements in regulatory services, identification of suitable infrastructure projects, synchronization of upstream and downstream investments, etc. These will benefit all businesses and communities within the cluster regions.

76. **The clusters and roadmaps, being multi-sector initiatives, are unique opportunities to introduce IBs to a broad group of stakeholders.** These include: other organs and levels of government (LGUs, Regional Development Councils); grassroots organizations (cooperatives, farmer associations, etc.); civil society (NGOs, faith-based groups, etc.); and other private sector entities (banks, input suppliers, chambers of industry, etc.) Dissemination and advocacy can lead to improved understanding of the concept and benefits of IB, as well as in linking IB to BoP households in each locality.

77. **Problems have been noted in the country's investment incentives regime, underscoring the need for reforms.** A common justification for tax incentives is to remain competitive with ASEAN neighbors, particularly in attracting foreign investments. Indeed corporate income taxes in the Philippines are higher than those charged by its neighbors, i.e. Indonesia, (25%), Malaysia (25%), Vietnam (22%), and Thailand (20%). However incentives are a distortionary solution to the high tax regime; the correct response is to reduce corporate tax rates across-the-board. One suggestion is to align the corporate income tax rate closer to ASEAN standard by reducing it to 25% (World Bank, 2014).

78. Bracketing the issue of the overall tax rate, there is still a rationale for investment incentives if specific types of investments (distinguished e.g. by type of technology, sector, area, or modality) are deemed strategic and worthy of subsidy; if the optimal subsidy is below the tax due, then the subsidy can simply be administered as a tax incentive. Indeed, such incentives have been called "tax expenditures".

79. However giving a standardized ITH to priority sectors seems to be a ham-handed way to extend investment subsidies. Moreover the cost to the economy of such expenditures should not be underestimated; in 2011, tax expenditures extended by investment promotion agencies amounted to P83 billion, equivalent to 6.1% of government revenues (DOF, 2011).

80. Investment incentives have also been criticized for redundancy, i.e. investment would have been made even in the absence of incentive. Reside (2006) found that in 2004, redundant incentives transferred the equivalent of 1% of GDP to investors. The ITH approach to tax incentives have been especially criticized (Botman et al, 2008): an ITH exempts profits regardless of amount, hence the most profitable investments (which would have made anyway) obtain the biggest subsidy. Moreover they are most attractive for “footloose” industries that plan to exit upon expiration of the ITH, but are less attractive to investors with a longer planning horizon.

81. Currently there are two major legislative bills, both in the Senate, advocating for tax incentive reform; Manasan and Parel (2014) favor one (SB 987) for its more salutary impact on the investment regime. The reform measure seeks to unify BOI and PEZA under a single office and policy. Incentives are extended to two sets of enterprises: an export enterprise, defined as one whose export sales are not less than 70% of its total output; and domestic enterprises, defined as non-export enterprises, but are located in the thirty poorest provinces of the country (subject of minimum investment or employment requirement). This effectively abolishes the IPP in lieu of promoting all exporters, and non-exporters located in disadvantaged areas.

82. The bill also seeks to abolish the ITH. For export enterprises, incentives take the form of a corporate tax rate of 15%, or gross income tax rate of 5%, replacing all national and local taxes (except the value added tax and the real property tax on land); net operating loss carryover for ten years; accelerated depreciation; customs duties exemption for imported capital and raw materials; and exemption for wharfage dues. Meanwhile registered domestic enterprises enjoy a 15% tax rate, no loss operating cover of 5 years, and accelerated depreciation.

83. **These reform initiatives create an opportunity to integrate IB in the country’s investment promotion regime.** In particular the push towards dispersing industries to the poorest provinces in the country as in SB 987 is laudable but is remains too blunt if the objective is to increase social impact of investment. The more direct approach to integrate IB in fiscal incentives is proposed in Section IV.

D. Agribusiness programs

1. Department of Agriculture

84. Programs for agribusiness supply chains begin with development of farm production, for which the lead agency is the Department of Agriculture (DA). The national development policy is laid out in the PDP Chapter on Competitive and Sustainable Agriculture and Fisheries. The chapter identifies the following sector outcomes: A) Productivity in the agriculture and fisheries sectors increased; B) Forward linkage with the industry and services sectors increased; and C) Sector resilience to climate change risks improved.

85. Under Outcome A are strategies related to: investments in R&D and extension; capacity building of farmers and fishers; improved rural infrastructure; completion of asset reform; and improved access to credit and other financial services. Under Outcome B are the following strategies: promotion of high value commodities produced with comparative advantage; expanding markets and linking farmers to value chains/commodity clusters; capacity building of stakeholders; development of agro-processing and related products; providing timely market information to farmers and fishers; supporting the transformation of farmer and fisher associations into viable SMEs; and promoting product and safety standards. Under Outcome C are the following strategies: encouraging diversification of livelihood

options; reducing resource degradation; increasing resilience of communities in responding to climate risk. A last cluster of strategies are cross-cutting, relating to governance and institutional development, namely: enhancing convergence among government agencies; pursuing PPPs, as well as national and local commodity roadmaps; eradicating smuggling; and passage of key laws.

86. DA organizes its work around a number of commodity programs, namely: rice, corn, livestock, fisheries, high value commercial crops, sugarcane, and coconut. Its major final outputs are the delivery of the following services: agriculture and fishery policy services; technical and support services; irrigation network services; farm-to-market network services; agricultural equipment and facility support services; plant and animal regulatory services.

87. The DA, in partnership with the World Bank, is also implementing the Philippine Rural Development Program (PRDP). The PRDP is a six-year project aims to raise incomes, productivity, and competitiveness, by establishing a government platform for a modern, climate-smart, and market-oriented agri-fishery sector. The intended outcomes are as follows:

- i) At least five percent increase in annual real farm incomes of PRDP in household beneficiaries;
- ii) Thirty percent increase in income for targeted beneficiaries of enterprise development
- iii) Seven percent increase in value of annual marketed output
- iv) Twenty percent increase in number of farmers and fishers with improved access to DA services

88. Components of the PRDP are: infrastructure development; enterprise development; and local planning. Enterprise development aims to strengthen viable agri-fishery based enterprises through installation of production and market support facilities towards efficient value chains. Meanwhile, local planning seeks to harmonize regional and provincial agriculture and fisheries modernization plans through the formulation of the Provincial Commodity Investment Plan using value chain approach.

2. *Department of Agrarian Reform.*

89. The Department of Agrarian Reform (DAR), together with DA Department of Environment and Natural Resources (DENR), collaborate on a national convergence initiative (NCI), of which Agro-Enterprise Development and Agribusiness is identified as a key component. In the PDP two specific projects are highlighted. First is the *Convergence on National Value-Chain Enhancement for Rural Growth and Empowerment (CONVERGE)*, which aims to reduce poverty through crop diversification and increased farm incomes. It targets 135,000 farm households in Mindanao, located in Agrarian Reform Communities (ARCs) and ARC clusters. The project has three components: i) participatory value chain analysis and planning; ii) integrated smallholders agricultural and rural enterprise development; iii) project management. The outcome of component ii) is improved production, value addition, and marketing, as a result of components i) and supported by component iii).

90. Also highlighted in the PDP is the the Gearing Rural Organizations for Wealth Creation Towards Household Income Improvement (GROWTH) Project. The five-year project likewise aims to significantly raise household incomes, productivity and the quality of life of agricultural households in 14 ARC clusters involving 102 ARCs located in 14 provinces, including Pangasinan, Negros Occidental, Camarines Sur, Leyte, Iloilo, Eastern Samar and Masbate, and spread in 10 regions. The provinces. This project involves provision

of matching grants to grassroots organizations (cooperatives, farmers' associations, etc.), combined with enterprise capacity building, including project preparation assistance.

3. *Assessment of agribusiness programs*

91. As with MSME development and other industry and services programs, the country's agribusiness thrust appears strong on empowerment of BoP farm households. **However the policy pronouncements contrast sharply with budget priorities and implementation.** There remain binding horizontal and vertical constraints, limiting growth in output and productivity, as well as diversification of the commodity mix (Briones, 2015). These constraints include: i) inadequate support for farmers; ii) bottlenecks and coordination problems in supply chains; iii) low and misplaced investments in public goods including R&D, resource management, and rural infrastructure; iv) Weak regulatory and certification system; and v) defective property rights regime.

92. The DA's own Agriculture and Fisheries Modernization Plan admits these problems, also pointing out weaknesses in the agricultural extension service (especially after devolution of these services in 1991); a contradictory rice policy; lack of support for market information; limited investments in commodities with comparative advantage (especially in the public sector); and incomplete implementation of land use planning and investment in the form of Strategic Agriculture and Fishery Development Zones (SAFDZs). In contrast, other countries have had a more successful experience in promoting agribusiness-oriented development of the agricultural sector (Box 3).

Box 3: Inclusive agribusiness arrangements: Case of Thailand and India

Thailand has had the most wide-ranging experience in contract farming among all Asian countries. Its business model has been characterized by a high degree of government planning, the involvement of the private sector, and focus on high value crops. Government support focused on the following: a) public research and extension services that support the introduction of new and high value crop varieties and follow through to their adoption at farm level; b) Provision of credit to the agriculture sector through the Bank of Agriculture and Agricultural Cooperatives, which was capitalized through a government policy; and c) Public infrastructure development such as dams to better support agricultural production and roads to promote economic development.

The case study for India refers to the state of Punjab. The specific interventions involved: establishment of the Punjab Agrofinance Corporation (PAFC); financial infrastructural support to agribusiness companies engaged in contract farming; abolition of the restriction on the movement of foodgrains, sugar and edible oil; and reduction of state government taxes and levies on agricultural products. PFAC served as the contract farming state implementing agency. It provides high-yielding varieties of seeds, technical assistance to farmers, technical assistance to farmers and monitoring of agronomic practices; and (for selected crops) assurance of produce purchase at the agreed price or market price. PFAC approached contract farming as a tripartite structure involving farmers, private agribusiness companies, and government, with the last functioning as a facilitator between farmers and agribusiness.

Source: Paglietti and Sabrie (2013)

93. **An agribusiness-based approach to agricultural development will benefit greatly from an IB accreditation scheme.** On the side of government, both national and local, accredited IBs should be prioritized for facilitation of linkages with farmers and farmer organizations; growers and organizations with IB linkages should likewise be prioritized for receiving technology, capacity building, land allocation, zoning, and other support from government. Farmer groups and CSOs may be more open to accredited IBs compared to conventional agribusiness corporations, conditional on the credibility of the certification as a seal of social responsibility, and responsiveness to the needs of the rural communities. Based on initial meetings, the multi-stakeholder mechanism within DA, namely the Philippine Council for Agriculture and Fisheries (PCAF), has welcomed further discussion to explain and disseminate IB models to the various stakeholders.

E. Credit programs

1. Financial inclusion strategy

94. The goal under the PDP for the financial sector is a resilient and inclusive financial system. It notes that inflows (e.g. savings) are attracted based on expectation of return, on the premise of robust financial system, which allocates funds towards profitable investments, adjusted for risk. A financial system is inclusive if it offers services to a broad spectrum of society, including small savers and borrowers. The outcome indicators for financial inclusion are: improvement in microfinance services delivery; regulatory framework for financial system strengthened and improved; and access points to financial services (e.g. bank branches) increased.

95. RA 8435, the Social Reform Agenda of 1998, relates microfinance to credit and savings mobilization for the poor, to improve asset base and expand access to savings. It involves alternative yet viable schemes including: small loans, simplified loan application procedures, group character loans, collateral-free arrangements, alternative loan repayments, minimum requirements for savings, and small denominated savers' instruments. The government has since adopted a market-based approach to microfinance. Government focuses on maintaining a sound regulatory framework, including market interest rate regime, and deploying GFIs as the conduit of both retail microfinance, or wholesale financing support for private MFIs.

96. The Philippines is widely regarded as a pioneer in microfinance development. In 2009 the country ranked third worldwide in the Economist Intelligence Unit (EIU) microfinance index; among the component criteria, the country ranked first (together with Cambodia) on regulatory framework (EIU, 2009). A performance evaluation report finds that MFIs in the Philippines demonstrated sustainable operations; the menu of products provided to clients has diversified (i.e. housing loans, agri loans, insurance, remittances, and mobile banking); and that the average MFI is operating efficiently, i.e. bringing operating cost – to loan portfolio ratio near the 25% benchmark (ADB, 2012).

97. More specifically for agricultural credit, the umbrella program for government financing is the Agriculture Modernization and Credit Financing Program (AMCFP), established by the Agriculture and Fisheries Modernization Act (AFMA) of 1997. The AMFCP funds agricultural credit wholesalers or retailers; eligibl end-borrowers are small farmers and fisherfolk, rural women engaged in production, processing, and/or trading of agriculture and fisheries products; and agri/fishery-based microenterprises (in case of sole

proprietorship and partnership), and SMEs in case of cooperatives and corporations (provided majority of members or stockholders are small farmers and fisherfolk).

98. The country's agriculture and fisheries strategic plan (2011 – 2016) targets an increase in the proportion of formal small farmer and fishing (SSF) households to increase from a baseline of 57% in 2008 to a target of 85% by 2016. Five major strategies are outlined in the Plan to achieve the target, namely: (i) Strengthen as well as LandBank lending to SFF) households; (ii) Reduce costs of lending and provide incentives for private banks to increase lending to agriculture and fisheries; (iii) Strengthen credit guarantee and agricultural insurance programs; (iv) Build up small farmers and fishers credit database, intensify information dissemination, and strengthen monitoring and evaluation; and (v) Expand programs that build the capacity of small farmers and fishers cooperatives/other organizations to manage credit funds.

2. *Mandatory credit allocation*

99. Mandatory credit allocation is a policy instrument for directing credit to selected sectors. One of the priority sectors is are MSMEs; based on the amended Magna Carta for MSMEs, up to 2018, all lending institutions are required to allocate 10% of total loan portfolio net of exclusions for MSMEs, with 8% for micro and small enterprises, and 2% for medium enterprises. Alternative compliance includes: subscription of preferred shares of stock, or purchase of liability instruments of SBC; wholesale lending for on-lending to MSMEs; purchase/discount of MSME receivables. Non-compliance is subject to a penalty of 500,000 per year, pro-rated by percent of non-compliance.

100. For agriculture there is the 25% mandatory allocation of loanable funds for the agri-agra sector under RA 10000, composed of 15% for agriculture and 10% for agrarian reform beneficiaries (ARBs). Other than direct lending for agriculture, alternative compliance includes: wholesale lending to accredited rural banks and rural financial institutions; bonds delared eligible by DA and DAR; loans for the construction or upgrade of rural infrastructure; loans to the National Food Authority, its accredited warehouse, millers, and wholesalers. Undercompliance is penalized 0.5% of the amount of undercompliance, of which 10% goes to BSP (for administration cost), and 90% is divided equally between the Agricultural Guarantee Fund Pool (AGFP) and the Philippine Crop Insurance Corporation (PCIC).

101. Based on BSP data, as of September 2014, compliance of banks for lending to micro and small enterprises was P178.2 billion, equivalent to 4.64% (lower than the mandatory 8%); lending for medium enterprises was P218 billion, equivalent to 5.68% (above the mandatory 2%). Meanwhile compliance of banks for the agri sector was 15.4%, slightly above the mandatory 15%, whereas compliance for the agra sector was only 1.56%, far below the mandatory 10%. Apparently banks find it more difficult to comply with mandatory lending to ARBs.

3. *Small Business Corporation.*

102. SBC supports MSMEs with wholesale and retail lending programs. The former caters to banks serving SMEs; SBC also offers credit guarantees based on its Borrower Risk-Rating (BRR) system, subject to a guarantee fee. Typical clients are banks who wish to extend credit to MSMEs. SBC also has a retail lending program aimed at MSMEs for fixed asset acquisition, working capital finance, or other upgrading activity (R&D, adoption of IT, etc.) A credit line facility is extended to suppliers to finance purchase orders (Pos) from top-2000 firms or government agencies/corporations on case-to-case basis (other firms may be supported but subject to issuance of post-dated checks to cover the PO). The minimum loan is

P200,000. Collateral is required, e.g. assets to be financed by the loan, or assets external to the business. In 2013, the SBC released P3.3 billion worth of loans in 2013. That year it had shifted towards retail lending to MSMEs, increasing its share in total portfolio from 16% to 18% (corresponding to a 60% increase in number of borrowers).

103. SBC also offers credit guarantees for MSMEs, intended to encourage financial One institutions to this sector. Guarantee facilities are distinguished as follows: without collateral; with partial collateral; and with collateral but with credit risk concerns. Loans that can be covered include working capital, fixed asset acquisition, purchase of land, plant construction or improvement, and loan refinancing. There is no loan ceiling though the cover depends on debt-servicing capacity of the borrower. Guarantee fees (premiums) range from 1% to 3% depending on risk rating. Note that unlike for AGFP, as the payment of guarantee transfers liability of the borrower to the SBC. Nonetheless the SBC requires co-supervision with the creditor on the loan resolution process (e.g. settlement or foreclosure).

4. *ASENSO Program*

104. A collective program involving eight Government Financial Institutions (GFIs) is the Access of Small Enterprises to Sound Lending Opportunities (ASENSO) program. ASENSO is the government's flagship credit program for the MSME sector and in support of the MSME Development Plan. Eligible borrowers range from sole proprietorships to corporations and cooperatives. Maximum loan under ASENSO is P5 million; loans are secured with real estate mortgage, chattel on machinery and equipment, deed of assignment on inventory and receivable, guarantee cover from SBC, Philippine Export Import Credit Agency, etc. Including its predecessor, the SME Unified Lending Opportunities for National Growth (SULONG), ASENSO has released P303.2 billion since 2004, assisting 319,309 MSMEs.⁴

5. *Land Bank of the Philippines*

105. One of the GFIs in ASENSO is the Land Bank of the Philippines (LBP), which implements other development lending programs. Most of these programs are aimed directly or indirectly MSMEs or livelihood support, including:

- Agricultural and Fisheries (AFFP) Financing Program
- Agricultural Production Credit Program (APCP)
- DA - Sikat Saka Program (SSP)
- Agricultural Credit Support Project (ACSP)
- Access of Small Enterprise to Sound Lending Opportunities (ASENSO)
- Credit Assistance for Cacao Agri-Business and Other Organizations (CACAO 100) Program
- Kalikasang Kabuhayan para sa Wastong PamaYanan (KAWAYAN) Program
- Integrated Support for the Development of Aquaculture (ISDA Program)
- Masustansyang Inumin para sa Likas na Kalusugan (MILK Program)

⁴ <http://www.sbgfc.org.ph/index.php/about-us/corporate-profile/agency-performance>.

106. These programs are open to individual small borrowers, farmer associations, cooperatives, and large agribusiness enterprises (except the SSP). Depending on the program, a flexible range of loan securities are allowed, similar to ASENSO, with assignment of crop insurance also allowed as collateral.

107. The LBP also administers the AGFP, under the supervision of the Department of Agriculture. The AGFP provides guarantee cover to lending institutions serving SFF borrowers, i.e. those engaged in agriculture/food-based production, and have no assets acceptable as collateral. Eligible lending institutions include rural banks, cooperatives, SMEs, NGOs, and farmer organizations. The guarantee extends up to 85% of the principal, covering all risks (except fraud on the part of the conduit). Nonetheless, 85% of any collection from a subrogated account shall be remitted to the AGFP until payment is made in full. As of May 2014, the AGFP has guaranteed more than P20.8 billion agricultural food production loans released by more than 600 lending institutions to more than 340,000 small farmers and fishers; more than three-fourths of these was used for palay production. Guarantee claims paid out since 2009 amount to P563 million, of which more than 70% is due to calamities, pests, and diseases (Pajarillo and Lumawig, 2014).

6. *Assessment of credit programs*

108. Despite numerous reforms and government programs towards finance of underserved BoP households in micro and small enterprises, and in agriculture and fisheries, the lack of financing remains a perennial complaint. A couple of innovations have been identified in Llanto and Badiola (2010) that could lead to greater access to agricultural finance are: i) value chain financing – warehouse receipts lending, contract growing, other instruments, e.g. repurchase agreements; and ii) risk management tools – index-based weather insurance, and guarantee schemes.

109. Of these, the most promising appear to be contract farming and guarantee schemes. Under value chain finance, **the BoP supplier can gain access to finance** (or perhaps to lower interest rates) **if a third-party financial institution can agree to lend on the basis of a formal contract** between the producer and a corporate buyer. **Government can support this by providing credit guarantees** for the supplier, conditional on their participation in the value chain. The concept can certainly be extended beyond agriculture; value chain financing combined with government guarantee can apply say to micro and small enterprises that supply food requirements of hotels, construction services for socialized housing developers, and so forth.

110. On the other hand, mandatory allocation for BoP sectors is unpopular among financial institutions. The disadvantage is that they contribute to raising the cost of financial intermediation across-the-board. Teves (2014) makes some valuable suggestions, namely: that the agri-agra law be modified, with the 25% allocation reduced, and the lower amount reserved for ARBs. Rather than relying on mandatory allocation, he recommends incentivizing banks to lend to the agraria sector, i.e. by raising guarantee cover, and harmonizing the benefits of crop insurance and loan guarantees. He notes that a key disincentive to lending institutions to avail of AGFP cover is that it still requires collection of the loan from delinquent borrowers, up to the amount covered; this is unlike crop insurance, in which the liability is extinguished upon pay-out.

111. Note that similar arguments apply towards relaxing the mandatory allocation for MSMEs. Instead, **government financial programs can phase in value chain participation of IBs** as part of its strategy for an inclusive financial sector. Details of this phasing in are provided in Section IV.

F. Tourism programs

1. Development plan and legal framework

112. The legal framework for tourism regulation and development in the Philippines is laid down in the Tourism Act of 2009 (RA 9593). In the Declaration of Policy, the Act affirms the potential contribution of tourism as an engine of socio-economic growth, as well as affirmation of Filipino culture and an opportunity to enhance national pride. Major thrusts in the Declaration of Policy are presented in Box 4.

113. The Act reorganizes the Department of Tourism (DOT), and assigns its powers and functions, including: to formulate and promulgate rules and regulations governing the operation of all tourism enterprises, including national standards for licensing, accreditation, and classification of tourism enterprises. Tourism enterprises refer to *facilities, services and attractions involved in tourism, such as, but not limited to: travel and tour services; tourist transport services, whether for land, sea or air trans- portation; tour guides; adventure sports services involving such sports as mountaineering, spelunking, scuba diving, and other sports activities of significant tourism potential; convention organizers; accommodation establishments, including, but not limited to, hotels, resorts, apartelles, tourist inns, motels, pension houses, and home stay operators; tourism estate management services, restaurants, shops and department stores, sports and recreational centers, spas, museums and galleries, theme parks, convention centers and zoos.*

Box 4: Tourism Act Declaration of Policy (Chapter I, Section 2)

The State declares tourism is an indispensable element of the national economy and an industry of national interest and importance, which must be harnessed as an engine of socio-economic growth and cultural affirmation to generate investment, foreign exchange and employment, and to continue to mold an enhanced sense of national pride for all Filipinos. To this end, the State shall seek to:

- (a) Ensure the development of Philippine tourism that is for and by the Filipino people, conserve and promote their heritage, national identity and sense of unity;
- (b) Recognize sustainable tourism development as integral to the national socio- economic development efforts to improve the quality of life of the Filipino people, providing the appropriate attention and support for the growth of this industry;
- (c) Promote a tourism industry that is ecologically sustainable, responsible, participative, culturally sensitive, economically viable, and ethically and socially equitable for local communities;
- (d) Create a favorable image of the Philippines within the international community, thereby strengthening the country's attraction as a tourism destination and eventually paving the way for other benefits that may result from a positive global view of the country;
- (e) Develop the country as a prime tourist hub in Asia, as well as a center of world congresses and conventions, by promoting sustainable tourism anchored principal on the country's history, culture and natural endowments, and ensuring the protection, preservation and promotion of these resources; and
- (f) Encourage private sector participation and agri-tourism for countryside development and preservation of rural life.

114. Under the Local Government Code, direct regulation of tourism enterprises is still vested in LGUs; nevertheless the DOT can recommend to LGUs concerned the suspension or

prohibition of operation of a tourism enterprise. DOT also monitors LGU compliance to national standards, receive and investigate complaints concerning these enterprises, and act on such complaints; ensures coordination between local and national tourism plans; and provides technical assistance to LGUs.

115. The Act also provides incentives for investments in tourism enterprises. It establishes a Tourism Investment Enterprise Zone Authority (TIEZA), which is mandated to designate Tourism Enterprise Zones (TEZs), which are contiguous geographic areas endowed with historical and cultural significance, environmental beauty, or existing or potential integrated leisure facilities; has or may have strategic access to transport infrastructure and connection with utilities infrastructure; large enough to attract new investments; and in a strategic location to catalyze socio-economic development of nearby communities.

116. Registered tourism enterprises within TEZs are entitled to fiscal and non-fiscal incentives. The former covers ITH (six years), extendable to six years for a significant expansion. A new enterprise shall be levied a 5% gross income tax, replacing all other national and local taxes, license fees, imposts and assessments, except real estate taxes, and fees imposed by TIEZA. It is also provided tax-free importation of goods, services, and equipment, as well as a social responsibility incentive, i.e. tax deduction up to half of the cost of protecting the environment, cultural heritage, sustainable livelihood, and other similar activities.

117. Meanwhile tourism enterprises outside the TEZs may also avail of investment incentives. Expansion activities for registered tourism enterprises can also be subject to ITH of six years and tax and duty free importation capital equipment and spare parts. Tourism enterprises may also avail of BOI incentives; the Act mandates that tourism activities shall always be included in the IPP.

118. Tourism development will be a priority program of the government, based on the following strategies will be pursued: (a) develop and market competitive destinations and products; (b) improve market access, connectivity and destination infrastructure; and (c) improve tourism governance and human resource capabilities. Strategic tourism products to be developed include: include medical and retirement tourism; leisure and entertainment; meetings, incentives, conventions and exhibitions; cruise and nautical tourism; education tourism; and agri-tourism. By deploying these strategies, the country hopes to achieve, in 2016, ten million visitor arrivals; P455 billion international visitor receipts; 56.1 million domestic travelers; and P1.86 trillion domestic receipts.

2. *Assessment*

119. **Tourism incentives are perceived by companies to be limited in scope**, based on focus group discussions. On the side of BOI, projects in Metro Manila, Cebu City, Mactan Island, and Boracay Island are not entitled to ITH. As for TIEZA incentives, only few sites have been classified as TEZ, including: Resorts World Manila; Ciudad de Victoria in Bocaue, Bulacan; Queen's Castle in Medellin, Cebu; San Vicente, Palaway; and Rizal Park Complex, Manila.

120. **Tourism policies and programs are therefore not specifically designed to engage the base of the pyramid** The declaration of policy of the Tourism Act highlights socioeconomic development, together with cultural identity; however the main thrusts relate to economic benefits from tourism, sustainable development, community and private participation, the country's global image, and b. ecoming a prime tourist hub in the region. On the other hand, there is no goal in the Tourism Act, or in the various tourism strategies,

explicitly engaging the lower income households. Hence, tourism policies do not mention or make room for IB.

121. IB accreditation will offer a useful service to LGUs and tourism enterprises.

LGUs benefit from identifying responsible corporations who can implement high impact tourism projects. Tourism enterprises benefit by obtaining a more favorable reception of its projects among communities and other local stakeholders.

122. Under the current regime, incentives cannot be leveraged to promoting IB.

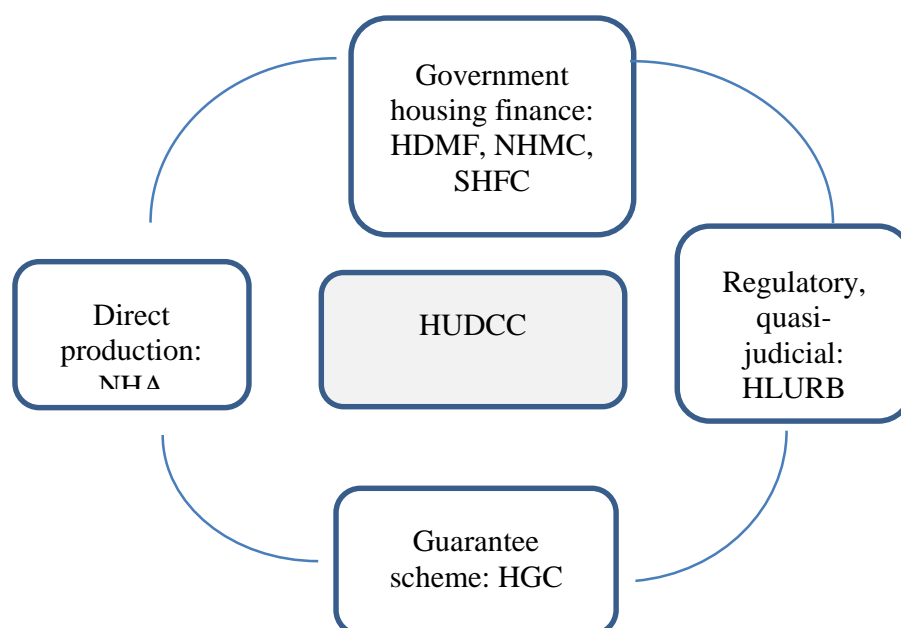
Tourism enterprises are already offered a considerable range of benefits, none of which are predicated on social impact, with one exception: the tax deduction of up to 50% of the cost of a sustainable livelihood project. However the existing procedure to obtaining such a deduction appears to be simpler than going the relatively more involved route of obtaining IB accreditation. Therefore, tourism incentives must first be incorporated in fiscal incentive reforms, to be able to deploy them as an instrument for IB promotion.

G. Housing programs

I. Government interventions

123. The Subdivision Housing Development Association (SHDA) Roadmap (SHDA, 2013) provides an overview of the regulatory framework for socialized, economic, and low cost housing (Figure 6). The Housing and Urban Development Coordination Council (HUDCC) is at the hub, around which the major players are: Government housing programs, namely those of Home Development Mutual Fund (HDMF), National Home Mortgage Finance Corporation (NHMFC), and Socialized Housing Finance Corporation (SHFC); direct production of housing settlements, by the National Housing Authority (NHA); support from housing finance guarantees, extended by the Home Guarantee Corporation (a public company); and land use regulation and quasi-judicial functions carried out by the Housing and Land Use Regulatory Board (HLURB). Socialized housing falls under the legal framework of Urban Housing Development Act or UDHA (RA 7279).

Figure 6: The regulatory framework for housing in the Philippines



Source: Adapted from SHDA (2013).

124. The Act defines “socialized housing” as *housing programs and projects covering houses and lots or homelots only undertaken by the Government or the private sector for the underprivileged and homeless citizens which shall include sites and services development, long-term financing, liberalized terms on interest payments, and such other benefits in accordance with the provisions of this Act.* The Act meanwhile defines “underprivileged and homeless citizens” as *individuals or families residing in urban and urbanizable areas whose income or combined household income falls within the poverty threshold as defined by the National Economic and Development Authority and who do not own housing facilities.*

125. In practice however, socialized housing is defined in terms of price ceiling of a home, as defined by HUDCC; currently the definition is P400,000. Other types of housing are: economic housing (P401,000 to P1,250,000); and low-cost housing (P1,250,000 to P3,000,000). These cut-offs are consistent with assumed affordability for low-income groups (Table 9). Note that socialized and even economic housing falls under the BoP income levels.

126. The UDHA mandates “balanced housing development”, i.e. developers must allocate 20% of subdivision area or project cost to socialized housing, preferably within the same city or municipality. Alternative compliance includes: (a) Development of new settlement; (b) Slum upgrading or renewal; (c) joint venture projects; and (d) Participation in the community mortgage program; according to HLURB, the last option can take the form of a purchase of SHFC securities for the Community Mortgage Program (CMP).

127. UDHA also provides incentives for housing developers to participate in socialized housing, as follows:

- (a) Reduction and simplification of qualification and accreditation requirements for participating private developers;
- (b) Creation of one-stop offices in the different rations for the processing, approval and issuance of clearance, permits, and licenses, with a ceiling of 90 days for issuance after developers have submitted all requirements;
- (c) Simplification of financing procedures;
- (d) Exemption from taxes, namely: project-related income taxes; capital gains tax on raw lands; value added tax for the project contractor; transfer tax; and donors tax for land donated to socialized housing.

Table 9: Indicators for required family income for socialized, economic, and low cost housing in the Philippines

Housing category	Interest rate, public housing finance (%)	Annual amortization (pesos)	Needed monthly income (pesos)
Socialized	4.5	23,468	6,500
Economic	8.5	38,042	10,800
Low cost	10.5	404,978	33,750

Note: Required monthly income assumes about 30% of monthly income is allocated to housing, as estimated in Batas Pambansa 220.

Source: SHDA (2013).

128. While the UDHA provides exemptions for socialized housing, the 2014 IPP extends ITH for economic and low cost housing. The BOI requires that registered economic and low cost housing projects allocate for socialized housing, 20% of project area or 20% registered

project cost. (For vertical housing, the requirement is 20% of total floor area of qualified saleable housing units).

129. In 2014, public programs delivered 58.9 billion pesos worth of housing (equivalent to 222,789 units); half of this was delivered through HDMF and Government Financial Institutions (GFIs). Another 46% was delivered as direct housing and settlements provision by NHA; the remainder is financed by SHFC (HUDCC, 2014). Nonetheless, at current rates of provision, SHDA (2013) projects a backlog over the period 2012 – 2030 of as much as 663,283 socialized housing units, and as much as 1.9 million economic housing units.

2. *Assessment of housing programs*

130. Ballasteros (2011) describes the status of government subsidy schemes. The major player for housing finance is the HDMF. NHMFC is currently focused on collection of past due accounts, as well as establishing a secondary mortgage market; its subsidiary corporation, SHFC, has taken over in developing and administering social housing programs, e.g. the CMP and Abot-Kaya Pabahay Fund (AKBF) Program.

131. Meanwhile as of 2010, HGC has extended 62.7 billion worth of guarantees outstanding. However only 6% of its outstanding guarantees are to socialized housing, far below its charter requirement of 40%; most of the packages guaranteed under socialized housing are for the AKBF Program. Moreover HGC charges premium which are not risk-based (Ballesteros, 2011). The premium is 1.5 to 2.5%, depending on type of guarantee and loan package (socialized housing and retail package are charged lower premiums). However the current guarantee schemes appears unsustainable, in 2012, the Commission on Audit Report (COA, 2012) found that the HGC had suffered continuous losses since 2002 due to defaults on guaranteed mortgages. By year-end, current liabilities exceeded current assets by a whopping P13.4 billion, diminishing its capability to serve the housing sector with loan guarantees.

132. For 2009, Ballesteros (2011) estimates a total housing subsidy of P6.9 billion. The biggest expense item was administrative and other cost at 31.3%, followed by the interest subsidy (i.e. the difference between market rate and housing finance rate), equivalent to 30.3%. Next are losses (impaired assets, and losses from resale), at about 19%. Tax exemptions are the lowest expense item (4%).

133. **Despite a large fiscal burden, there is unfortunately evidence that these subsidies are benefiting the poorest income deciles.** Over time the ratio of housing price to income has increased (Ballesteros, 2011). This is consistent with an earlier finding (Section II.B.2), which shows that at the BoP, households allocate just 18% of total expenditure on housing, which is much lower than the assumed 30% under national policy.

134. Likewise, Llanto and Orbeta (2001) had found that the bottom 40% have a lower chance of participating in government financing schemes, simply because of the amortization charges. In their view, the subsidy schemes then (and perhaps now) are provided at huge fiscal cost by providing implicit and explicit subsidies that do not meet their target clientele, the low-income households, while crowding out private sector financing.

135. To avoid these inadvertent effects, and improve targeting, **a one-time lumpsum cash grant to the targeted household is proposed**, to be used as downpayment for the purchasing of a housing unit; this is in lieu of a subsidized loan (Llanto and Orbeta, 2001). Current conditions are even more favorable now than when first proposed by the authors, for two reasons: one is that interest rates are relatively low and banks are awash with funds, hence consumers will not experience a dramatic increase in borrowing rates when shifting to this

subsidy scheme. Furthermore targeting of the poor is much better now thanks to the National Household Targeting System (NHTS), developed in support of the conditional cash transfer program of the government.

136. Based on estimates of SHDA (2013), the socialized housing requirement of the country in the period 2001 – 2011 was 26%, exceeding the balanced housing rule of UDHA. However some individual developers fail to comply with the balanced housing requirement, even those that qualify for BOI incentives (Dietrich, 2014b). To improve compliance and raise consumption of socialized housing, some instrument is needed to raise the price received by developers while reducing price paid by consumers low. SHDA (2013) favors a housing production subsidy for socialized urban and urban development housing. This is an alternative to the voucher scheme, which can have identical effects if the subsidy to the developer is conditional on offering discounted sale price to qualified (i.e. poor) buyers.

IV. Integrating IB in government programs

A. Overview

137. This section synthesizes the discussion on opportunities for integrating IB in government programs. The framework relies on the matrix introduced in Table 6; priority approaches in the Philippine setting are isolated in Table 10 as shaded cells.

Table 10: Priority policy approaches to integrate IB in Philippine government programs

	Information	Rules	Financial resources	Structure and capacity
Enable companies		Policy frameworks Standards		
Encourage companies			Financial support Public procurement	Development partnerships
Empower BoP			End-user subsidies Insurance schemes	MSME support Capacity-building

138. The lynchpin for integrating IB in government programs is IB accreditation, which is primarily an information device, hence the grey highlight for the Information benefit. IB accreditation allows the government a practical way of incorporating IB into the policy framework, as well as establish (voluntary) standards for identifying an IB. With accreditation, IBs can qualify for financial support, and be recognized in government procurement, and in PPP projects. BoP households linked to IB may also qualify for financial resources as well as MSME support and capacity-building.

B. The IB Policy Proposal

139. The following discussion elaborates on proposal for integrating IB in government programs. There are two versions of the proposal; the first is **IB Policy** which involves programmatic and policy adjustments, without need for changes in legislation. This category includes adjustments that may entail additional funding, but which is not likely to be controversial. The second version is **IB Policy Plus**, relevant to the darker-shaded cells. IB Policy Plus integrates policy and programmatic adjustments under IB Policy, but requires changes in legislation, contentious budgetary appropriation (also from Congress). The latter are less feasible than the former; however if there is a strong initiative from Congress anyway

for a change in law (e.g. for fiscal incentives), IB Policy Plus offers an opportunity to integrate IB into the legislative reforms.

1. Enabling companies

Information

140. **There is a great need to identify specific businesses which meet IB standards among CSOs, SFFs, SMES, and LGUs , a need that can be met by IB accreditation.** In one stakeholder consultation for agribusiness conducted for this study, some of the farmer and private sector representatives voiced unease about the entry of large investments from agribusiness. The value of accreditation is premised on a communication campaign that will explain to stakeholders the nature and scope of IB, the specific features of IB accreditation, and how a typical IB scheme works. For example, innovative approaches in supply chains (e.g. risk protection mechanism, in terms of price variations and output delivery) should be made transparent in the accreditation methodology.

141. **The list of companies with accredited IB projects should be kept on a public database to be disseminated nationwide,** i.e. through the newly established Negosyo centers. The list should also be incorporated into the Philippine Business Registry Databank. Dissemination and promotion by DTI through BOI and the Negosyo Centers can provide a valuable information service to LGUs, producer organizations, farmer's groups, and other stakeholders, e.g. private banks, GFIs, donor agencies, etc.

Rules

142. **Government must explicitly incorporate IB in the country's industrial development strategy.** This will complement its current grassroots orientation. The private sector will welcome an IB approach to industrial policy. The banner of inclusive growth has rallied the stakeholders in Philippine development, including a broad representation of the private sector.

2. Encouraging companies

Industry roadmaps and IB

143. **Inclusive growth can be more explicitly incorporated into roadmaps by specifying social impact targets (e.g. number of small farmers engaged as contract growers) or even number of companies with IB-accredited projects.** The roadmaps offer an opportunity to incorporate IB in the country's coordination and industrial promotion strategies. The current set of roadmaps require an industry appraisal (including problem analysis), objectives and targets, a flexible set of strategies and roles, and a monitoring system, to inform stakeholder dialogue and implementation. The targets are typically cast in terms of output (or value added) growth, and perhaps jobs generated. A related opportunity is the industry cluster (IC) program, which will be a good jump off point; DTI – Regional Operations Group (DTI-ROG) help drawing up the value chains for the 6 priority clusters (Processed Food (Fruits and Nuts), Cacao, Coco coir, Coffee, Processed Rubber, and Tourism Support Industries). The IB accreditation can have far reaching consequences for these ICs especially in the areas of RM sourcing, production/technology, financing and marketing.

Investment incentives

144. **BOI should institute a Services and Monitoring Lane for IB-accredited projects.** IB projects that are also registering for incentives with BOI should be prioritized in receiving advisory services in dealing with other government agencies in the paper trail, as well as after-sales service in complying with registration and accreditation requirements. These services will also serve as a monitoring for compliance with the parameters of its IB model.

Financial resources: credit guarantees

145. **Lending institutions financing IB-accredited agribusiness and tourism projects should qualify for enhanced guarantee cover.** Financing can be coursed through the IB, or directly to BoP households or enterprises in the IB value chain. The enhancement should not otherwise be available for non-IB accredited projects.

146. In the case of finance for SFF suppliers in the IB value chain, the enhancement involves a change in the treatment of subrogated loans by AGFP; following the model of SBC, the liability of the subrogated loan transfers to the AGFP, though the creditor may co-supervise the settlement process together with AGFP. Meanwhile enhanced SBC coverage can apply for micro and small enterprises in an IB value chain. Enhancement can take the form of increased loan coverage, i.e. up to 85%, based on the experience of AGFP.

147. In the case of housing, HGC guarantee is already highly favorable to lending institutions. However the HGC charter imposes the amount of guarantee cover, i.e. 100% of the principal plus interest and yields up to 11% for socialized housing; it also provides for transfer of liability to HGC for subrogated housing loans. The adjustment may therefore lie in the guaranty premiums. However these are also required to be set at actuarial rates; it is not recommended that separating pricing of housing project guarantys depending on IB accreditation. Hence, adjustments in financial resources for BoP housing require legislative changes, discussed in Section IV.C.

Procurement and development partnerships

148. Currently there is no special consideration for IB models in procurement of goods and services, or in PPP investments. Procurement of goods and services by government entities, imposes the principle of *fair and equal access to all prospective bidders*. However in principle **there is no restriction against specifying IB-based criteria in evaluating bids** for government procurement or PPP projects. For example, in the construction of rural infrastructure, bidding my state preference for proposals that involve participation of registered barangay microenterprises in the project supply chain, hiring laborers from low income communities as part of the project work force, and so forth. There is in fact a policy of adopting labor-based equipment supported methods in public works projects (EO of 1999). Likewise, there is no restriction in various PPP modalities (e.g. Build – Operate – Transfer) to specify engaging BoP workers or firms in the project value chain.

149. However, **introducing IB practices into government procurement and PPP projects should be approached cautiously, as it is likely to complicate contracts already prone to implementation problems.** The main obstacle in implementing EO was not legal, but rather procedural: including labor-based methods will typically prolong time to completion, compared to equipment-based methods. Often the project timelines from the implementing agency is inconsistent with the longer time period needed to adopt labor-intensive techniques and to source from local microenterprises.

3. Empowering BoP households

150. **IB can be integrated in MSME and SFF development interventions by granting preferential treatment to IB-linked BoP households and their enterprises.** Government programs such as Shared Service Facilities (SSF) target support to micro and small enterprises, as well as small farmers and fishers. Such support may be designed so as to prioritize MSMEs already linked to IBs. Moreover, the IB may be tasked with providing technical and other services so as to optimize government support for MSMEs; the recommendation however falls short of actually extending program benefits to the IB itself (e.g. in terms of the SSF, the IB need not qualify as a co-operator).

151. As discussed earlier, MSMEs and SFFs in IB value chains gain access to markets and technologies, increasing likelihood of successful grassroots interventions. A practical way to exploit this opportunity is to incorporate IB linkages in the project selection.

152. For instance in the case of SSF, consider Table 12. Integrating IB involves modification of the project selection scoring scheme, namely an additional criterion and changes in scoring (indicated in red font).

Table 11: Maximum scores for selection criteria of SSF projects, current and proposed

Criteria for proposed facility	Current	Proposed
High impact-low investment ratio	30	30
Needed for expansion of a ready market	25	25
SFF participation part of an IB-accredited project	-	10
Located in 609 focus towns/cities within priority clusters	25	20
Targets industry clusters with the greatest need	25	15
TOTAL	100 (sic)	100

153. In the case of DILEEP – Kabuhayan, the current implementation guidelines identify the following criteria for evaluating proposals:

- i) Beneficiary/accredited partner capability indicator 40%
 - a. Track record: 10%
 - b. Qualified trainers/managers: 10%
 - c. Financial standing: 10%
 - d. Facilities/equipment: 10%
- ii) Project relevance 40%
 - a. Target beneficiaries: 20%
 - b. Target industry: 20%
- iii) Proponent equity 20%

154. Here the project relevance is benchmarked against the priorities identified by the Human Development and Poverty Reduction Cabiner Cluster, other relevant national agencies, and the RDC. To integrate IB in project selection, criterion ii) can be modified to: target beneficiaries and target industries *or* participating in the value chain of an IB-accredited project, with the same weight (40%). These and similar prioritization schemes can be introduced not just for SSF but for various other MSME Development programs.

155. For the DOST SET-UP, proponents are MSMEs, meeting the following requirements: i) proponent's proposal covering technical, marketing, management, financial, and environmental aspects; ii) business permits and license; iii) certificate of registration of business from DTI, SEC, or CDA; iv) quotations from suppliers for equipment to be purchased; and v) technical design/drawing of equipment to be purchased. IB may be integrated into SET-UP by introducing pre-proposal assistance to MSMEs, operated by or employing primarily BoP households, and linked to an accredited IB. The assistance can be provided collaboratively as follows: DTI Negosyo Centers may assist with facilitating business permits and registration; SME Academy may also help in technical support for other business requirements, such as financial projections; and the IB partner may help in equipment specifications, technical drawings, and obtaining supplier quotations.

156. For agribusiness, the DA PRDP has a enterprise development component (I-REAP), which includes matching grant assistance. An I-REAP proponent is an SFF association, supported by the partner LGU. Prioritization of proponents is done at the provincial level by project management unit, according to the following criteria:

- Importance in the local economy (30 points)
- Market potential (30 points), broken down to:
 - Value addition potential (10 points)
 - Demand (10 points)
 - Identified commercial/industrial buyer (10 points)
- Resource base (20 points)
- Environmental impact (10 points)
- Women's participation (10 points).

157. A straightforward way to integrate IB is to award maximum points under "Identified commercial/industrial buyer" if the proponent can show an agreement or some proof of collaboration with an accredited IB.

158. A final example may be offered, also under agribusiness: the DAR-IFAD CONVERGE project has a farm and value chain enterprise development component. CONVERGE offers a matching grant for eligible proposals of producer associations. Allocation of grants and other assistance is on a first-come, first-served basis. As part of project guidelines, allocation of matching grants and other assistance can be prioritized first for SFF associations and other rural MSMEs linked to an accredited IB; and then to other eligible proponents on first-come, first-served basis.

159. **The IB may be tasked with providing technical and other services for optimizing government support for MSMEs.** For example in the SSF program, a problem cited by the implementing agency (DTI) is ensuring proper specification of the equipment to be procured. Here the micro/small enterprise beneficiaries may have the advantage if linked in an IB value chain, supposing the buyer has a better idea of the right specifications for the equipment to be operated by the beneficiaries. Suppliers though retain ownership or control of the equipment.

160. Other assistance from IB buyers should be considered in the value chain, so long as this is agreeable to both all parties, such as: technical assistance in operating and maintaining specialized equipment; or even management and maintenance services for specialized equipment. In case of the latter, control over the equipment may be vested, by contract, to the institutional buyer, though ownership continues to reside in the BoP supplier or government

provider. Specific options for implementing such arrangements are described in Dietrich (2013).

C. The IB Policy Plus Proposal

1. Investment incentives

A more radical approach to integrating IB in government programs entail major legislative changes in the area of fiscal incentives, mandatory allocation, and subsidies. For fiscal incentives, reforms are divided into two scenarios. The first scenario is **EO 226-amended**. The second scenario is **new fiscal incentive regime**.

161. In the first scenario, EO 226 benefits are kept intact, with one key amendment: **IB-accredited projects should qualify for pioneer status**. For domestic firms this extends the ITH by an additional two years; for foreign investors, pioneer status entitles them to register at the BOI for both fiscal and non-fiscal incentives (subject to other conditions, e.g. exporting 70% of its production, divesting to Filipino ownership after 30 years, etc.)

162. The legal basis for pioneer status may be seen in Article 17 of the OIC, which identifies one condition for pioneer investment as follows: “uses a design, formula, *scheme*, method, process or system of production or transformation of any element, substance or raw materials into another raw material or finished goods which is new and untried in the Philippines” [underscoring supplied]. The intentional targeting of BoP households may conceivably be treated as a novel scheme which would qualify the project for pioneer status. The amendment can make this coverage more explicit by inserting the following wording: “... which is new and untried in the Philippines, including inclusive business arrangements for which prior accreditation has been provided by the Board, or...”

163. Classifying IB as pioneer investment is potentially controversial given the DOF thrust towards limiting tax expenditure. To justify this let *tax expenditure ratio* be an indicator equal to foregone revenue per peso worth of additional employment income. We propose the following criterion: **approve of pioneer status if the tax expenditure ratio of the project is below unity**.

164. A sample calculation is shown in Table 12. Here the job ratio is the underemployment factor is not the underemployment rate, but is some proportion of the underemployment rate, equal to the assumed average shortfall of an underemployed worker’s days of work relative to full-time work, on an annual basis. The ratio of discounted foregone revenue to discounted employment income is 0.7, i.e. the government foregoes 0.70 pesos of revenue for every peso additional employment income. In this case the indicator meets the threshold for pioneer classification.

Table 12: Sample calculation of tax expenditure ratio for an IB project

Year	# Workers	Tax owed, P '000	Wage, P/ day	Additional wage income, P '000	Discounted values, P '000 (Discount rate = 8%)	
					Tax expenditure	Additional wage income
1	1,000	0	302	7,973	0	7,382
2	1,000	3,000	302	7,973	2,572	6,835
3	1,000	6,000	302	7,973	4,763	6,329
4	1,000	9,000	302	7,973	6,615	5,860

5	1,000	9,000	302	7,973	6,125	5,426
6	1,000	9,000	302	7,973	5,672	5,024
Sum		36,000		47,837	25,747	36,857

Notes:

- i) In the absence of the project, workers are assumed to have a 20% chance of being visibly underemployed; of these, the average worker is able to work half-time.
- ii) Wages equal the minimum wage of Region XI; agricultural wage in 2012 nationwide was P221/day.

165. In the second scenario of a new fiscal incentive regime, EO 226 incentives are assumed to be repealed by an act of Congress. There are discussions on-going within the Economic Cluster, together with both Houses of Congress, for a radical overhaul of fiscal incentives through law. Should such radical reform push through, the new incentive regime should generate social benefits in a cost-effective manner, i.e. with least tax expenditures foregone. One option is that sectoral fiscal incentives be abolished, whether for IPP industries, housing, tourism, and agribusiness. Such reform of fiscal incentives opens up new opportunities for promoting IBs. **A more effective way to promote inclusive growth is reserve the grant of fiscal incentives exclusively for IB-accredited projects.**

166. The most promising bill on fiscal incentive reform (SB 987) abolishes the ITH, and provides instead a reduced corporate income tax rate. Incentives are limited only to exporters, or domestic firms located in the poorest provinces. However, incentivizing firms based on location is no guarantee that social impact will be increased, as firms need not hire the poorer workers from the province, nor source their material and service requirements from small enterprises from within the province. **A better rule is to limit fiscal incentives (lower corporate tax rates) only to IB-accredited projects.** Accreditation validates that the investment will likely benefit BoP households, and therefore meriting special treatment (i.e. subsidy) from the government.

2. *Mandatory allocation and end user subsidies*

167. **Mandatory allocations of credit or housing for target groups, or subsidized credit schemes, should be replaced by targeted cash transfers to the base of the pyramid.** Mandatory allocations of credit or housing facilities (MSMEs, agriculture, ARBs, and socialized housing) raise the cost of doing business. Abolition of these mandates will increase the total supply of credit and housing. Directing credit and housing services to the base of the pyramid can be done using targeted transfers, designed as “smart subsidies”. **Targeting shall be supported by the government database on BoP households and even individuals, i.e. the NTHS, and the Registry System of Basic Sectors in Agriculture (RSBSA).**

168. The evidence of impact from targeted subsidies, e.g. matching grants, is admittedly mixed. Several case studies (e.g. value chain interventions in Africa) show apparently successful implementation of matching grants (World Bank, 2014). Most importantly, the transfer approach avoids hidden costs inflicted by market distortions under the mandatory allocation. The cost of promoting a target group is made transparent, and opened up to debate with decision-makers and stakeholders in the public budget. The following discussion focuses on capital acquisition; finance for working capital is subsumed under the credit programs covered in Section IV.B.

169. **To promote IB and social impact, BoP households/suppliers within an IB-accredited value chain shall be prioritized to receive the transfers.** At the pilot stage the

subsidy can be limited only these IB-linked BoP households. If successful, the subsidy can be scaled up and divided into two tiers. The first tier (the larger portion) can be reserved to IB-linked BoP households/suppliers. The second tier can be allocated to BoP households/suppliers linked to *potential* IBs, i.e. who have undergone an accreditation process and are deemed likely to meet accreditation criteria at a later time.

170. **Capital financing for MSMEs shall be provided using matching grants for enterprise development.** This is the concept behind the GROWTH, CONVERGE, and to some extent the PRDP projects. The matching grants shall be designed so as to require counterpart financing, either from the enterprise itself, or a development partner, e.g. a rural bank, or even an institutional buyer. Other conditions can be imposed, such as a market study and business plan.

171. **Capital financing for socialized housing shall be provided as co-payment grants to BoP households.** The socialized housing category based on housing value can be retained; however the subsidized credit scheme now extended by various housing agencies shall be phased out. Instead the BoP homebuyer will be given a grant that can be used as downpayment; the buyer will be required to match the grant with a modest cash outlay. The balance can be amortized by the homeowner on mortgage basis. Such grants can be designed to avoid distorting incentives, e.g. by following best practices from the CCT, i.e. relying on prior means testing (the National Household Targeting Survey) and providing cash transfers with calibrated conditionalities.

D. Concluding remarks

172. Numerous programs are in place in pursuit of inclusive growth based on a competitive industry, service, and agricultural sectors, with MSME development as a strategic thrust. Various government programs have been identified as relevant to IB, focusing mostly on empowering BoP households or individuals as an entry point, with interventions ranging from technical assistance, equipment support, financial service, to sectoral tax incentives, information dissemination and training, and streamlining of formal sector standards and regulations.

173. These programs represent polar opposites, of either private sector support without explicit targeting of BoP households (e.g. investment incentives), to programs using low income households or communities as the entry point of intervention. Conspicuously missing are measures to encourage and enable formal, established, private sector companies to engage BoP households in IB activities. Conventional MSME development approaches fall short of decisively addressing small business growth constraints, is prone to lapses in public sector performance, and is of dubious financial and economic sustainability.

174. It is possible that more direct engagement of private sector in IB leads to more effective inclusive growth strategy that may mitigate or avoid the aforementioned problems. Weakness in private sector engagement can be addressed by improving information; providing a better governance framework; offering judicious financial support, e.g. through fiscal incentives; and forging development partnerships. The last is critical to linking private sector firms to government resources and programs, in a concrete way, by incorporating BoP – private sector business arrangements in prioritization of MSME and livelihood support programs.

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