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STAFF APPRAISAL REPORT

PHILIPPINES

INDUSTRIAL INVESTMENT CREDIT PROJECT

SEPTEMBER 5, 1989

Industry and Energy Operations Division
Country Department II
Asia Regional Office

CURRENCY EQUIVALENTS
(as of November 30, 1988)

Currency Unit - Peso (₱)

US$1.00 = ₱ 21.4
₱ 1.00 = US$ 0.0467

ACRONYMS

ADB	-	Asian Development Bank
AJDF	-	ASEAN Japan Development Fund
APT	-	Asset Privatization Trust
BOI	-	Board of Investment
CBP	-	Central Bank of the Philippines
CALF	-	Comprehensive Agricultural Loan Fund
DBP	-	Development Bank of the Philippines
DOF	-	Department of Finance
DTI	-	Department of Trade and Industry
ERL	-	Economic Recovery Loan
FSAL	-	Financial Sector Adjustment Loan
FSS	-	Financial Sector Study
FX	-	Foreign Exchange
GATT	-	General Agreement on Tariffs and Trade
GDP	-	Gross Domestic Product
GFIs	-	Government Financial Institutions
GNP	-	Gross National Product
GSIS	-	Government Service Insurance System
IACC	-	Inter Agency Coordinating Committee
IDP	-	Institutional Development Plan
IGLF	-	Industrial Guarantee and Loan Fund
IMF	-	International Monetary Fund
OPG	-	Operating Policy Guidelines
PFI	-	Participating Financial Institutions
PNB	-	Philippine National Bank
QRs	-	Quantitative Import Restrictions
SEC	-	Securities and Exchange Commission
SME	-	Small and Medium Enterprises
SSS	-	Social Security System
TA	-	Technical Assistance

Fiscal Year

DBP: January 1 to December 31

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This report is based on the findings of an appraisal mission consisting of Messrs. Vinod Busjeet (Task Manager), Christian Duvigneau and Joachim Iske (AS2IE), which visited the Philippines in February/March 1989,

Annexes

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Loan and Project Summary

Borrower:	Development Bank of the Philippines (DBP)
Guarantor:	Republic of the Philippines
Beneficiaries:	Accredited participating financial institutions (PFIs) and private sector medium and large enterprises.
Amount:	US$65.0 million equivalent
Terms:	Repayable over 20 years, including five years of grace, at the standard variable interest rate.
Relending Terms:	DBP would relend the proceeds of the Bank loan to accredited PFIs in domestic currency at market rates. Maturities would conform to the maturity of subloans made by the PFIs to subborrowers, but would not exceed 13 years for equipment subloans and leasing, 7 years for working capital subloans, and 10 years for the financing of equity and quasi-equity investments. The grace period would not exceed 3 years for equipment and working capital subloans and 5 years for the financing of equity investments. Lease financing would have no grace period. The PFIs would on-lend the funds to their subborrowers at prevailing market interest rates. The Government would bear the foreign exchange risk in exchange for a market-related fee payable by DBP.
Co-financier:	The Japan Grant Facility will provide grant funds of US$3.5 million equivalent to finance industrial subsector restructuring studies.

Project Objectives: The proposed project aims to: fill the gap in the supply of term credit to medium and large industrial enterprises; improve credit delivery for industry by assisting DBP carry out its wholesale banking function of channeling term funds to retail financial institutions; broaden the financial services available to enterprises; help promote development of the capital market by introducing the financing of equity and quasi-equity investments by PFIs; support and develop, within DBP and the Department of Trade and Industry (DTI), capabilities to conduct analytical and policy-oriented studies on industrial subsectors; and assist the Government in identifying, in selected subsectors, the appropriate policy and institutional framework which could lead them to become internationally competitive and efficient.

Project Description: The project would have the following components: (a) a line of credit for (i) equipment and working capital financing; (ii) lease financing; (iii) financing of equity and quasi-equity investments; and (b) studies, training, and technical assistance related to subsectoral industrial restructuring.

Benefits: The project would (a) provide timely assistance to industrial development in the Philippines; (b) enable DBP to develop the institutional capabilities to embark on the wholesale banking role envisaged for it in the Financial Sector Adjustment Program supported by the Bank and (c) through provision of technical assistance, help the Government in charting reforms that may be necessary for the efficient and competitive development of enterprises in specific subsectors.

Risks: The major risk is that investment demand may not materialize as projected. Commitments could slow down because of slower than expected economic growth or reluctance by financial intermediaries to accept new financial instruments that would be introduced under the proposed project. Leasing is a relatively new industry in the Philippines. Moreover, the local market for equity is small and owners of privately held companies may remain reluctant to allow PFIs to hold shares in their companies, even for a limited period. Consequently, the loan size has been set in light of conservative demand projections, and the amounts allocated for lease contracts, equity and quasi-equity instruments are relatively small.

Estimated Costs:

	Local	Foreign	Total
	------(US$ million)----		
Credit Component	45.0	65.0	110.0
Studies, Training and Technical Assistance	1.0	3.5	4.5
Total	46.0	68.5	114.5

Financing Plan:

	Local	Foreign	Total
	-------(US$ million)----		
Subborrowers	30.0	-	30.0
PFIs	15.0	-	15.0
DBP/DTI (Technical Assistance Beneficiaries)	1.0	-	1.0
Japan Grant Facility	-	3.5	3.5
IBRD	-	65.0	65.0
Total	46.0	68.5	114.5

Estimated Disbursements:

Bank Fiscal Year	1990	1991	1992	1993	1994	1995
Annual	2.6	15.6	22.1	14.3	7.8	2.6
Cumulative	2.6	18.2	40.3	54.6	62.4	65.0

Rate of Return: Not Applicable

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INDUSTRIAL INVESTMENT CREDIT PROJECT

I. THE INDUSTRIAL SECTOR

A. The Economic Setting

1.1 Recent Bank economic reports[1/] indicate that while economic growth in the Philippines was rapid during the 1970s, distortions in the pattern of incentives resulted in inefficient investments, slow employment growth and low levels of domestic savings. Heavily dependent on imports and foreign capital, the economy did not adjust well to the severe external shocks of the post-1979 period with its high oil prices and interest rates, and declining export prices. The economy experienced declining growth rates, a deteriorating balance of payments, and the accumulation of a large external debt. A political crisis in 1983, combined with a worldwide debt crisis, led to a cessation of foreign credits, and forced the Government to embark on a major stabilization effort. The stabilization measures were supported by International Monetary Fund (IMF) Standby Arrangements of December 1984 and October 1986. Overall, the objectives of the stabilization programs have been met or surpassed. Inflation has been brought under control, with the consumer price index registering an increase of 8.8% in 1988 and 3.8% in 1987, compared to 50% in 1984 and 23% in 1985. The current account swung from a deficit of 4.8% of GNP in 1984 to a surplus equal to 3.0% of GNP in 1986, and showed only slight deficits in 1987 (1.3%) and 1988 (1.0%). GDP growth was positive in 1986 after two years of decline and showed an impressive acceleration to 4.7% in 1987 and 6.6% in 1988.

1.2 The remarkable recovery of the Philippine economy has been largely led by the industrial sector which grew at 7.7% in 1987 and 8.9% in 1988. Contributing 33% of GDP and 42% of total merchandise exports and accounting for 15% of total employment in 1988, the industrial sector, which is mostly private, has benefitted from the comprehensive structural reforms introduced by the Government which aimed at increasing economic efficiency by stimulating private sector initiative and activity. Among the important reforms implemented since February 1986 are a significant devaluation of the Peso, a major tax reform, the removal or reduction of a host of import controls and import duties, a re-orientation of the public investment program to focus on essential infrastructure improvements, the restructuring of the two largest government financial institutions and the commencement of a privatization program. Since, despite the recent economic growth, GDP in 1988 was barely ahead of the pre-recession (1983) level and gross value added in manufacturing of ₱25.2 billion (expressed

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1/ Philippines: An Agenda for Adjustment and Growth (Report No. 5268-PH, November 30, 1984); Philippines: A Framework for Economic Recovery (Report No. 6530-PH, November 5, 1986); Philippines: Toward Sustaining the Economic Recovery (Report No. 7438-PH, January 30, 1989).

in 1972 prices) only slightly surpassed the pre-recession peak, there is substantial scope for expansion of the industrial sector. With the present policy framework being characterized by a substantial reduction of past distortions, the industrial sector is poised for growth. Term credit to finance the investment requirements of industry will consequently be required.

B. The Policy Framework

1.3 Industrial policy in the Philippines from 1950 to 1980 can be divided into three distinct periods: a first phase of import substituting industrialization in the 1950s under rising protective barriers; a major shift towards a more open and liberal trade regime in the early 1960s which, however, was not sustained; and a reversal to more interventionist policies beginning in the late 1960s with increasing recourse to protective barriers, large public-sector-led or-supported investments and generous incentives administered by the Board of Investment (BOI). The result was an incentive environment that led to suboptimal investments and an inefficient industry that was largely inward oriented and internationally uncompetitive.

1.4 In the eighties, momentum for reform was provided by the onset of the second oil price shock, the world economic recession, the surge in interest rates and the weakening in primary commodity prices. The Government accordingly initiated a broad range of structural reforms with the support of two Bank-financed Structural Adjustment Loans (Loan Nos. 1903-PH, 1980; 2266-PH, 1983). Among the policy initiatives taken were: (a) a major trade liberalization program and (b) reform of BOI incentives. The trade reforms, which aimed at correcting in a comprehensive manner the adverse incentive effects of the trade regime by reducing the level and variability of protection, included actions in all key areas affecting the protection regime: tariff reform, phasing out of import restrictions, removal of the protective elements of the indirect tax system, and curtailment of exemptions to import-substituting industries. As for BOI incentives, they were rationalized in the Omnibus Investment Code which corrected two major weaknesses of past incentives: (a) the favoring of import substituting industries over exports and (b) the favoring of capital-intensive over labor-intensive technologies.

1.5 A cornerstone of the trade policy reform was the significant narrowing of the band of import tariffs: from a 0% - 100% band before 1980 to 10%-50% by 1985. This led to a major reduction in average nominal and effective protection rates and their variability. This reduction was initially accompanied by a relaxation of import restrictions, but as a response to severe balance of payment pressures in 1983 and 1984, the number of regulated import items increased again between 1983 and 1985. Since the end of 1985, however, 1,292 import restrictions have been liberalized including those on iron and steel, yarn and thread, tires, plastics and other important industrial inputs, and some consumer goods, including garments and textiles. While average nominal tariff protection has not changed in recent years (Annex 1.01), liberalization of import restrictions has been the focus of trade reform.

1.6 The trade liberalization has had a major impact on the structure of industrial protection, by significantly reducing the pro-import-substitution bias. In the absence of full trade liberalization even today, an effective system of export incentives and promotional measures in accordance with the General Agreement on Tariffs and Trade (GATT) is also necessary to counteract the anti-export bias of the past trade regime. Given the nascent stage of export development, it is important that small and new exporters, as well as indirect exporters, are covered by the export promotion system: to be able to obtain imported inputs efficiently and at world market prices, and to have access to working capital financing. Consequently, in addition to trade liberalization measures, the Government has been pursuing an export promotion policy, using duty drawback exemption schemes to ensure free access to intermediate imported inputs for exporters, and supporting exporters through an export finance facility.

1.7 As a result of cumulative policy adjustments since 1980, the Philippine economy is now more open and transparent in its regulatory and incentive structure than at any time since 1950. The average nominal tariff in the Philippines is now comparable to that of other countries that have also liberalized in recent years and effective protection may be even lower in some areas.

1.8 The Government remains committed to a policy of trade liberalization. A schedule for liberalization of products that remain under trade control has been provided by the Government as part of a program associated with an Extended Fund Facility approved by the IMF in May 1989. Some 104 items are scheduled to be liberalized in 1989 and 455 items will be reviewed for liberalization in the future. This will leave 114 items under continued import control, mostly for health and security reasons.

1.9 While it is important to maintain the momentum of trade reform, the industrial sector will need financial support to take advantage of the trade liberalization and incentive reforms already undertaken. Moreover, future trade reforms should be carried out in the context of subsector specific strategies that consider the entire impact of tariff, price and other government policies on each industry's costs of production and the level of effective protection. Many firms in protected industries will need time to restructure so as to be competitive at world prices. These subsectoral issues, which will be addressed through the technical assistance (TA) component of the proposed Industrial Investment Credit Project, are discussed in more detail in paras. 1.14 to 1.18 and in Annex 1.03.

C. Structure and Performance

1.10 As a result of the policies pursued at the time, the structure of the industrial base created in the 1970s was brittle and largely uncompetitive. Non-traditional manufacturing export growth was narrowly concentrated in product mix (semi-conductors and garments) and destination (the United States). The remainder of industry, accounting for the bulk of value added, was highly dependent on domestic demand which, however,

was artificially inflated by heavy foreign borrowings and infusions of subsidized credit and government transfers. The momentum given to industrial growth by these measures began to taper off in the late 1970s, when the scope for expansion of import substitution under heavy protection was exhausted, and technological weaknesses and other inefficiencies fostered by the lack of competition began to take their toll. Moreover, the financing requirements of high domestic demand could not be sustained indefinitely.

1.11 Rapid changes in the international environment since 1980, high interest rates and a foreign exchange crisis led to forced austerity measures which accelerated industry's downward trend. The situation was exacerbated by political instability. The decrease in investments and the suboptimal allocations, as well as high power costs and frequent labor disputes contributed to low productivity. Total factor productivity growth in the manufacturing sector, an indicator of efficiency performance, was negative whereas the Philippines' major competitors displayed a positive growth in that period. Poor performance, high domestic interest rates and devaluation losses for firms with foreign currency denominated loans left many firms in financial distress (Annex 1.02), with low profitability and high indebtedness. Many firms ceased operation and declared bankruptcy. Firms in operation limped along at 50-60% capacity utilization. After steady growth rates of gross value added in industry in the 1970s, the sector experienced a slowdown in 1980-83 followed by a sharp decline after two years of severe recession in 1984-85, during which industrial output fell by almost 20% in real terms.

1.12 The industrial sector began to recover at the end of 1986. The recovery was led by rapid expansion of private construction (17.2% in 1987 and 12.8% in 1988), fueled by increased availability of housing loans. Spurred by rising private consumption, manufacturing output increased by an impressive 7.1% in 1987 and 8.7% in 1988. The financial performance of manufacturing corporations improved, both in terms of profitability and adequate capitalization (Annex 1.02). The improved performance of industry can be attributed to the increasingly stable political environment, growing domestic demand and the policy reforms which, by providing enterprises with access to competitively priced imported inputs, enhanced the competitiveness of Philippine exports.

1.13 The recent growth has been well diversified. Rapid recovery of the manufacturing sector has been fueled by growth in virtually all manufacturing subsectors, with only a few subsectors remaining in continued depression or recovering slowly; among these are pulp and paper, wood processing, chemicals and some metal working/engineering industries. The most dramatic growth has been registered by three consumer goods subsectors: food, beverage industries and textiles. This primarily reflects strong consumer demand in the domestic market, but also increased exports of processed foods and textiles as a result of the improved incentive framework.

D. Selected Subsectoral Issues

1.14 In the context of the more open economy that the Government is trying to foster, there is need for both financial and physical restructuring that would enable firms to improve efficiency and international competitiveness The more liberal policy environment has affected various subsectors differently, with some able to fashion the appropriate competitive response but others not equipped to do so. Given the diverse structure of industry, a restructuring strategy needs to address specific constraints, problems and requirements of individual subsectors. This subsector approach to restructuring is warranted since at the policy level, certain trade and regulatory policies are often subsector-specific and, at the enterprise level, the technology, marketing and organization needed to compete effectively differ according to the subsector.

1.15 The articulation and implementation of a sound restructuring strategy has been hampered by insufficient know-how and Government reluctance to introduce, at this stage, further policy reforms in some subsectors, out of fear that they would collapse if these reforms were embarked upon hastily and without proper sequencing. In addition to inter-island shipping, a service subsector with substantial linkages to industry, these subsectors are the capital-intensive processing industries with large, sunk investments and include cement, pulp and paper, chemicals, and certain metal working/engineering industries. These as well as some other subsectors (textiles, certain agro-food processing industries) also face the reluctance of banks to extend credit given the subsectors' poor performance in past years and the banks' inability to assess their growth potential. Thus, there is need to assist the Government, the banking sector and industrialists to analyze these subsectors and identify public policy measures as well as business strategies that would together form part of a coherent subsectoral strategy.

1.16 Two of the major[2/] and promising industrial subsectors --- cement, pulp and paper -- and the inter-island shipping subsector are described in Annex 1.03. All three are hampered by physical, financial and policy constraints. Many of the existing plants in the cement and pulp and paper subsectors lack economies of scale and are overmanned and technologically obsolete. The last decade has seen no fundamental rehabilitation of existing capacity or major additional investments. As for inter-island shipping, the fleets have deteriorated substantially, with the average age of the more than 4,000 inter-island vessels exceeding 20 years. Firms in these subsectors also face financial distress resulting from declining profitability in the pre-1986 years and foreign exchange losses incurred on their foreign currency loans following the Peso devaluations in the mid-eighties.

2/ In 1987, the largest enterprises in the cement (10 firms) and pulp and paper (19 firms) subsectors accounted for 9.3% of total assets and 4.7% of total sales of the top 1,000 corporations in the Philippines.

1.17 The physical and financial problems of these subsectors are compounded by policies that inhibit competitive efficiency. Inter-island shipping is regulated by as many as fifteen different agencies, with the setting of passenger and freight rates being the most constraining regulation. The pulp and paper industry suffers from distorted policies and regulations in the forestry sector which contribute to raw material costs which compare unfavorably with those of competing countries; furthermore, there is need for improved incentives to promote waste paper collection, classification and processing and for reduced duties on inputs and outputs to foster industry competitiveness. As for the cement industry, it is characterized by a tightly controlled distribution system that perpetuates de facto import control and price ceilings.

1.18 These subsectoral problems call for an examination of the physical and financial restructuring needs of the subsectors as well as of the policy and institutional changes required to foster competitiveness and efficiency. More specifically, the following issues need to be delved into more fully: (a) the impact of trade policy on the structure of the subsector and recommendations for policy improvements; (b) the role of regulatory policy, in particular policies governing distribution and pricing, in shaping the industry, and how the policy might be improved; (c) cost structures in the Philippines, now and potentially after rehabilitation, and proposals for physical restructuring of the industry; (d) investments necessary to increase efficiency of distribution and production and (e) financial distress in the subsector and options for financial restructuring. Issues specific to the pulp and paper subsector that need further examination are: the efficiency of raw material production and processing; desirable changes in policies governing tree farming and tree plantations for pulp production. Specific issues facing the inter-island shipping subsector which need study are: the feasibility and scope of fleet restructuring, repair yard modernization and privatization of government owned companies. These subsectoral issues will be addressed in the studies forming part of the TA component of the proposed Project.

II. THE FINANCIAL SECTOR

A. Introduction

2.1 The industrial policy reforms designed to improve the environment for efficient private production and investment, presented in Chapter I, were accompanied by financial sector reforms. In 1980, the Government initiated policies that led to deregulation of interest rates and liberalization of exchange controls, with the result that the financial system is now characterized by market-determined interest rates and an open capital account. Following the dislocations in the real sectors during 1983-85 and the concomitant disarray of the financial sector, the Government undertook measures for rehabilitating government-owned financial institutions, notably the Philippine National Bank (PNB) and the Development Bank of the Philippines (DBP), in the context of the Economic Recovery Loan (ERL; Loan No. 2787-PH, 1987). With the restructuring of these two financial institutions largely accomplished and the banking sector

having regained its health, what remains to be done is to put the financial sector on a firm enough footing to support the significant shifts in resource allocation which the economy must undertake in response to the new array of incentives put in place with the stabilization and reform programs of recent years. In addition, the financial sector must be relied on to mobilize a large quantity of private savings, and to intermediate funds at reasonable cost to new productive activities. Consequently, the Government has embarked on a series of financial sector reforms which would be supported by the Bank through a Financial Sector Adjustment Program Loan (FSAL), approved on May 3, 1989. The aim is to make the banking sector more competitive and responsive to the needs of the real sectors. An important component of the reform program is to improve the institutional arrangements for the provision of long-term credit; this involves the transformation of DBP into a wholesale bank channeling funds to the private sector through retail financial institutions. By providing funds to DBP to help it carry out its wholesale functions, the proposed Project fits into the overall strategy for development of the country's financial sector.

B. Evolution and Structure

2.2 As of December 31, 1988, assets of the financial system totalled ₱ 879 billion, representing an increase from 1980 of 180% in nominal terms but a decline of 23% in real terms. The major components of the system, their nominal size and percentage distribution in 1980 versus 1988 are presented in Annex 2.01.

2.3 Commercial Banks. The commercial banks account for the largest share of total assets of the financial system. During 1980-86, the banking sector underwent substantial contraction in real terms as a result of the political turmoil and economic shocks experienced by the country: total assets contracted by 44% in real terms; loans to the private sector contracted even more sharply, by 63%. Between 1980 and mid-1987, three commercial banks, 147 rural banks and 32 thrift institutions, involving total assets of ₱ 14 billion (US$700 million equivalent), failed. These failures were compounded by the de facto insolvency of the largest commercial bank, PNB. With increasing stability and improvement in the real sectors starting in 1986, the health of the banking sector has steadily improved as evidenced by good profit margins in 1986-88. As an additional indication, the banks' capital adequacy ratios have improved in recent years: loan volumes contracted sharply in 1984-86 while the bank margins improved substantially, resulting in improved capital-to-assets and capital-to-loans ratios in 1986 and 1987. There are now 29 banks, of which four are foreign and one (PNB, still the biggest) is government-owned. Privately-owned banks form, by far, the largest part of the banking system. Seven banks are licensed as universal banks, a classification that allows them to engage in many near-banking activities such as those undertaken by investment banks, leasing companies and finance companies.

2.4 Non-bank Institutions. The next largest component of the financial system comprises the non-banks, which include insurance comp-

anies, pension funds, investment institutions, trust operations and others. Their assets amount to ₱ 138 billion, or 16% of the system's financial assets. The most important are insurance companies (with assets of ₱ 75 billion) and investment institutions, i.e., finance and investment companies (with assets of ₱ 24 billion).

2.5 The Securities Market. Though there are two operating stock exchanges, the Manila Stock Exchange and the Makati Stock Exchange, the equities market in the Philippines is still small relative to the totality of the financial system. In 1985, market capitalization of the 138 listed securities was ₱ 12.74 billion, representing 3% of systemwide assets, compared with 4% in Korea, 5% in Thailand, 9% in Taiwan, 12% in India, and 24% in Malaysia, in the same year. Renewed confidence brought about by a new Government and the higher earnings prospects of companies has led to growth of the market capitalization in the last three years, with the 141 companies listed in 1988 valued at ₱ 88.6 billion. Nonetheless, the securities market has yet to function as an important source of investment capital; the primary market for equity remains small: except for additional issues through stock dividends and pre-emptive rights offerings, new issues are rare. As for the secondary market in equities, it has been active, with the market turning around and breaking all previous records in 1986 and 1987. The 1986 turnover of ₱ 11.47 billion represented an increase of 555% over the preceding year's turnover of ₱ 2.07 billion while that of 1987, ₱ 31.35 billion, was a 273% increase over 1986. In 1988, turnover was ₱ 23.90 billion.

2.6 Foreign investments in Philippine securities totalled US$ 61.8 million in 1988. Hong Kong-based dealers accounted for the biggest block of foreign investors in Philippine securities with a share of 64.1% of the total volume of portfolio investments, followed by the United States (23.6%) and the United Kingdom (5.0%). These portfolio investments were primarily in commercial sector securities (68.2%), with the rest invested in mining sector issues (16.8%), financial sector securities (11.1%) and oil and manufacturing (3.4%).

2.7 As for corporate debt securities, both the primary and secondary markets are small, with very few issues being offered in the public market. As of year-end 1987 there were ₱ 3.36 billion registered commercial paper issues, but only ₱ 1.16 billion were sold in the market. There have been no new corporate bond issues. The government securities market is far more active, with national government bond issues totalling approximately ₱ 34.0 billion and those of government-controlled corporations and the Central Bank of the Philippines (CBP) being about ₱ 4.0 billion and ₱ 7.4 billion, respectively. Government bonds are not widely traded because they carry fixed interest rates which are far below market rates. They are consequently issued with "sweeteners" such as eligibility for bank reserves and as substitutes for mandated agricultural lending. The largest issued and actively traded government securities are T-bills, which had a total of ₱ 107.5 billion outstanding as of end-1987.

2.8 Leasing. Introduced in the Philippines in 1957, the leasing industry consists of financing companies which act as lessors. Supervision is carried out by the Securities and Exchange Commission (SEC) in consultation with CBP. The industry's growth was stunted by the political and economic crises in the earlier part of this decade. In view of the country's substantial investment needs in durable equipment, the use of leasing as a financing instrument has been quite limited. As of September 30, 1988, the nine leading lessors had an outstanding lease portfolio of ₱ 1.4 billion distributed thus: motor vehicles, 31.5%; industrial machinery, 10.4%; business and office machines, 10%; heavy equipment, 9.1% and others, 34%.

C. Major Financial Sector Policies

2.9 Interest Rate Policy. There has been a gradual move away from a regime of close control over interest rates combined with restrictions on international payments, current as well as capital, to a system which in practice is open to international flows and characterized by market-determined interest rates. Starting in 1980, ceilings on various categories of bank lending and deposit rates were eased and then progressively removed. The last deposit rate ceiling (on deposits with maturity of two years or less) was removed in mid-1981, and the last lending rate ceiling (on short-term loans) on January 1, 1983. Before the deregulation of interest rates, the banks had been circumventing the ceiling through a proliferation of additional charges and fees. The change thus brought greater transparency to the system. Real interest rates in the Philippines have remained substantially positive for deposits as well as lending, except in 1983, when inflation suddenly flared up.

2.10 Foreign Exchange Pricing and Allocation. From the system of foreign exchange rationing introduced in October 1983, there has been a progressive liberalization of exchange controls. Banks are no longer subject to control on their holdings of foreign exchange. Despite remaining controls on capital movements, wholesale funds are relatively free to move in and out of the Philippines. The relatively small gap between the official and open market exchange rates in recent times illustrates this openness and the small practical relevance of controls.

2.11 CBP/Government Role in Credit Allocation. Until recently, the Government/CBP played a direct role in credit allocation in sectors considered by it to have priority: it did so by designing credit programs and subsequently assuming responsibility for obtaining funding for them and their implementation. It is estimated that these programs, which cover both agriculture and industry, accounted for about 5% to 7% of total banking sector loans outstanding at the end of 1986. Most of the agricultural programs involved subsidies. The subsidy provided to the end users of funds under 13 major agricultural sector credit programs for which data are available amounted to at least ₱ 3.4 billion during 1981-86 in the form of lower than market interest rates and uncollected loans. As a percentage of the annual budget deficit during this period, subsidies on

these 13 programs ranged from a low of 2% in 1986 to a high of 8% in 1983. The cost to the Government was substantially higher than the amount of ₱ 3.4 billion stated above if the following additional items were considered: interest rate subsidies and uncollected loans for the smaller programs for which data are not available; administrative expenses of the implementing agencies including CBP; and government equity in failed rural banks and the tax exemptions granted to them.

2.12 The policy in government-sponsored credit programs in recent years, however, has been to move towards elimination of subsidies; for all major programs, the on-lending rates are now market oriented. Moreover, the basic nature of many of the programs is changing so that while they still reflect broad government objectives, decisions on lending to individual borrowers and the credit risks involved are now left to the banking system.

D. Financial Sector Reforms

2.13 As pointed out in para. 2.3, the sharp contraction of the economy during the first half of the eighties had its inevitable impact on the banking system and highlighted its weaknesses and fragility. In the wake of this distress and pressure on the banking system, there has also been a spate of legal suits against CBP and its personnel, hampering CBP's role as the supervisor and regulator of the financial system. The present institutional arrangement for safeguarding the interests of insured depositors has also proved inadequate. In addition, the expected increase in the demand for investment credit has prompted concern about the absence of an institutional framework for the mobilization and provision of long-term funds for investment purposes.

2.14 The first financial sector reforms undertaken by the Government to address the problems and concerns stated above were in the context of the ERL in 1986-87. As its main focus was on adjustment and stabilization of the whole economy, ERL dealt with only the most pressing of the financial sector problems: the rehabilitation of the government financial institutions (GFIs). The GFIs had suffered from outside interference in lending decisions, the undertaking of costly government credit programs without reimbursement, lack of internal controls and auditing, poor management practices in terms of lending decisions and portfolio management, and excessive size and diversity of functions. At the same time, their special position allowed them unlimited use of government deposits, exemptions from taxes and access to government-guaranteed borrowings. In the context of ERL, the Government undertook a reform program centering on the rehabilitation of PNB and DBP, the two largest GFIs. During 1986, the Government, recognizing the de facto insolvency of these two institutions, arranged a transfer of all their non-performing assets of ₱ 10 million or more each to the Asset Privatization Trust (APT) for workout, and relieved them of the corresponding liabilities. Institutional strengthening plans were also adopted at the same time. PNB's financial restructuring plan involved a reduction of its assets from ₱ 79 billion to ₱ 26 billion. The restructuring of DBP is described in detail in Chapter III.

2.15 The GFI reform program also laid the groundwork for future reform of the Social Security System (SSS), the Government Service Insurance System (GSIS), Philguarantee and the Land Bank of the Philippines based on detailed policy studies of these institutions. Furthermore, under the ERL, the Government undertook to privatize the six commercial banks taken over by the Government because of their weak financial condition. Thus far, two banks have been fully and two partially privatized; privatization of the remaining two banks is envisaged in the near future after the litigation involving them is resolved.

2.16 With the rehabilitation and financial restructuring of PNB and DBP substantially completed, the stage was set for a comprehensive review of the financial system, carried out by the Bank and supported by the Government. The resulting Financial Sector Study (FSS)[3/] identified the following as four critical problem areas: (a) supervision and regulation of commercial banks, including the governing legal framework; (b) institutional arrangements for the protection of insured depositors; (c) high intermediation costs and lack of effective competition; and (d) institutional arrangements for the mobilization and provision of long-term capital.

2.17 Based on the FSS findings, a Financial Sector Adjustment Program to be supported by a US$300 million Bank loan (FSAL; Loan No. 3049-PH, 1989) has been designed for implementation in the next two years. The program involves specific actions in the problem areas listed in paragraph 2.16. Bank supervision and regulation would be improved by (a) strengthening the legal and supervisory framework so as to empower CBP to take corrective actions in a timely fashion with respect to problem banks and, if necessary, to effect bank closures; (b) improving the supervisory and regulatory procedures; and (c) separating the supervisory and regulatory function from receivership-liquidation. Arrangements for depositor protection would be strengthened by enlarging the role of the Philippines Deposit Insurance Corporation to empower it to act as receiver-liquidator of failing banks and strengthening it financially and institutionally to enable it to play that role effectively. Intermediation costs would be reduced through promotion of more effective competition, reduction and elimination of certain fiscal impositions as well as improvement of laws governing debt recovery and insolvencies. Fund mobilization and medium- and long-term credit delivery would be enhanced through actions involving a revamping of DBP to enable it to act essentially as a wholesaler of long-term funds, and the elimination of CBP's role in credit allocation.

E. Institutional Arrangements for Providing Long-Term Credit

2.18 Under the FSAL, CBP has agreed to continue to reduce sharply, and ultimately eliminate, its direct involvement in the management of government-sponsored credit allocation programs. Since mid-1986, the

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3/ Philippines: Financial Sector Study (Report No. 7177-PH, August 23, 1988).

responsibility for making policy decisions regarding a number of agricultural programs has shifted to the Comprehensive Agricultural Loan Fund (CALF). The reduction of CBP's role in administering credit programs will be pursued further by transferring the administrative responsibility for remaining agriculture sector credit programs to CALF; the sole exception is the Agricultural Loan Fund which will likely be transferred to the Land Bank of the Philippines. The administrative responsibility for industrial sector programs will be assigned to a revamped DBP (see para. 3.9). When these measures have been completed, CBP will have completely withdrawn from the management of credit allocation programs, and its role would be confined to liquidity management through discount window operations.

2.19 While the banking system has been able to meet most short-term credit needs, the provision of long-term credit has been inadequate. Indeed, the most significant gap in the current financing system is in the provision of long-term credit. With the shrinking of lending activity by DBP and PNB concurrent with their rehabilitation programs, the specialized government institutions have not made a substantial contribution to the supply of term credit in the last three years. Their share in the total credit made available to the manufacturing sector, for example, declined sharply from a high of 43% in 1984 to only about 2% in 1986. As for the commercial banking system, the short-term nature of their lending and their caution became even more pronounced in recent years with the turmoil the financial system went through. The limited amount of term lending made by the commercial banks is usually through "roll-over" of short-term loans. The short-term horizon of lenders and investors is not surprising in view of the interest rate and exchange rate volatility during the last decade. Term transformation has not been accomplished to any significant degree because the banks have been unwilling to assume the liquidity risk. This has resulted in a situation wherein the main sources of medium - and long-term funding in the Philippines have been the government-directed credit programs described earlier. Instead of lending from resources raised from the market, the banks merely acted as lending conduits for funds borrowed by the Government from foreign sources or to a lesser extent, provided from the budget.

2.20 The situation is expected to worsen as the demand for investment credit increases with the growth of the economy. The current constraint on the availability of long-term credit reflects a lack of adequate arrangements regarding credit, interest rate and liquidity risks. The credit risk in long-term lending in itself is substantial, and commercial banks will be willing to assume such risk only if arrangements are made to relieve them of another accompanying risk, i.e., the liquidity risk. Given the liquidity crises of the past, banks are unwilling to assume the liquidity risk inherent in term transformation, and their present liability maturities are not, nor are they expected in the foreseeable future to be, long enough to enable the banks to lend long-term.

2.21 However, some domestic long-term resources are available in the system from institutional savers like insurance companies, SSS and GSIS and pension funds. It is estimated that gross premium receipts in 1986 amounted to ₱ 5.8 billion and ₱ 5.7 billion for private and public in-

surance companies, respectively. Also, it is generally believed, and confirmed by the institutions, that the annual increments to investible funds are quite large. For pension funds, the estimate for incremental funds mobilized in 1986 was at least ₱ 600 million. These institutions are also willing to invest long-term in the private sector if suitable opportunities are identified, i.e. they are willing to assume the maturity risk. As for the interest rate risk, the end users have already shown their willingness to assume it by borrowing on a variable rate basis. What is needed is to develop a financially viable institutional arrangement to bring the providers and users of long-term funds together.

2.22 Given the availability of domestic long-term funds through GSIS, SSS, pension funds and insurance companies on the one hand, and the lack of long-term credit on the other hand, the FSS identified the need for a financial institution to assume the role of a wholesaler by mobilizing long-term funds and channelling them to other financial institutions (retail) for onlending to individual enterprises. According to agreed FSAL measures, a revamped DBP will fulfill this role in line with an Institutional Development Plan which spells out its new role. As a wholesale institution, DBP will not assume the credit risk on the individual subloans. Chapter III provides a detailed description of the strategic reorientation of DBP.

F. Industrial Credit

2.23 The Bank's growth projections, based on an assumption of continued good policy performance and a favorable external environment, suggest an average overall GDP growth in the Philippines of about 6%, with a rate of 8% for industry, during the 1989-92 period. Achieving this target will necessitate a gradual increase in the rate of investment, from the 1988 level of 18% of GNP to at least 22%. Financing this investment will be a major challenge to the financial system in the next few years.

2.24 Short-term Working Capital Credit. The larger creditworthy enterprises obtain the working capital finance they need from the banking system. Small and medium enterprises (SMEs) have generally relied on trade credits, internal cash generation, loans from informal credit sources (usually family and friends), and, to a limited extent, loans from commercial banks. Recently, due largely to their excess liquidity and lack of alternative investment opportunities, commercial banks have begun to lend to well-collateralized SMEs with whom they have established relationships, usually through the Industrial Guarantee Loan Fund (IGLF) program. The expectation is that since the banks' relationships with these SMEs have now been established, they will continue to have their working capital needs met unless the economic recovery attains such strength that there is a general liquidity squeeze.

2.25 Demand for Industrial Term Credit. The business community, financial institutions and government officials feel strongly that demand for term credit will increase substantially as political stability in the country is sustained and macroeconomic conditions improve. Credit demand has thus far been mostly for working capital and, to an extent, for

investment capital to enable firms to reach full capacity utilization. There is, however, now a substantial need for financing expansion and new projects in industry as existing production facilities have reached their full capacity.

2.26 A review of the project pipelines of financial institutions active in the provision of term credit to industry suggests that for the creditworthy large-scale enterprises, concrete demand as evidenced by actual loan applications would amount to around ₱ 8.5 billion for 1989-90. Demand for term credit by SMEs in the formal industrial sector is expected to be around ₱ 4 billion for the same period. Thus, term credit demand of approximately ₱ 12.5 billion by the formal private industrial sector for 1989-90 appears to be a reasonable estimate. A conservative assumption of an annual growth rate of 5% in demand for term credit over the next three years, in line with prevailing estimates of GNP growth, would lead to a projection of about ₱ 20 billion (US $950 million equivalent) for the term credit needs of the formal private sector in industry during the 1989-91 period.

2.27 An evaluation of demand for finance by the private sector should also include the financing needs arising from the restructuring and rehabilitation of industrial enterprises. In the subsectors discussed in paras. 1.16-1.18 and Annex 1.03, many firms are finding it difficult to maintain adequate levels of working capital finance and service their debt. For such firms, the need is for extensive financial restructuring, converting their short-term borrowings into long-term debt to conserve cash flow and remove uncertainty, in addition to physical restructuring. Preliminary estimates by a recent World Bank mission looking into industrial restructuring needs suggest that for the cement, textile and garment, and pulp and paper subsectors alone, at least US$500 million (₱ 10.5 billion) would be needed over the next three years.

2.28 Supply of Industrial Term Credit. Credit by the banking system to manufacturing increased substantially between 1980 and 1984, but then declined sharply in line with falling growth rates of value added in the sector, as Annex 2.02 shows. Reflecting the continued acceleration in economic activity, outstanding loans of the commercial banks to the manufacturing sector grew substantially in 1937 and 1988. If past trends continue, the commercial banks, which do not have long-term resources to on-lend, will continue to concentrate on the provision of credit on a short-term basis, using the short-term "revolving" bank loan as the primary debt instrument and leaving the demand for term credit unsatisfied. It is in this context of paucity of term credit, that the proposed Project for financing private medium-scale and large enterprises was developed.

2.29 Given the estimated demand for industrial term credit of US$950 million (US$1.45 billion if industrial restructuring needs are included) for 1989-91, the term finance available to the sector is inadequate: the IGLF program would make US$275 million available for SME term financing (including US$60 million from the Bank, US$100 million from the Asian Development Bank (ADB) and US$28 million from local financial institu-

tions) whereas the Asean Japan Development Fund (AJDF) would provide US$300-350 million to all sectors, including agriculture. This would leave a gap of at least US$325 million (US$825 million if restructuring requirements are also considered), after taking into account the funds supplied by the various sources, including AJDF and ADB. The proposed Bank loan of US$65 million for financing medium-scale and large industrial enterprises is therefore a conservative amount, compared to expected total needs. As for the substantial financing requirements for industrial restructuring, they could be addressed by a subsequent Bank operation, depending on the findings of the subsectoral studies to be undertaken under the proposed Project.

G. Bank Strategy In the Sector

2.30 Bank support for the proposed Project would be consistent with its country assistance strategy of helping to sustain economic recovery and bring about a structural transformation of the economy. The Bank remains committed to assisting the Government maintain a reasonable and sustainable rate of growth in the industrial sector over the medium to long term. The recently completed Country Economic Memorandum and Industrial Sector Reports[4/] identify areas where further improvements would promote industrial sector growth. These include: continued policy and regulatory reforms to encourage greater competition and more efficient production; financial and physical restructuring of many large firms in the face of a changing policy environment which better recognizes the Philippines' comparative advantage in labor; expanded availability of long-term finance; and measures to boost exports. To support the industrial sector, therefore, Bank assistance would take the form of policy advice (related both to the industrial and financial sectors), institutional support, and the transfer of term resources. The dialogue with Government on broad policy issues will continue in the context of economic and sector work, and implementation of reform measures under the ERL Program and the FSAL.

2.31 The proposed Project is a follow-up to the Industrial Finance (Apex) Loan (Loan 1984-PH, 1981) designed to provide term funds to medium and large industrial projects. Under the Apex Loan, the Apex Development Finance Unit was established as a separate unit in the Central Bank to onlend the proceeds of a US$150 million Bank loan and a commercial loan of US$100 million to private sector enterprises through participating financial institutions (PFIs). In the face of deteriorating economic conditions, disbursement of Apex loan funds, however, was disappointing. What discouraged loan utilization was the effective cost of funds to subborrowers because of their assumption of the foreign exchange risk. Given the significant Peso depreciations since the Apex program was initiated, potential subborrowers grew extremely averse to borrowing foreign currency

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4/ Philippines: Toward Sustaining the Economic Recovery (Report No. 7438-PH, January 30, 1989); The Philippines: Issues and Policies in the Industrial Sector (Report No. 6706-PH, July 30, 1987).

loans. To increase the utilization of Apex funds, CBP decided in July 1984 to bear the foreign exchange risk on loans to export-oriented or import-substituting projects. Even this did not help because the adverse economic and political developments that subsequently occurred depressed demand for medium - and long-term credit. Total disbursement of Bank funds amounted to only US$44.7 million while commercial loan funds disbursed totalled US$32.2 million. While approval and disbursement targets were not met, the Apex program has been successful in achieving its institution building objectives: it has made possible the establishment of a semi-autonomous, professional Apex Unit within CBP and the development of organizational units in each PFI that have the capability of handling long-term, project based lending. The proposed Project was designed in the light of the experience of the Apex loan and incorporates changes in the denomination of the subloan currency and assumption of the foreign exchange risk to remedy past problems.

2.32 The Bank's continuing participation in the term financing of industry at this time is a logical step since the proposed Project will (a) assist the industrial sector exploit the opportunities provided by the improved economic and socio-political environment; and (b) build upon the successful institution-building experience of the Apex project as well as on the restructuring of DBP undertaken in the context of the ERL Program (Chapter III). Given the size of the financing gap and the modest amount of the Bank loan, the Bank funds will be complementary to, rather than competing with, other suppliers of funds. The TA component dealing with industrial subsectors would facilitate and enhance the Bank's dialogue with the Government on industrial restructuring and lay the groundwork for a program of reforms that may be supported by future subsector lending operations.

III. THE BORROWER AND PARTICIPATING FINANCIAL INSTITUTIONS

A. The Development Bank of the Philippines

Introduction

3.1 DBP would be the borrower of the proposed Bank loan, the proceeds of which it would relend to participating financial institutions (PFIs) for on-lending to medium-scale and large enterprises. The proposed operation is designed in the context of a long-term Institutional Development Plan for DBP that, as made clear in Chapter II, is linked to a coherent vision of the evolution of the overall financial sector. As a result of its rehabilitation under ERL, DBP is already moving towards integration into the market-based financial system that characterizes the Philippines: precluded from reliance on government resources, notably deposits, it is now self-sustaining; its lending policies are market-oriented; and its role in the system will be defined as being that of a predominantly wholesale bank for onlending funds to retail financial institutions rather than to end-users. The proposed Project would reinforce the expected evolution of DBP by strengthening its wholesale lending function through provision of term funds for relending to PFIs and by monitoring its progress in achieving its wholesale lending targets.

Historical Perspective: 1958-1986

3.2 Established in 1958 as a Government-owned development bank, DBP's financing operations until 1986 encompassed almost all segments of the economy, and both large and small-scale enterprises. In addition to its industrial, agricultural, real estate and transportation lending, DBP engaged heavily in lending to social sectors such as education and health care. Starting in the seventies, under the guise of its developmental mission, DBP financed high-risk and low-return government development programs ("directed" or "behest" lending), and the takeover of financially distressed firms at Government's direction.

3.3 This lack of financial discipline in its lending, compounded by serious weaknesses in internal organization and procedures (notably credit appraisal and supervision), led to serious financial problems. In the early 1970s, the total debt to equity ratio rose to over 10:1; the current ratio fell to 0.2:1; and arrears in the loan portfolio and defaults in the guarantee portfolio were high. With its resource mobilization capacity undermined, DBP had to rely mainly on government deposits for funding its activities.

3.4 Several capital increases between 1972 and 1980, substantial government deposits to support its liquidity position, and various measures to strengthen its organization and procedures all failed to stop DBP's deterioration in the early eighties. Serious portfolio arrears and poor collection rates persisted, as did the more intractable issue of high-risk and low-rate behest loans. As part of the Industrial Finance Loan, the Government and DBP were asked to implement an "Action Program", which included further organizational changes, measures to reduce DBP's dependence on government deposits, and actions to improve the collection performance. The financial effects of "behest" lending were to be made transparent, and Government was to provide financial assistance if DBP's financial viability would be impaired as a result of "behest" lending. However, continuation of DBP's problems, exacerbated by the economic and political crises of the period, led to DBP losing its accreditation as a participating financial institution in the project. Consequently, Bank loans to DBP were suspended. As evident in Annex 3.01 and in Table 3.1 below, DBP's financial situation in 1985 remained poor, with a net loss of ₱ 6.9 billion (US$370 million equivalent) and a high debt/equity ratio of 15:1.

DBP's Rehabilitation: 1986-88

3.5 Following the advent of a new Government in 1986, the severity of DBP's problems and its technical bankruptcy were addressed by a comprehensive rehabilitation and financial restructuring program developed in conjunction with the Bank-financed ERL. Major components included: (a) a new charter and policy statement, (b) installation of a new management team and Board of Directors, (c) transfer of ₱ 74 billion of non-performing accounts to the Asset Privatization Trust (APT), created by the Government to sell those assets; (d) implementation of a drastic cost

reduction program through staff reduction and sale of branches; (e) an internal reorganization and strengthening program focussing on credit policies, legal procedures, financial controls, accounting and internal controls, and personnel management; and (f) phasing out of subsidized Government deposits.

3.6 DBP's financial restructuring and the major elements of its internal strengthening program under the ERL have essentially been completed, with DBP being solvent during the last two years (Annex 3.01). Its recent performance, summarized in Table 3.1, shows that DBP has met and, in some areas, bettered the ERL targets set jointly by the Bank, the Government and DBP. Its indicators of capital adequacy, liquidity and earnings performance are sound. DBP's debt/equity ratio is now a very conservative 1.2:1, compared to the ceiling of 5:1 set under the ERL. Earnings indicators look impressive: return on assets is 14.4%; return on average net worth, 38.4%. DBP's performance also compares favorably with that of leading private financial institutions in the Philippines (paras. 3.27-3.28 and Table 3.3), except for its relatively higher administrative expenses; these, however, are expected to decline as a percentage of average total assets over the coming years as its loan volume increases and its activities shift from retail to primarily wholesale banking which is less personnel-intensive.

Table 3.1: SUMMARY OF DBP'S FINANCIAL PERFORMANCE, 1985-88
(Peso billion)

	1985	1986	1987	1988	ERL Targets
Total Loans Outstanding	27.5	5.27	4.39	5.01	n.a.
Total Debt	67.6	6.82	7.07	6.32	n.a.
Total Equity	4.5	2.68	3.46	5.11	n.a.
Net Income	6.9	5.6	0.8	1.6	n.a.
Ratios:					
Debt/Equity	15.0	2.5	2.0	1.2	5.0
Net Worth/Risk Assets (%)	11.3	35.9	37.4	52.8	10
Liquid Assets/Deposits and Short Term Borrowings (%)	0.57	35.5	26.8	57.6	n.a.
Liquid Assets/Deposits (%)	63.1	208.4	161.3	64.5	80
Provisions for Doubtful Accounts/ Total Loans (%)	0	47.3	34.9	28.6	25-39
Net Interest Margin/Total Assets (%)	(8.6)	(29.5)	9.7	9.2	4.5
Return on Average Net Worth (%)	(182.2)	(157.7)	25.5	38.4	10.0
Administrative Expenses/ Average Total Assets (%)	1.1	6.1	5.7	6.0	n.a
Personnel Costs/Total Assets (%)	0.4	3.7	2.5	2.6	2.5-3.5

3.7 It should, however, be pointed out that DBP's 1988 earnings performance is not fully indicative of DBP's long-term earning capability on a going concern basis. Of the total operating revenues of ₱ 2.6 billion, only 31% is interest from loans, whereas 18% comes from investment in securities, primarily Government issues, and 50% from the sale of assets acquired through foreclosure on loans made prior to the 1986 rehabilitation. This reflects the cautious investment approach taken in the first two years after the financial restructuring. As for interest expense, ₱ 1.4 billion of interest-free Government funds or 12% of total funds, were on DBP's books in 1988; as these free deposits are gradually being repaid (the rehabilitation schedule calls for full repayment by the end of 1989), these funds will have to be replaced with higher-cost funds, which would decrease the spread DBP is realizing. This combination of factors which reduce revenues and increase expenses will lead to lower, though still positive, net returns in the future.

DBP's New Role and Strategic Orientation

3.8 As described in paras 2.18-2.22, the recent FSS identified the lack of institutional arrangements for mobilizing and channeling long-term funds as a major constraint to investment and recommended that a revamped DBP could be developed to fill this institutional gap. This involves mandating DBP to act as a predominantly wholesale financial institution, catering to financial intermediaries rather than directly to business enterprises. Under the FASL, agreement with Government has been reached on this new orientation.

3.9 The wholesale DBP would mobilize and channel term funds to the private sector through retail financial institutions. Given the availability of domestic long-term funds from SSS, GSIS, insurance companies and pension funds, DBP is expected to play a major role in domestic resource mobilization. However, DBP's increased reliance on domestic resource mobilization can only be gradual: in the near future, the lack of a developed capital market and the Government's continuing need to tap domestic savings through high-yield Treasury bills would impede DBP's raising significant long-term peso funds. In such an environment, DBP will have to fund itself to a significant degree through foreign sources in the coming years. In this context, DBP has been designated as a principal conduit for official foreign borrowings, the proceeds of which are to be channeled through retail financial institutions for financing private enterprises. In line with this, the Government has agreed to the transfer from the Central Bank to DBP of the existing credit programs with foreign funding -- the Apex Development Finance Program (APEX) and the Industrial Guarantee and Loan Fund (IGLF). Moreover, DBP is expected to be the main wholesale conduit for the AJDF.

3.10 As part of the FSAL, the Bank helped DBP formulate an Institutional Development Plan (IDP) that defines and makes operational DBP's wholesale banking strategy, including an action plan for mobilizing domestic term funds. DBP's transformation to a primarily wholesale bank will be accomplished through a gradual reduction of its retail loan approvals and outstanding retail loans to enterprises, relative to the

wholesale loan approvals and outstanding wholesale loans to financial institutions. Agreement has been reached under the FSAL that by the end of 1993, DBP's portfolio is to be primarily wholesale. Subject to the availability of expected bilateral and multilateral funds, DBP projects that 64% of its outstanding loan portfolio will consist of wholesale loans by then. Annex 3.02 provides details of the gradual reduction, in relative terms, of retail lending and the concomitant growth of wholesale loans, as set out in the IDP. During negotiations, DBP agreed to the implementation of the IDP.

3.11 The transition will also entail gradual disinvestment from DBP's branch network. With the exception of 15 regional and metropolitan branches, all branches will be pooled into five regional development banks, which are to be privatized according to a schedule agreed under the ERL as well as the FSAL. By 1993, DBP's equity stake in these regional development banks would have been reduced to 30%.

Organization and Management

3.12 Before 1987, the Board of Directors held day-to-day operational responsibilities. Under the revised charter, the Board is a policy making body distinct from management; only the Chairman and the Vice-Chairman of the Board are also bank managers. Composed of nine members appointed by the President of the Republic of the Philippines, the Board now includes five members from the private sector.

3.13 DBP has developed a revised organizational structure (Annex 3.03) that is appropriate for implementing its wholesale banking strategy. The guiding principles behind the new organization structure are: (a) clear separation of funding and lending operations; and (b) upgrading of the resource mobilization function by creating a Capital Markets Department. Given the increased importance of resource mobilization, which has to be carried out in the financial markets by an individual of high standing, the Capital Markets Department is headed by an officer holding the rank of Vice President, reporting to the Executive Vice-President in charge of the Treasury Group. On the lending side, an Executive Vice President for Marketing will oversee the Wholesale Loans Department that will manage wholesale lending; the Entrepreneurial Banking Department will be in charge of the Metro Manila Branch, and the Corporate Banking Department will be in charge of project management. The Industrial Restructuring Unit (IRU), which forms part of the Strategic Planning Center, reports directly to the Chairman. The two Executive Vice-Presidents and the Senior Vice-President in charge of Accounting and Administrative Services also report to the Vice-Chairman, who in turn reports to the Chairman. An Internal Audit Department reports directly to the Board of Directors. The revised organizational structure and the arrangements regarding the head of the Capital Markets Department and staffing of the IRU were confirmed during negotiations.

Personnel Policy and Training

3.14 Under the ERL, DBP has reduced its staff from about 3500 to 2000, mainly through an early retirement scheme. The new wholesale orientation of DBP is expected to lead to a further net staff decrease of about 250: selective recruitment of a small number of qualified individuals to handle the new wholesale banking functions will be offset by reductions in staff resulting from DBP's disinvestment from the branch network and reassignment of existing staff from retail banking to wholesale banking.

3.15 A job and performance evaluation system as well as a merit oriented financial reward system are in place, with the integration of the two systems planned for end-1989. The Chairman and senior management are aware that the reorganized DBP must be able to offer compensation competitive with the private financial sector, if it is to attract and retain the high caliber staff necessary for it to perform its functions effectively. Consequently, DBP now supplements its salaries with productivity bonuses. In the last two years, DBP has been able to attract nine senior officers from leading private sector banks to head its departments.

3.16 DBP has engaged in extensive training of its staff in corporate finance, loan packaging, financial analysis and legal issues. Aware that the training efforts will have to be reoriented towards DBP's new activities in wholesale banking, DBP's management is reviewing its training needs for the period 1989-92. This assessment will take into account: (a) the incorporation of the APEX and IGLF units currently in the Central Bank; (b) the increased importance of resource mobilization efforts; and (c) DBP's role in conducting industrial restructuring studies and acting as a wholesale channel for loans. As a first step, a training program in industrial restructuring will be implemented as part of the TA component of the IIC Project. During negotiations, an understanding was recorded in the Minutes of Negotiations for Bank review of DBP's institution-wide training program to follow the one on industrial restructuring.

Accounting and Management Information System

3.17 The flow of accounting data has improved substantially over the last two years. Revised Branch and Head Office Accounting and Procedures Manuals have been completed. Liquidity and reserve summaries are generated daily; financial statements of branches and the head office are consolidated monthly. The general ledger is computerized and closed daily. Subsidiary ledgers for loans, which had been booked separately by lending groups and industries before the reorganization, have been centralized in the Transactions Processing Department. A central mainframe computerized information system, acquired from Citibank, is expected to be operational by 1990. This state-of-the-art system will provide an integrated management information system that allows immediate access to all transaction information which is stored in a centralized data base. The system will also integrate on-line authorization and printing of customer advices, and contract administration for loans, placements, bonds, deposits, commitments, receivables and sundries until final

maturity. The system will also incorporate an automated accounting service. Internal communications within the head office and between branches and head office are expected to be computerized by the end of 1989. In the meantime, the branches operate with stand-alone microcomputer systems for the general ledger, loans and liabilities and the savings and current accounts. The ongoing computerization and a system of account profitability analysis are expected to improve the management information system considerably.

Loan Activities and Asset Management

3.18 The DBP loan window was reopened in mid-1986 after a hiatus of four years during which no new loans were disbursed. Since then, DBP's investment policy has been conservative, with lending being primarily short-term and excess liquidity being invested in securities, primarily Government issues. In 1987, DBP realized no positive new net lending, while its securities portfolio grew by ₱ 2.7 billion. In 1988, outstanding loans increased by ₱ 610 million, while investments in securities were reduced by ₱ 192 million.

3.19 DBP's lending in the coming years will consist of (a) wholesale loans to PFIs, (b) retail loans to enterprises in areas where the commercial banking system may still be hesitant to enter fully and (c) syndicated loans wherein it will play a catalytic role in mobilizing the participation of private sector banks. Given its predominantly wholesale orientation, the transfer of the IGLF program to DBP and its expected role as the main AJDF wholesale conduit, wholesale loans outstanding are projected to grow substantially, from ₱ 3.8 billion in 1989 to ₱ 31.1 billion in 1993. The bulk of these loans will be for the industrial sector. Retail lending is projected to grow at a more modest pace, from ₱ 7.9 billion in 1989 to ₱ 15.2 billion in 1993.

3.20 DBP uses resources from its "Regional Development Fund" to extend loans that do not completely satisfy traditional commercial banking risk or collateral criteria. Considered essential from a developmental point of view, these loans involve concessions in one or more of the following parameters -- interest rates, repayment terms, or collateral requirements. They are intended to finance mostly projects outside the Metro Manila area which would introduce new technologies or manufacturing processes, or projects enabling enterprises to reduce or minimize environmental pollution. The Regional Development Fund comprises, and is limited to, 30% of each year's net income after taxes and repayments of loans sourced from the Fund. As of December 1988, these loans amounted to ₱ 74 million. By 1993 these loans are projected at ₱ 1.9 billion or 3.9% of total loans outstanding. The IDP provides that (a) the risk exposure of these loans and compliance with the 30% net income ceiling will be monitored closely; and (b) appropriate provisions will be made to take into account the potentially higher risk. These provisions will be at least 10% above the average provisioning on conventional performing loans.

3.21 Recovery of pre-rehabilitation non-performing loans has met with some success. Out of 6,000 non-performing accounts, representing ₱ 4 billion, that remained on DBP's books after the transfer of the bigger accounts to APT, ₱ 1.2 billion were collected on 3,800 accounts. In addition to standard loan collection and foreclosure activities, an "incentive scheme for pretermination" has been devised. By offering the debtors a roll-back of interest to 1984 (retroactive computing of interest due on the basis of 1984 rates) and condonation of penalties in exchange for a 20% downpayment and an agreed schedule of repayment of the recomputed past due, DBP collected on about 300 formerly doubtful accounts. Loan loss reserves cover 98% of the pre-rehabilitation portfolio; actual arrears on this portfolio amounted to 65.9% as of March 31, 1989. DBP intends to write off the past due accounts of this portfolio by end-1989. As for loans made after the rehabilitation (1986), loan loss reserves are more than adequate: they amount to 11% though actual arrears equalled only 1.98% as of March 30, 1989. This low arrears ratio compares favorably with the 4.0% average arrears ratio of the ten largest private commercial banks. Given DBP's past history, its conservative provisioning policy is appropriate.

Liability Management

3.22 The current average maturity of funding liabilities is about 1.8 years, against an average loan maturity of 3.8 years. DBP's balance sheet is now exceptionally liquid, with cash and due from banks representing 65% of deposits. In the coming years, liquidity will decrease somewhat as (a) interest-free Government deposits are reduced and (b) wholesale lending activities grow.

3.23 To fund its projected lending, DBP intends to supplement its foreign currency sources by actively tapping the domestic capital market. As a wholesale institution, DBP aims at playing a major role in domestic resource mobilization. In addition to promoting an active secondary market and lobbying for appropriate regulatory changes designed to open up the primary market, DBP will enter the market for its own account by issuing a variety of instruments, specially designed to tap different categories of institutional investors. Through recruitment of a few experts in its Treasury Group, DBP would acquire the required capabilities for designing, packaging, timing, pricing and placing its debt instruments. Given investors' current preference for short-term paper, DBP envisages that it would initially launch a ₱ 300 million, 3-year, bond issue in 1990 to establish its presence in the market. Favorable reception in the market would then be followed up by a ₱ 500 million issue in 1991 and further issues with longer maturities and lower coupons, to the extent allowed by market conditions and crowding-out effects resulting from government funding requirements. DBP's efforts at domestic resource mobilization will be closely monitored during the supervision of the Project by the Bank.

Projected Financial Position and Performance

3.24 Though DBP's performance still has room for improvement, its results for the last two years show that DBP is now endowed with features that enable real optimism regarding its future prospects. It has a new management that has demonstrated a willingness and an ability to make hard decisions; it has developed a focused strategy and has restructured its organization to implement that strategy; it has developed and is implementing improved controls and procedures. Of equal importance, its operations are to be governed by a set of policies designed to ensure that it avoids the mistakes of the past. On April 5, 1989, DBP's Board approved a new Policy Statement (Annex 3.04) which reflects its wholesale lending orientation and which deals with, among other things, DBP's investment policies, financial prudence limits and capital structure. Salient features of the Policy Statement provide for: (a) private sector orientation with autonomy in decision-making; (b) an interest rate and fees policy that is consistent with prevalent market rates and that ensures full recovery of all its direct and indirect costs, including provisions as required, plus an adequate profit margin; (c) prudent interest rate and maturity match between its assets and liabilities; and (d) a debt-equity ratio not exceeding 5:1. These market-oriented policies, implemented by its now more streamlined organization under new management, should enhance and speed up the integration of DBP into the market-based financial system of the Philippines. DBP has agreed to carry out the Project in accordance with its Policy Statement. Barring an unexpected deterioration in the macroeconomic environment, DBP is now poised for growth.

3.25 Detailed projections of DBP's future financial performance are presented in Annex 3.02 and summarized in Table 3.2. These projections are of an indicative nature, as the assumptions underlying them are dependent on general macroeconomic conditions, the development of the local capital market, and the availability of bilateral and multilateral funds.

Table 3.2: SUMMARY OF DBP'S PROJECTED FINANCIAL PERFORMANCE, 1989-1993
(Peso Billion)

Year	1989	1990	1991	1992	1993
Wholesale Loans Outstanding	3.85	13.23	18.03	23.90	31.13
Retail Loans Outstanding	7.88	9.00	11.34	13.31	15.17
Total Debt	10.24	19.21	25.45	32.39	40.09
Total Equity	5.16	6.11	6.99	8.17	9.67
Net Income	0.84	0.96	0.88	1.18	1.41
Ratios:					
Debt/Equity	1.9	3.1	3.6	3.9	4.1
Liquid Assets/Deposits and Short Term Borrowings (%)	20.7	27.4	31.5	34.4	28.3
Liquid Assets/Deposits (%)	26.2	32.9	33.9	34.4	28.3
Provisions for Doubtful Accounts/ Total Loans (%)	8.1	3.9	4.0	3.7	3.8
Net Interest Margin/Total Assets(%)	6.6	6.7	6.6	6.4	6.3
Return on Average Net Worth (%)	17.7	17.0	13.4	15.6	15.8
Administrative Expenses/ Average Total Assets (%)	4.6	2.6	1.9	1.6	1.4

Audit

3.26 In addition to the audit performed by the Government Commission on Audit, a private independent firm audits DBP's annual financial statements. Continued use of independent external auditors, agreed under the FSAL, will help enhance DBP's ongoing efforts to build a positive market reputation and image in the financial community.

B. The Participating Financial Institutions

3.27 The seven PFIs identified by DBP for possible participation in the proposed Project are privately-owned and comprise six commercial banks and one investment house. As of December 31, 1988, they accounted for 22% of total assets of the financial system excluding the Central Bank. In terms of assets, four of the PFIs are among the five largest commercial banks in the country. Key financial data and ratios on the PFIs are presented in Annex 3.05 and summarized in Table 3.3 below.

Table 3.3 PFIs - FINANCIAL DATA AND RATIOS
(December 31, 1988)

PFI	Total Assets (P Billion)	Return on Average Net Worth (%)	Debt/ Equity (Times)	Risk Assets/ Net Worth (Times)	Liquid Assets/ Deposits (%)	Adm. Expenses/ Avg. Total Assets (%)
Far East Bank	28.09	24.9	11.6	6.3	57.6	4.1
Bank of Philippine Islands	26.28	22.5	12.8	6.1	62.7	4.1
Metropolitan Bank	26.05	27.1	16.3	8.6	57.0	3.4
PCIB	19.68	21.2	8.0	4.4	54.6	4.9
Citytrust	8.09	16.9	7.9	3.3	95.3	5.0
International Corporate Bank	7.27	15.4	5.6	3.0	116.1	4.9
Anscor Capital and Investment Corp.	0.29	13.5	0.8	1.0	n.a.	6.6

3.28 All the seven PFIs being considered have good profitability, with annual return on average net worth ranging from 13.5% to 27.1% and averaging 20.2%. This compares with an average of 20.0% for the ten largest private commercial banks. Although their debt/equity ratios ranged from a low of 0.8:1 to a high of 16.3:1 and averaged 9:1, they all are in compliance with CBP's maximum risk assets to capital ratio requirement of 10:1. Moreover, they have all maintained a satisfactory liquidity position.

3.29 The identified PFIs have both the past record and the potential to operate effectively as term-lenders if provided with term funds. Having participated in the Apex project, six of the seven PFIs have experience in term-lending and have organizational units with the skills to undertake project financing. They all have good management and well-trained staff.

IV. THE PROPOSED LOAN

A. Project Objectives

4.1. The proposed Project would help fill the gap in the supply of term credit to medium and large industrial enterprises with healthy operations and good business prospects; improve credit delivery for industry by assisting DBP to carry out its wholesale banking function of channeling term funds to retail financial institutions; broaden the scope of financial services available to enterprises; help promote development of the capital market by introducing, on a pilot basis, the financing of equity and quasi-equity investments by participating financial institutions (PFIs); support and develop, within DBP and the Department of Trade and Industry (DTI), capabilities to conduct analytical and policy-oriented studies on industrial subsectors; and assist the Government in identifying, in selected subsectors, the policy and institutional framework which would provide the correct signals and support for these subsectors to become internationally competitive and efficient.

B. Project Description

4.2 To achieve the above objectives, the Project would include the following components:

(a) Line of Credit for Equipment and Working Capital. This would be the project's largest component, estimated at US$40 million and accounting for about 62% of the Bank loan. It would provide long-term financing to viable industrial enterprises, covering plant improvements or construction and acquisition of equipment as well as the working capital requirements associated with investment in plant and equipment. Incremental marketing and worker training and relocation expenses may also be financed.

(b) Lease Financing. As medium-term financial instruments, leasing contracts can be part of a financing package offered to industrial enterprises. The project would provide an estimated $15 million (about 23% of the loan) to finance PFIs for the purchase of equipment which they would lease to subborrowers.

(c) Equity and Quasi-Equity Investments. A pilot component, estimated at US$10 million (some 15% of the loan amount) would provide financing for equity and quasi-equity investments by the PFIs against their financing subborrowers' purchase of equipment, goods, services and works. Such investments would include common or preferred stock, convertible debentures or subordinated debt, which could be used either alone or packaged in combination with debt. Through this pilot component, the project would be able to offer comprehensive financing packages designed to meet the long-term needs of companies that are operationally healthy but need additional capital for expansion. The equity component is also designed to assist enterprises which, as SMEs, formerly benefitted from

the IGLF loan program but which have since graduated from the program and are now poised for growth.

(d) Studies, Training and Technical Assistance (TA). This component would be financed through a US$3.5 million grant from the Japan Grant Facility. It would complement the provision of finance through improvements in the technical capabilities of DBP and DTI to conduct subsectoral studies which would (i) provide subsector data, analyses, and strategies that would help financial institutions assess individual projects, and (ii) develop proposals for subsectoral restructuring, including measures to improve the policy and institutional framework for the selected subsectors. The first set of studies would cover the following subsectors: cement; pulp and paper; inter-island shipping and textiles. These subsectors were selected because they need substantial restructuring, operate under regulatory policies requiring major improvement and, under present circumstances, are unable to obtain financing from the banking system. These studies, under terms of reference finalized with the Bank's concurrence, have already started. Following their completion, it is envisaged that studies covering chemical industries, metal working/engineering and agro-industries/food processing would be undertaken. The final version of the studies would be published to ensure a wide dissemination of the information collected and analyzed by the consultants. Bank supervision missions will review the findings of these studies and discuss their implementation. Consultant services as well as training and technical assistance requirements identified by the studies would be financed through this component. All the studies are expected to be completed by October 1990.

4.3 The allocation of the Bank loan among the various components (equipment financing, leasing and equity investments) are indicative estimates based on expected use. During project implementation, the Bank loan funds would be allocated among the various financing instruments depending on actual demand. The project would cater to medium and large industrial enterprises that, by virtue of their size, would not normally be eligible for financing under the Bank-financed Fourth Small and Medium Industries Development Project (SMI IV; Loan No. 3038-PH, 1989). The minimum size for assets of eligible firms would be ₱ 20 million (before the financing provided under the project). The line of credit provided under the Project would not be subsector-specific.

C. Loan Amount

4.4 The proposed loan of US$65 million equivalent would be made to DBP at the Bank's standard variable interest rate and would have a term of 20 years including 5 years of grace. The Government of the Philippines would guarantee the Bank loan to DBP. It is expected that the Bank loan will be fully committed within two years after effectiveness.

4.5 The proposed Bank loan would cover 57% of a total financing package of US$114.5 million. The balance would be provided by the project sponsors, PFIs and the Japan Grant Facility as shown in Table 4.1.

Table 4.1 PROJECT COSTS AND FINANCING PLAN

Estimated Costs

	Local	Foreign	Total
	------	(US$ million)	-----
Credit Component	45.0	65.0	110.0
Studies, Training and TA	1.0	3.5	4.5
Total	46.0	68.5	114.5

Financing Plan

	Local	Foreign	Total
	------	(US$ million)	-----
Subborrowers	30.0	-	30.0
PFIs	15.0	-	15.0
DBP/DTI (Technical Assistance Beneficiaries)	1.0	-	1.0
Japan Grant Facility	-	3.5	3.5
IBRD	-	65.0	65.0
Total	46.0	68.5	114.5

D. Project Implementation

4.6 DBP, as a wholesale bank, would channel project funds to the PFIs which in turn would finance their clients' long-term plant, equipment and working capital needs, make equity or quasi-equity investments and/or write equipment lease contracts. The transfer of the APEX Development Finance Unit from the Central Bank to DBP would help DBP perform this wholesaling function. The PFIs would be duly accredited institutions. The financial intermediaries already accredited under the first Central Bank-Apex Program and which have remained sound and in good financial standing, based on monitoring reports of the CB-Apex Unit, would maintain their status as PFIs, at their option. Other financial institutions interested in participating would be accredited by DBP using criteria which include: (a) a track record of profitable operations and sound capitalization; (b) an ability to maintain a sound and healthy portfolio as demonstrated by the PFI's level of arrearages; (c) a qualified management team of good reputation; (d) adequacy of trained staff, established systems and procedures to be an efficient and reliable surveyor of retail credits and (e) project analysis capability and experience in corporate finance. Failure to continue to live up to these criteria would disqualify PFIs from further participation in the project. The accreditation of PFIs will be regularly reviewed during Bank supervision. In order to ensure that the project implementation starts on a sound footing, signing of subsidiary loan agreements between DBP and at least two PFIs which have met the accreditation criteria and are acceptable to the Bank is a condition of effectiveness of the proposed loan.

4.7 The Operating Policy Guidelines (OPG) of the Apex Unit, appropriately amended, will be adopted by DBP to serve as the document spelling out the policies and procedures that will apply to its wholesale

role under the Project. The revised OPG spells out, among other things, the following: accreditation criteria for PFIs (para 4.6); exclusion of DBP as a retailer of funds under the proposed project (para 4.10); subproject eligibility criteria and minimum and maximum subloan sizes (para 4.15); relending terms, conditions and rates to the PFIs (paras. 4.13, 4.18 to 4.19); on-lending terms, conditions and interest rates to subborrowers (paras. 4.14, 4.16); minimum loan participation by PFIs and minimum equity contribution by sub-borrowers (para. 4.15); conformance with environmental laws (para. 4.21). During negotiations, agreement was reached with DBP on the inclusion of the above components in the OPG. Adherence to the OPG is a covenant of the loan. Adoption of the OPG, satisfactory to the Bank and putting it into effect, by DBP's Board is a condition of effectiveness.

4.8 The PFIs, which would bear the subloan credit risk, would be responsible for subproject appraisal and supervision. DBP would review the documentation submitted by the PFIs for subproject approval to determine whether the eligibility criteria for subborrowers and subprojects have been met. Neither the World Bank nor DBP would duplicate the credit or project analysis of the PFIs and pass upon individual subloan applications except for very large projects involving subloan amounts beyond the free limit of US$4 million (para. 4.23).

4.9 The institutional structure for carrying out the subsectoral studies is such as to ensure a policy focus and representation of private sector views in the output. An Inter-Agency Coordinating Committee (IACC) would set the broad policy parameters for and supervise the studies. Established in January 1989, it has the following permanent members: (a) the Secretary of Trade and Industry, or his representative, acting as chairman; (b) a representative of the National Economic and Development Authority; (c) a DOF representative; (d) a DBP representative; and (e) a representative of the Bankers Association of the Philippines. The additional members of the Policy Committee would include a representative of the industry group which is the subject of the study and, if applicable, the representative of the concerned government regulatory agency. To handle the logistics and ensure the execution of the studies and the required training and technical assistance, DBP acts as the Secretariat to the Committee. For that purpose, it has set up an Industrial Restructuring Unit which is intended to grow into a source of technical expertise on restructuring which DBP's lending department as well as the PFIs would draw upon. Working Groups reporting to the Policy Committee and consisting of DBP and DTI staff and private sector industry and banking representatives would be counterparts to the consultants carrying out the studies. The IACC will play no role in DBP's lending decisions.

E. Relending Mechanism, Terms and Conditions

4.10 Relending Mechanism. Under contractual arrangements satisfactory to the Bank, DBP would pass on the proceeds of the loan to the PFIs which would onlend the funds to eligible industrial enterprises. During negotiations, agreement was reached with DBP that it will not lend the

project funds directly to eligible enterprises, in line with its wholesale banking function. It would establish a separate project account to channel project funds to the PFIs and to accumulate subloan repayments until they become due for repayment under the Bank loan. The funds thus accumulated would be used for further onlending for similar purposes and on similar conditions.

4.11 Foreign Exchange Risk. The World Bank would lend to DBP at its standard variable rate. The Government would assume the foreign exchange (FX) risk for a market-based variable fee payable by DBP.

(a) In the case of variable rate subloans, this FX fee would be set equal to the difference between the World Bank lending rate and the weighted average interest rate on peso time deposits of six months or less minus an administrative fee of 0.75% for DBP. The FX fee would be adjusted every six months in line with the movements in the two rates and shall be paid to the Bureau of Treasury.

(b) In the case of fixed rate subloans, the FX fee shall be computed as follows:

FX = WAIR2 minus (WB + 2.00% + Gross Receipts Tax)

Where: WAIR2 is the weighted average interest rate on two-year time deposits at the start of each amortization period.

WB is the rate of interest payable by DBP to the World Bank for the applicable amortization period.

4.12 Since domestic interest rates in the Philippines are market-determined and the capital account is essentially open, this market-based variable formula provides a reasonable estimate of FX risk. Based on World Bank projections of foreign inflation (average GNP deflator for the G-V countries of 5.1% for 1989-94) and Philippines inflation (average of 8.3% for the same period), the currently expected average inflation differential would amount to 3.2%. Based on prevailing interest rates on deposits of six months or less (12%), the variable rate formula would yield a FX risk fee of around 3.6% for the next six-months period. During negotiations, an understanding with the Government and DBP was reached on the above arrangement for FX risk.

4.13 Relending Rate of DBP to PFIs. DBP would relend the project funds in Pesos to the PFIs at market rates of interest. In line with market conditions, it is anticipated that DBP would offer alternative variable and fixed rate options to the PFIs. It is expected that the relending rate would approximate the cost to the PFIs of borrowing funds of a similar maturity in the market. Based on prevailing market conditions, DBP's relending rate would probably be in the 13% - 14% range, allowing for an adequate intermediation margin. During negotiations agreement was reached with DBP that it will maintain relending rates which are market-based and provide it with adequate spreads over its costs.

4.14 On-lending Rate of PFIs to Subborrowers. PFIs will also be free to charge market rates of interest, allowing them flexibility in assessing risks and differences in creditworthiness, or covering administrative costs associated with individual clients or loans. This mechanism is also expected to increase competition among the PFIs which would bear the full credit risk of each subloan made. Under current market conditions, the on-lending rate to subborrowers would be around 18% - 19%.

4.15 Eligible Subprojects. The project would finance technically, financially, and economically sound investment subprojects of viable industrial enterprises. The minimum size for assets of eligible firms would be ₱ 20 million (before the financing provided under the project) and the minimum subloan size would be US$250,000. The maximum subloan amount to be lent to any individual company by a PFI would not exceed US$6 million equivalent; in the case of loan syndications, the maximum subloan would be US$8 million equivalent. For each subproject, the PFIs would be required to finance at least 10% of the financing package from their own funds; this may include the working capital loans they normally extend. The minimum equity contribution by the subborrower would be 20% of total project cost. Subprojects would have to yield a financial rate of return of not less than 15% in real terms. Equity investments would be expected to yield an after-tax return on equity of at least 18% in real terms. Subprojects that are in subsectors that receive a high level of protection through quantitative restrictions would not be eligible for financing under the Project; an understanding with DBP on a list of these ineligible subsectors, to be revised semi-annually, was recorded in the Minutes of Negotiations.

4.16 Maturities and Grace Periods. The maturity of equipment and working capital subloans would vary from 3 to 13 years and 3 to 7 years, respectively. Equity and quasi-equity investments financed under the project would have maturities ranging from 5 to 10 years and would in no case exceed the period of the equity or quasi-equity participation. The financing of new equipment for leasing will be for lease contracts that have a maturity of 3 to 13 years. The maximum grace period would be 3 years for equipment and working capital subloans. To take into account the fact that equity and quasi-equity investments may not produce returns in the first 4 to 5 years of the investments, loans to finance them will have a grace period of up to 5 years. Lease financing will have no grace period.

4.17 Quasi-Equity Investments. Quasi-equity investments are attractive because they offer to both investors and investees a high level of flexibility with respect to liquidity of the investment, risk distribution, and profit sharing. Some quasi-equity investments that may be financed are as follows:

(a) Conditional Loans. These could be a useful financing instrument for risk sharing between the subborrower and the PFI. They offer a high degree of flexibility in their design: conditional payments of the subborrower could refer to the interest payments, the principal or both; and the yield of the loan could be based on the interest rate, a revenue sharing scheme or a profit sharing scheme. The pricing of condi-

tional loans would, of course, be commensurate with the increased risk associated with them.

(b) Convertible Loans. These offer, commensurate with the increased level of risk, flexibility and the prospect of better returns than traditional loans or equity investments.

(c) Subordinated Debt. Compensated through a higher interest rate, this could be of interest if the borrowing company does not have sufficient collateral to back up its overall funding requirements.

4.18 Special Conditions for the Equity Component. To be eligible for financing, equity and quasi-equity investments would have to be used for purposes similar to term credit, i.e. plant improvement or construction acquisition of equipment, and permanent working capital requirements. Project funds, however, cannot be used for the refinancing of existing debt. In line with current Central Bank regulations, equity investments by the PFIs to be financed with loan funds would be restricted to a maximum of 25% of the share capital of any company. Furthermore, each PFI shall limit its total equity investments in a single enterprise to no more than 15% of its own total equity. These restrictions would help keep the risks within reasonable limits. The risk of equity investments would be borne by the PFIs, as DBP would merely finance the equity holdings according to agreed guidelines.

4.19 Relending terms and conditions for equity and quasi-equity financing would be as follows:

(a) The obligation of the PFIs to DBP would take the form of a loan. Interest rates that PFIs would pay DBP for funds to be used for equity or quasi-equity investments would be the same as those charged to them for equipment and working capital lending; and

(b) Investment terms and conditions for equity and quasi-equity instruments would be negotiated on a case-by-case basis between the investor (PFI) and the investee (enterprise). In the case of quasi-equity instruments, the agreement between the investor and the investee could include a broad variety of terms and conditions, including a participation in sales or profits, the issue of warrants, or interest rates above those specified for subloans to allow for the increased risk that investors would face.

4.20 Eligible Expenditures. The proceeds of the loan would be used to finance 100% of the foreign currency cost of directly imported goods and services, and 60% of local expenditures (corresponding to the estimated average foreign exchange content of these items). Project related expenditures made within 90 days of receipt of subloans by DBP would be eligible for financing. In addition to financing investments in plant and equipment, the Bank may consider financing the following expenditures:

(a) Marketing and Distribution. Since marketing expenses represent a necessary investment, they would be eligible for financing under the loan.

These would include, for example, (i) participation in trade fairs and exhibitions in prospective markets; (ii) start-up and initial financing of a sales force; (iii) financing of advertising and promotion campaigns in foreign markets; and (iv) investments in the domestic distribution system. To be eligible, marketing expenses would have to be incremental; i.e. they would have to go beyond the current marketing expenses of a subborrower.

(b) Worker Retraining and Relocation. A shift in market focus or changes in the organization of the production process are likely to affect the size and the composition of the work force. Retraining and relocation will be important not only to protect jobs but also to employ new machinery or take advantage of new technologies. Therefore, retraining and relocation expenditures may be considered as eligible expenditures and could be included in the subloan to a company.

4.21 Environmental Considerations. To sensitize the PFIs to the risks associated with ignoring environmental concerns, the Operating Policy Guidelines would include a provision for the PFIs to finance subprojects that are in compliance with applicable laws and regulations of the Philippines governing environmental protection.

4.22 The Philippines has stringent environmental regulations, but the ability of existing industrial plants to comply with them as well as the Government's monitoring and enforcement capacity are limited. During preparation of the proposed Project, it was agreed with the Department of Environment and Natural Resources, the Environmental Management Bureau, DTI and DBP that industrial pollution issues should be addressed in a comprehensive manner which would lead to the setting of realistic goals for pollution control and the development of a sound strategy for achieving those goals. This would involve (a) reviewing the relevance and applicability of existing environmental laws and regulations, as many of them appear to have been adopted, with little or no modification, from industrialized countries; (b) formulating policies and incentives to encourage and ensure compliance by enterprises and (c) strengthening the institutional framework for more effective monitoring and enforcement as well as for providing technical assistance to industry on pollution control. The Bank has offered to support this comprehensive approach through a study of the policy, regulatory and institutional framework, whose findings could help develop an environmental support and industrial pollution abatement project. The subsector studies under the proposed Project will provide an important input to this comprehensive study. They will include an assessment of environmental issues in each subsector and will propose measures to (a) provide economic and financial incentives and technical assistance for installation and proper operation of clean and efficient technologies and appropriate pollution control equipment; (b) strengthen monitoring of plant effluents; and (c) improve institutional arrangements for environmental monitoring and pollution control.

4.23 Free Limit and Subproject Documentation Requirements. The free limit would be set at US$4 million. The proposed free limit is based on the experience of PFIs in the evaluation of subloans under the Apex

project. In addition, the proposed free limit would allow the Bank to focus subloan evaluation efforts on larger and more complex projects. If the Bank share in the subloan made by the PFI is below the free limit, the Bank would not carry out an individual subproject review, but would make periodic sample analyses during supervision missions. DBP would submit to the Bank the original subloan application (submitted by the subborrower to the PFI), the PFI's credit evaluation and the subloan agreement between the subborrower and the PFI. DBP would, then, issue authorization to withdraw funds for approved subprojects. If the Bank share in a subloan is above the free limit of US$4 million, DBP and the Bank would review the basis used by the PFI in approving the subproject before granting approval. The subproject documentation submitted to the Bank would then have to include, in addition to the items mentioned above, a separate feasibility study of the investment project and an extensive analysis of the operational and financial situation of the company.

4.24 To provide for sufficient flexibility and to speed up the subloan approval process, DBP would use an immediate disbursement system whereby (a) the PFIs would be eligible for immediate reimbursement of their disbursements to subborrowers under the project and (b) DBP can disburse to suppliers or contractors at the request of the PFIs. If a subloan above the free limit is not subsequently approved by the Bank, the PFI would reimburse DBP any funds extended prior to the Bank decision. No funds shall be directly transferred to the subborrower or the PFI except for reimbursement of actual payments made.

F. Disbursements

4.25 The Bank would disburse against 100% of the loans made by DBP to the PFIs up to the financing share made up by the eligible expenditures (para. 4.20) and requested for the respective subproject. A Special Account (revolving fund) of US$4 million would be established in DBP to finance the Bank's share of subloans, thus helping to expedite project execution. Withdrawals from the loan account would be made on the basis of Statements of Expenditures, and DBP would ensure that all supporting documentation is being adequately maintained and that it would be available for review upon the Bank's request. DBP would submit to the Bank a monthly statement of the transactions of the Special Account. The loan is expected to be disbursed in about five years, based on the standard disbursement profile for industrial finance projects.

4.26 Disbursement of funds from the Japanese Grant Facility, for which DBP is the executing agency, will be administered by the Bank. For services, the Bank will disburse 100% of expenditures; for equipment and materials, the Bank will disburse 100% of foreign expenditures for imported items and 100% of local ex-factory costs, and 80% of local expenditures for equipment and supplies procured locally. Disbursement for all contracts below US$100,000 equivalent will be made on the basis of statements of expenditure. A Special Account of US$400,000 equivalent is proposed to be established in DBP to facilitate disbursement. For all sub-components using Statements of Expenditures, adequate records of

documentation will be maintained by DBP and will be made available to the Bank upon request.

G. Procurement

4.27 Procurement procedures for goods, works and services financed with loan funds would comply with those customary for industrial development finance operations. DBP and the PFI will satisfy themselves that the goods, works and services to be purchased are for the investment subprojects and are reasonably priced, by ensuring that the subborrowers have canvassed the main sources of supply and purchased from the most advantageous source. During negotiations, it was agreed that contracts above US$ 5 million equivalent will be procured by International Competitive Bidding.

4.28 Procurement of consultants for the TA component will be in accordance with the Bank's Guidelines for the Use of Consultants.

H. Monitoring, Reporting and Auditing

4.29 A Supervision Plan is presented in Annex 4.01. DBP would prepare semi-annual progress reports on project implementation. These reports would include an assessment of progress in implementing both the financing and technical assistance components. The Bank's monitoring will be at two levels: (1) DBP's implementation of the Project and (2) the institutional development of DBP. The monitoring of DBP's Project implementation will focus on (a) the accreditation of PFIs by DBP; (b) adherence to the OPG and (c) the PFIs' repayment of loans to DBP. The Bank's supervision of DBP's institutional development would involve concentrating on the general performance of DBP in accordance with the agreed Institutional Development Plan. This would mean assessing the progress made in the strategic transformation of DBP against performance criteria which include: (a) adherence to its revised Policy Statement; (b) increase in the proportion of wholesale lending in its total outstanding portfolio in line with DBP's Institutional Development Plan; (c) preparation of a Resource Mobilization Plan acceptable to the Bank and (d) reduction of its staff by 250 persons by July 1990. Bank supervision of DBP for this project will be in conjunction with supervision of the Financial Sector Adjustment Loan. DBP will be responsible for preparing Part II of the Project Completion Report. During negotiations, these arrangements for Bank supervision of DBP were confirmed.

4.30 The accounts of DBP, including those kept for the purpose of the project, the Special Account, and Statements of Expenditures, would be audited annually by independent auditors acceptable to the Bank. The audit reports, including an opinion regarding the supporting documentation for disbursements based on Statements of Expenditures, would be submitted within six months after the end of DBP's fiscal year. During negotiations agreement was reached with DBP on these reporting and audit arrangements.

I. Justification and Risks

4.31 The project justification is based on the importance of providing timely support and assistance to industrial development in the Philippines. Based on the experience of the Apex loan, it is expected that the proposed Bank loan would finance about 45 subprojects with an average credit financing package (mix of equipment and working capital subloans, lease financing and equity and quasi-equity investments) of around US$1.5 million. These subprojects would generate incremental direct employment of about 5,300. The project will also enable DBP to develop the institutional capabilities to embark on the wholesale banking role envisaged for it by the Financial Sector Reform Program supported by the Bank. Moreover, the proposed project would strengthen the capacity of a wider number of financial institutions to provide development-oriented term lending. The TA for industrial restructuring studies would assist the Government in charting the reforms that may be necessary for the efficient and competitive development of enterprises in specific subsectors. The studies would provide the analytical basis for developing subsectoral strategies in the context of which subsectoral restructuring programs can be formulated, possibly to be financed by an industrial restructuring operation later.

4.32 The major risk is that investment demand may not materialize as projected. Commitments could slow down because of slower than expected economic growth or reluctance by financial intermediaries in accepting new financial instruments that will be introduced under the proposed project. Leasing is a relatively new industry in the Philippines. Moreover, the local market for equity is small and owners of privately held companies may remain reluctant to allow PFIs to hold shares in their companies, even for a limited period. To deal with these uncertainties, the loan size has been set in light of conservative demand projections, and the amounts allocated for lease contracts, equity and quasi-equity instruments are relatively small. If this allocation does not tally with actual demand for leasing and equity investments, the funds would be reallocated for traditional credit operations.

V. AGREEMENTS, UNDERSTANDINGS AND RECOMMENDATION

A. Agreements and Understandings

5.1 During negotiations, agreements regarding the following were reached with DBP:

(a) implementation of DBP's Institutional Development Plan (para. 3.10)

(b) execution of Project in accordance with DBP's Policy Statement (para.3.24).

(c) Operating Policy Guidelines for the Project (para 4.7) which will include:

- accreditation criteria for PFIs (para. 4.6)

- exclusion of DBP as a retailer of funds under the proposed Project (para. 4.10)
- subproject eligibility criteria and minimum and maximum subloan sizes (para. 4.15)
- minimum loan participation by PFIs and minimum equity contribution by subborrowers (para. 4.15)
- conformance with environmental laws (para. 4.21).
- free limit and subproject documentation requirements (para.4.23)

(d) Relending terms, conditions and rates to the PFIs (paras. 4.13, 4.18 to 4.19)

(e) Onlending terms, conditions and interest rates to subborrowers (paras 4.14, 4.16 and 4.19)

(f) Reporting and auditing requirements (para.4.30)

5.2 During negotiations, understandings on the following were recorded in the Minutes of Negotiations:

- mechanism for assumption of the foreign exchange risk by the Government (para. 4.11 - 4.12);

- list of subsectors ineligible for Bank financing on account of high quantitative restrictions (para. 4.15);

- Bank review of DBP's institution-wide training program (para. 3.16).

B. Conditions of Effectiveness

5.3 Effectiveness of the proposed loan will be conditional on the following additional events:

(a) signing of subsidiary loan agreements, satisfactory to the Bank, between DBP and at least two PFIs which have met the accreditation criteria and are acceptable to the Bank (para. 4.6); and

(b) adoption of and putting into effect the Operating Policy Guidelines for the proposed Project by DBP's Board (para. 4.7).

C. Recommendation

5.4 With the foregoing agreements and understandings, the proposed Project is suitable for a Bank loan of US$65 million to DBP. The loan would have a term of 20 years, including five years of grace on repayment of principal, and carry the standard variable interest rate. The loan would be guaranteed by the Republic of the Philippines.

ANNEX 1.01

PHILIPPINES

INDUSTRIAL INVESTMENT CREDIT PROJECT

Average Nominal Tariff Rates, 1982-88

Sector	Weighted Average			Unweighted Average		
	1982	1986	1988[a/]	1982	1986	1988
Agriculture	18.4	11.2	12.6	30.5	29.1	27.1
Mining	19.6	19.1	10.3	13.3	13.3	13.1
Manufacturing	21.6	22.7	22.2	31.8	28.3	28.3
Overall Average:	21.1	21.3	19.4	31.3	27.9	27.9
Consumer Goods	22.2	28.7	29.2	46.7	38.1	38.1
Intermediate Goods	22.6	21.3	20.5	27.6	25.2	25.2
Capital Goods	20.1	21.8	21.9	21.4	22.4	22.3
Overall Average:	21.6	22.7	22.2	31.8	28.6	28.5
Food, Beverage, Tobacco	19.3	27.2	30.4	38.6	35.4	35.9
Textiles	34.0	33.8	30.6	53.8	40.4	40.1
Wood and Products	39.1	49.1	37.8	42.0	36.4	36.4
Paper and Printing	33.7	36.8	27.9	37.2	30.9	30.8
Chemicals, Petr, Coal	19.6	18.4	19.2	24.9	22.0	22.0
Non Metallic Mineral	25.6	22.9	25.4	37.3	33.7	33.4
Basic Metal Industry	17.0	14.3	13.8	14.6	15.1	15.6
Machinery Metal	21.6	22.4	22.6	24.7	25.1	24.9
Other Manufacturing	37.5	37.5	34.4	38.0	36.3	36.3
Overall Average:	21.8	22.9	22.4	32.3	28.7	28.7

a/ Using 1987 imports as weights. The lower rates of weighted averages in comparison to unweighted averages indicate the presence of some very low tariffs on imports with large volumes.

Source: Tariff Commission.

ANNEX 1.02

PHILIPPINES

INDUSTRIAL INVESTMENT CREDIT PROJECT

Financial Performance of Manufacturing Corporations, 1979-87[a/]

	1979	1980	1981	1982	1983	1984	1985	1986	1987
Net income (₱ billion)	1.92	1.20	1.04	(0.11)	0.70	2.54	2.48	5.00	8.44
Net income/net worth (%)	9.97	5.60	3.88	(0.39)	2.16	7.26	6.69	10.00	14.49
Total Liabilities/Net Worth	2.17	2.51	2.17	2.16	2.43	2.82	2.66	2.19	1.81
Total Long-Term Liabilities/Net Worth	n.a	n.a	n.a	n.a	n.a	n.a	0.99	0.83	0.45

a/ Manufacturing Segment Top 1000 Corporations only.

Sources: Business Day, 1,000 Top Corporations in the Philippines (various editions); Central Bank of Philippines, 1985 Annual Report; Philippines Business Profiles and Perspectives, Inc./Center for Research and Communication, Philippines Business Perspectives (1987 and 1988 editions).

PHILIPPINES

INDUSTRIAL INVESTMENT CREDIT PROJECT

Subsectoral Issues

The Cement Subsector

1. Basic data on the cement industry are presented in Table 1 (page 2 of this Annex). Largely privately owned, the cement industry is basically inward oriented. A high level of protection (quantitative restrictions, high tariffs) and a tightly regulated domestic distribution system contributed to a reasonable performance, in spite of price control, as long as domestic demand was growing. With the economic collapse in the early eighties, performance rapidly deteriorated. In the mid-eighties, capacity utilization dropped to an average of around 55%, with four of the existing 18 plants being moth-balled. Apart from a conversion scheme to substitute coal for oil in this energy-intensive industry, very little investment has taken place in the subsector during the past ten years. By international standards, many of the plants lack economies of scale, are over-manned, and are technologically obsolete (more than half of the plants use the energy-intensive wet or semi-dry process). They have therefore not remained competitive. Moreover, several enterprises which incurred foreign debt in the last decade face financial distress as a result of the major Peso devaluations of the mid-eighties. No fundamental rehabilitation of existing capacity has taken place.

2. Though price control and import restrictions have been lifted in early 1989, the tightly controlled distribution system with its limited number of licensed agents acts to continue to uphold de-facto import control and a price ceiling. As a result of the construction boom starting in 1986, two moth-balled plants have been brought back into production; capacity utilization is currently close to 90%. There are shortages of cement in some parts of the country. Domestic production has therefore been complemented by imports. The result is a substantial upward pressure on cement prices. Given the strategic importance of cement in construction and fixed investment, cement shortages and excessive growth of cement prices could choke off investment demand, spur inflation and increase the cost of private and public investments.

3. The data on the largest companies indicate that after a period of losses and negative returns (1982-86), the industry witnessed a turnaround in 1987 when net income became positive. To sustain and improve upon the recent performance will necessitate addressing the physical, financial, and policy constraints facing the industry. This will require examination of the following issues: (i) the impact of trade policy, notably of QRs, on the industry structure and recommendations for improvements in policy to foster competitiveness; (ii) the role of regulatory

Table 1: Key Statistics for the Cement Industry, 1979-1988

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988p
A. PRODUCTION, TRADE & CONSUMPTION										
1. Production (000 MT)	3939.8	4516.2	3996.3	4035.0	4542.0	3637.4	3078.4	3282.6	3974.3	4300.0
2. Imports (000 MT)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	31.5	350.0
3. Exports (000 MT)	404.7	869.7	482.9	559.8	154.3	297.6	599.6	154.7	0.0	0.0
4. Apparent Consumption(000 MT)	3535.1	3646.5	3513.4	3475.2	4387.7	3339.8	2478.8	3127.9	4005.8	4650.0
5. PerCapita Cons.(kg)	76.4	75.8	71.0	68.5	84.4	62.8	45.6	56.2	70.3	79.8
6. Imports/Cons. (%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.8%	7.5%
7. Exports/Prodctn.(%)	10.3%	19.3%	12.1%	13.9%	3.4%	8.2%	19.5%	4.7%	0.0%	0.0%
B. DATA ON THE LARGEST CEMENT CORPORATIONS OF THE PHILIPPINES a/										
#of Cement Corporatns.	12	12	15	15	14	14	10	10	10	N.A.
Gross Sales(P Million)	1,209.4	1,660.6	2,424.8	2,680.8	2,532.0	2,148.3	2,401.2	2,378.7	2,931.0	N.A.
Net Income (P Million)	50.3	35.7	71.3	(65.3)	(116.1)	(264.9)	(204.5)	(257.3)	76.5	N.A.
Tot.Assets (P Million)	1,822.6	2,118.8	3,905.3	4,487.6	4,925.6	6,025.3	5,553.9	6,441.4	6,606.1	N.A.
Capital(pd)(P Million)	260.7	314.8	415.9	696.8	696.0	809.5	603.2	607.0	594.8	N.A.
Return on G. Sales (%)	4.2	2.1	2.9	(2.4)	(4.6)	(12.3)	(8.5)	(10.8)	2.6	N.A.
Return on Assets (%)	2.8	1.7	1.8	(1.5)	(2.4)	(4.4)	(3.7)	(4.0)	1.2	N.A.
Return on Capital (%)	19.3	11.3	17.1	(9.4)	(16.7)	(32.7)	(33.9)	(42.4)	12.9	N.A.
Pd.Up Capit./Assets(%)	14.3	14.9	10.6	15.5	14.1	13.4	10.9	9.4	9.0	N.A.
Total Manufacturing Sector (Top 1000 Corporations):										
Gross Sales(P Billion)	64.9	81.0	94.6	105.2	127.6	176.4	174.6	185.3	189.1	N.A.
Net Income (P Billion)	1.9	1.2	1.0	(0.1)	0.7	2.5	2.5	5.0	8.4	N.A.
Tot.Assets (P Billion)	61.0	75.2	84.9	89.5	111.6	133.6	135.7	159.4	163.6	N.A.
Equity (P Billion)	19.3	21.4	26.8	28.7	32.5	35.1	37.1	50.0	58.2	N.A.
Ratios: Cement Sector / Total Manufacturing Sector (Top 1000 Corporations) (Percent)										
G. Sales Ratio (%)	1.9	2.1	2.6	2.5	2.0	1.2	1.4	1.3	1.5	N.A.
N. Income Ratio (%)	2.6	3.0	6.9	57.8	(16.6)	(10.5)	(8.2)	(5.1)	0.9	N.A.
Total Asset Ratio (%)	3.0	2.8	4.6	5.0	4.4	4.5	4.1	4.0	4.0	N.A.
Equity Ratio (%)	1.4	1.5	1.6	2.4	2.1	2.3	1.6	1.2	1.0	N.A.

a/ Companies in the Philippines, classified as among the top 1000 corporations by gross sales.
p/ Preliminary

Sources: (1) Philcemcor (Cement Corporation of the Philippines)
(2) Miscellaneous Industry Publications
(3)"1000 Top Corporations in the Philippines"

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policy, in particular policies governing distribution and pricing, in shaping the industry, and proposed improvements to achieve economies of scale in plant facilities and distribution systems; (iii) international competitiveness in the cost structure of Filipino plants, actually, and potentially after rehabilitation, and proposals for physical restructuring; (iv) financial distress and options for financial restructuring; and (v) investments necessary to increase the efficiency of distribution facilities in the Philippines.

The Pulp and Paper Subsector

4. Data on the pulp and paper subsector are presented in Table 2 (pages 4-5 of this Annex). Developed behind a high and effective curtain of protection, the industry, which consists of 29 mills, was essentially established during the fifties and sixties, except for some pulping facilities installed in the seventies. Most of the plants lack economies of scale, have obsolete equipment and are over-manned. Given the outdated machinery, the subsector finds difficulty in securing replacement parts and, as a consequence, suffers from lengthy machine downtime. No major investments were made in the industry during the past 10 years. Industry performance during the first half of the eighties has been poor, with capacity utilization declining to about 40%, in line with the economic slump. The economic recovery from 1986 has seen resurgence of demand but capacity utilization is still only slightly above 70%. But despite optimistic forecasts suggesting continuously growing demand, only small investments are taking place in the sector because of uncertainties regarding needed policy reforms and the hesitancy of the banks to lend to the industry.

5. Distorted policies and regulations in the forestry sector and uncertainties related to land reform contribute to a raw material cost to the industry which compares unfavorably with that of Brazil, Indonesia and other competitors. Long fiber pulp has to be imported. However, the volume of short fiber pulp and waste paper that is currently imported could be furnished locally at competitive prices if appropriate measures (tree farming, industrial tree plantations) were adopted to a greater extent. Improved incentives for and promotion of industrial waste paper collection, classification and processing could contribute to reducing the cost of waste paper by reducing expensive imports.

6. On the output side, high protection (tariffs and QRs) made the industry complacent, with little concern for competitiveness. At end-1987, QRs were removed on most paper products except newsprint and cigarette paper. Nevertheless, effective tariff protection remains at about 100%, allowing the industry to survive with its present structure at the expense of the consumer. Through appropriate restructuring (closing of inefficient plants, cost-cutting measures and modernization investments), the industry should be able to compete with imports at effective

Table 2: Key Statistics for the Pulp & Paper Industry, 1979-1988

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
A. PRODUCTION, TRADE & CONSUMPTION a/										
1. Production (000 MT)										
Newsprint	N.A.	80.0	81.9	63.1	71.0	70.4	55.8	82.3	83.6	87.0
Printg. & Writing	N.A.	58.0	40.4	38.0	39.1	34.0	30.6	50.6	48.9	55.0
Industr. & Other	N.A.	81.1	147.5	126.3	145.0	90.4	56.6	83.7	104.4	112.0
Household Tissue	N.A.	15.9	20.4	14.5	16.7	19.9	12.1	13.0	14.0	15.0
Total production	350.0	235.0	290.2	241.9	271.8	214.7	155.1	229.6	250.9	269.0
2. Imports (000 MT)										
Newsprint	N.A.	20.0	4.8	2.7	1.2	2.6	0.6	0.9	0.2	3.0
Printg. & Writing	N.A.	12.0	9.1	19.3	19.4	10.4	8.0	11.0	15.4	16.0
Industr. & Other	N.A.	80.0	95.7	109.2	105.0	115.3	128.4	151.5	227.8	235.0
Household Tissue	N.A.	1.0	2.0	1.0	1.1	1.0	1.0	1.0	1.0	1.0
Total Imports	115.4	113.0	111.6	132.2	126.7	129.3	138.0	164.4	244.4	255.0
3. Exports (000 MT)										
Newsprint	N.A.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Printg. & Writing	N.A.	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Industr. & Other	N.A.	8.8	1.3	9.0	1.2	8.0	1.0	0.0	0.0	0.0
Household Tissue	N.A.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Exports	2.7	9.0	1.3	9.0	1.2	8.0	1.0	0.0	0.0	0.0
4. Apparent Consumption (000 MT)										
Newsprint	N.A.	100.0	86.7	65.8	72.2	73.0	56.4	83.2	83.8	90.0
Printg. & Writing	N.A.	69.8	49.5	57.3	58.5	44.4	38.6	61.6	64.3	71.0
Industr. & Other	N.A.	152.3	241.9	226.5	248.8	197.7	184.0	235.2	332.2	347.0
Household Tissue	N.A.	16.9	22.4	15.5	17.8	20.9	13.1	14.0	15.0	16.0
Total Consumption	462.7	339.0	400.5	365.1	397.3	336.0	292.1	394.0	495.3	524.0
5. PerCapita Cons. (kg)	10.0	7.0	8.1	7.2	7.6	6.3	5.4	7.1	8.7	9.0
6. Imports/Cons. (%)	24.9	33.3	27.9	36.2	31.9	38.5	47.2	41.7	49.3	48.7
7. Exports/Productn.(%)	0.8	3.8	0.4	3.7	0.4	3.7	0.6	0.0	0.0	0.0
B. EMPLOYMENT										
Pulp & Paper (000)	N.A.	15.0	15.0	18.0	17.0	17.0	16.0	16.0	17.0	18.0
Tot.Manuf.Empl.(000)	N.A.	1850.0	1780.0	1888.0	1822.0	1847.0	1926.0	1763.0	2054.0	2198.0
Pulp&Paper/Total (%)	N.A.	0.8%	0.8%	1.0%	0.9%	0.9%	0.8%	0.9%	0.8%	0.8%

a/ Data up to 1984: first source, data from 1985: second and third source

(Table Continued On Next Page)

Table 2 (Contd.): Key Statistics for the Pulp & Paper Industry, 1979-1988

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
C. DATA ON THE LARGEST PULP AND PAPER CORPORATIONS OF THE PHILIPPINES b/										
# of Pulp&Paper Corpns.	14	15	17	18	18	18	18	19	19	N.A.
Gross Sales (P Million)	2406.5	2604.3	2680.7	2755.8	3577.8	5054.6	4519.7	5231.6	6033.7	N.A.
Net Income (P Million):										
Picop Corporation c/	36.8	(148.6)	(275.4)	(308.2)	(209.7)	(276.6)	(562.4)	(509.0)	(125.5)	N.A.
Other Large Corporatns.	67.3	38.0	(5.1)	(13.5)	26.1	(480.5)	23.1	168.2	233.8	
Total Net Income	104.1	(110.6)	(280.5)	(321.7)	(183.6)	(757.1)	(539.3)	(340.8)	108.3	N.A.
Total Assets(P Million)	3306.3	4061.5	5047.9	4775.4	5602.0	7172.9	8037.1	8308.0	8648.8	N.A.
Capital(pd) (P Million)	651.7	696.7	1021.6	1175.4	1256.2	1284.1	1330.0	1382.6	1435.0	N.A.
Return on Gr. Sales (%)	4.3	(4.2)	(10.5)	(11.7)	(5.1)	(15.0)	(11.9)	(6.5)	1.8	N.A.
Return on Assets (%)	3.1	(2.7)	(5.6)	(6.7)	(3.3)	(10.6)	(6.7)	(4.1)	1.3	N.A.
Return on Capital (%)	16.0	(15.9)	(27.5)	(27.4)	(14.6)	(59.0)	(40.5)	(24.7)	7.5	N.A.
Pd.Up Capit./Assets (%)	19.7	17.2	20.2	24.6	22.4	17.9	16.5	16.6	16.6	N.A.
Ratios: Pulp & Paper Sector / Total Manufacturing Sector (Top 1000 Corporations) (Percent) c/										
Gross Sales Ratio (%)	3.7	3.2	2.8	2.6	2.8	2.9	2.6	2.8	3.2	N.A.
Net Income Ratio (%)	5.4	(9.2)	(27.1)	284.7	(26.2)	(29.9)	(21.8)	(6.8)	1.3	N.A.
Total Asset Ratio (%)	5.4	5.4	5.9	5.3	5.0	5.4	5.9	5.2	5.3	N.A.
Equity Ratio (%)	3.4	3.3	3.8	4.1	3.9	3.7	3.6	2.8	2.5	N.A.

b / Corporations in the Philippines, classified as among the top 1000 corporations by gross sales

c/ One Firm, Paper Industries Corporation of the Philippines (PICOP), accounts for about 45-60% of Sales and Assets, but it also accounts for most of the losses of the industry, as illustrated above.

Sources: (1)"Development of the ASEAN Pulp & Paper Industry", Abubakar Soetikuo, Tokyo, June 15, 1987
(2) Pulp & Paper Industry Association of the Philippines
(3)"Ten Year Development Plan for the Pulp & Paper Industry", 6/30/1988,by Leverage International (Consultants)Inc.
(4)"1000 Top Corporations in the Philippines"

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protection levels well below 100%, and, in some product lines, should be able to meet international competition in growing export markets in Asia. This suggests that duties on inputs and outputs could be further reduced significantly in order to foster and improve industry competitiveness.

7. The Philippines consumes 9 kilograms (kgs) of paper per capita yearly. This figure pales in comparison with the per capita annual consumption of 56 kgs in Korea, the over 100 kgs in Hongkong and Singapore, or even with the 12 kgs in Thailand. Since the Philippines expects to accelerate its industrial and economic growth in the coming years, demand for paper is projected to grow significantly. The production growth figure for the subsector has been conservatively estimated at about 5% per year, with the different paper products registering varied increases from 3% for paperboard to 6% for newsprint. The pulp and paper subsector will have to restructure to a large extent if it is to meet that growing demand at competitive costs.

8. The figures on the biggest enterprises indicate that, with the exception of the largest corporation (PICOP) which posted losses from 1980 to 1987, the subsector firms earned increasing profits in 1985-1987 after experiencing losses in 1981-82 and 1984. These results, combined with the projected increase in demand, suggest that the subsector, if properly restructured, has good recovery potential. The preceding paragraphs indicate that the subsector restructuring will necessitate looking at issues which are similar to those of the cement subsector: issues of trade policy, international competitiveness in cost structure of plants, physical and financial restructuring. Issues specific to the subsector that need further study are: efficiency of raw material production and processing; and policy changes regulating tree farming and tree plantations for pulp production.

Inter-Island Shipping/Ship Repair Subsector

9. Given the archipelagic composition of the Philippines, inter-island shipping is a vital component of the country's transportation network. Ship repair is essentially in the private sector. A quarter of the vessel fleets, however, are owned by the public sector; though these account for only 27% of total coastal trade, they dominate the trade of certain key commodities (95% of steel, 90% of copper concentrates, 72% of petroleum, and 47% of coal).

10. Though the Government intends to liberalize the granting of permits to shipping companies to promote cost reduction and more efficient service, inter-island shipping remains one of the most closely regulated subsectors, with 15 agencies involved in its regulation. The most constraining regulation is the setting of passenger and freight rates. With rapidly rising costs of services, inadequate infrastructure facilities and poor turn-around times, the sector's profitability has declined rapidly, so much so that the banks are unwilling to extend credit.

11. Lack of financing has led to deterioration of the fleets, with the average age of the over 4,000 interisland vessels exceeding 20 years. The maintenance and repair record is poor. These problems are compounded by inadequate safety regulations, as illustrated by the sinking of several vessels in the past few years. The poor inter-island shipping services combined with lack of other infrastructure on many of the islands contribute to the excessive concentration of industry in the Metro Manila area and its vicinity.

12. Issues which need study are: development of an economically rational set of policies and regulations as well as institutional support for the subsector to foster competition and efficiency; comparison of present and potential cost structures in the Philippines with those of other countries; fleet restructuring, repair yard modernization and privatization of government-owned companies.

The Textile and Garment Subsectors

13. In the textile sector, trade reforms have created new opportunities in the form of indirect exports. An Advance Tax Credit Scheme enables the textile industry to recover quickly, or even avoid payments of, tariffs and duties on inputs for manufacture of indirect exports. The resulting lower cost of local textiles has led the garment industry, which used to import almost 100% of its inputs, to source about 30% of such inputs from the local textile industry. The data on the textile industry (Table 3 on page 8 of this Annex) indicate increased production and sales revenues in 1986-87 as well as profits after a period of negative returns. In the light of recent developments, the study of the textile and garment subsectors prepared in 1986 and 1987 under the Bank's Textile Restructuring Project of 1982 (Loan 2127-PH) needs updating with particular attention to (i) further streamlining of trade policy, following a review of the cascading of tariffs on raw materials, intermediate and final products, (ii) a review of the quota allocation system for garments in export markets, (iii) environmental aspects notably with regard to finishing operations, and (iv) investment opportunities .

Table 3: Key Statistics for the Textile Industry 1979-88

		1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
A. PRODUCTION, TRADE & CONSUMPTION											
1. Local Production	(000 MT)	115	96	96	81	88	76	71	89	119	121
2. Imports	(000 MT)	35	27	26	33	14	12	16	14	21	25
3. Exports											
Direct Exports	(000 MT)	10	13	13	9	6	6	6	0	5	5
Indirect Exports	(000 MT)	1	2	3	2	2	4	6	17	37	43
Total Exports	(000 MT)	11	15	16	11	8	10	12	17	42	48
4. Consumption	(000 MT)	139	108	106	103	94	78	75	86	98	98
5. Per Capita Consumption	(Kg)	3.0	2.3	2.1	2.0	1.8	1.5	1.4	1.5	1.7	1.7
6. Imports/Consumption	(%)	25.2	25.0	24.5	32.0	14.9	15.4	21.3	16.3	21.4	25.5
7. Exports/Production	(%)	7.9	13.9	15.1	10.7	8.5	12.8	16.0	19.8	42.9	49.0
B. EMPLOYMENT											
1. Textile Industry	(000)	N.A.	96	85	72	77	71	70	70	70	86
2. Total Manufg. Empl.	(000)	N.A.	1,850	1,780	1,888	1,822	1,847	1,926	1,763	2,054	2,198
3. Text.Ind./Tot.Manufg.	(%)	N.A.	5.2	4.8	3.8	4.2	3.8	3.6	4	3.8	3.9
C. DATA ON THE LARGEST TEXTILE CORPORATIONS OF THE PHILIPPINES a/											
1. # of Textile Corporatns.	(#)	13	13	14	14	14	14	15	19	21	N.A.
2. Gross Sales	(P Million)	1259.1	1342.6	2034.2	1941.4	2145.0	2790.1	3291.8	3267.8	4999.2	N.A.
3. Net Income	(P Million)	[illegible].1)	(59.9)	(41.3)	(63.0)	(12.4)	21.3	(22.4)	40.6	194.6	N.A.
4. Assets	(P Million)	194[illegible]	2385.4	3251.5	3275.3	3250.3	3371.0	3815.1	3439.3	5578.5	N.A.
5. Paid-Up Capital	(P Million)	349.2	399.7	599.5	718.3	709.1	709.8	784.5	723.8	1377.0	N.A.
6. Return on Sales	(%)	(0.1)	(4.5)	(2.0)	(3.2)	(0.6)	0.8	(0.7)	1.2	3.9	N.A.
7. Return on Assets	(%)	(0.1)	(2.5)	(1.3)	(1.9)	(0.4)	0.6	(0.6)	1.2	3.5	N.A.
8. Return on Pd.-Up Cap.	(%)	(0.3)	(15.0)	(6.9)	(8.8)	(1.7)	3.0	(2.9)	5.6	14.1	N.A.
9. Pd.-Up Capit/Assets	(%)	17.9	16.8	18.4	21.9	21.8	21.1	20.6	21.0	24.7	N.A.
Ratios: Textile Sector / Total Manufacturing Sector (Top 1000 Corporations) (Percent) b/											
10. G. Sales Ratio	(%)	1.9	1.7	2.2	1.8	1.7	1.6	1.9	1.8	2.6	N.A.
11. N. Income Ratio	(%)	(0.1)	(5.0)	(4.0)	55.8	(1.8)	0.8	(0.9)	0.8	2.3	N.A.
12. Total Asset Ratio	(%)	3.2	3.2	3.8	3.7	2.9	2.5	2.8	2.2	3.4	N.A.
13. Equity Ratio	(%)	1.8	1.9	2.2	2.5	2.2	2.0	2.1	1.4	2.4	N.A.

a/ Corporations in the Philippines classified as among the top 1000 corporations by gross sales

b/ Data on the Total Manufacturing Sector (Top 1000 Corporations) is contained in the Cement Sector Table

Sources: (1)"A Review of the Textile Sector with Proposed Plans and Strategies 1986-1995", Tootal Consultants, 10/1986
(2)"A Review of the Textile Sector with Proposed Plans and Strategies 1989-1995", Tootal Consultants, 4/1989
(3)"1000 Top Corporations in the Philippines"

AS2IE, 89/05/17

ANNEX 2.01

PHILIPPINES

INDUSTRIAL INVESTMENT CREDIT PROJECT

Total Assets of The Financial System, 1980-88[a/]

	1980 Amount (Bil. P)	1980 %	1988 Amount (Bil. P)	1988 %
Central Bank[b/]	65.4	20.9	349.9	39.8
Banking System	188.8	60.3	391.8	44.6
Commercial Banks	138.4	44.2	328.9	37.4
Private Banks	103.8	33.1	290.1	33.0
Government Banks	34.6	11.1	38.8	4.4
Thrift Institutions	10.6	3.4	24.9	2.9
Rural Banks	5.6	1.8	10.7	1.2
Specialized Government Banks	34.2	10.9	27.3	3.1
Nonbanks	58.9	18.8	137.7	15.6
Total	313.1	100.0	879.4	100.0

Source: Central Bank of the Philippines

a/ As of December 31.

b/ The relative importance of CBP, as indicated by the volume of its assets, must be interpreted with care since many assets of CBP are merely book entries. For example, CBP assets include an item called Revaluation of International Reserves which in fact represents losses incurred by CBP in swap and forward-cover operations entered into in the past. Likewise, the accumulated interest expenses and issuances and servicing costs of CBP securities and open market instruments like CB bills and Reserve Repurchase Agreements are also carried in the books as assets. It appears that as much as half of CBP's assets may have this special character. If these items are eliminated, CBP's share of system assets would be reduced from 39.8% to 25%.

ANNEX 2.02

PHILIPPINES

INDUSTRIAL INVESTMENT CREDIT PROJECT

Outstanding Credit to Manufacturing, 1980-1988
(million Pesos)

	Commercial Banks		Thrift Banks		Specialized Govt Banks		Total	
	Amount	%	Amount	%	Amount	%	Amount	%
1980	27,053	75.9	435	1.2	8,172	22.9	35,660	100
1981	26,347	73.0	498	1.4	9,220	25.6	36,065	100
1982	29,958	74.4	639	1.6	9,645	24.0	40,242	100
1983	35,410	63.3	901	1.6	19,602	35.1	55,913	100
1984	32,136	55.7	822	1.4	24,715	42.9	57,673	100
1985	21,856	57.4	1,344	3.5	14,885	39.1	38,085	100
1986	20,532	92.0	1,392	6.2	408	1.8	22,332	100
1987	35,765	96.3	531	1.4	860	2.3	37,156	100
1988	47,207	94.2	825	1.6	2,102	4.2	50,134	100

Source: Central Bank

PHILIPPINES

INDUSTRIAL INVESTMENT CREDIT PROJECT

Development Bank of The Philippines

Balance Sheets, 1984 - 1988
(Pesos Million)

	1984	1985	1986	1987	1988
Assets			Audited		
Cash and deposits with banks	2,478	2,459	1,169	858	1,195
Loans and advances	38,802	27,451	5,271	4,395	5,005
Investments in securities	14,185	12,186	2,186	4,856	4,664
Fixed assets	5,467	8,324	459	332	276
Other assets	4,528	21,624	418	90	291
TOTAL ASSETS	65,460	72,044	9,503	10,531	11,431
Liabilities and Stockholders Equity					
Liabilities					
Short-term borrowings	8,742	12,817	585	727	221
Time and savings deposits	978	1,519	561	532	1,853
Interest due and other payables	5,477	4,728	1,199	2,184	1,556
Deferred credits	1,283	1,374	308	341	276
Long-term borrowings	43,808	45,001	2,026	1,340	998
National Gov't funds	2,000	2,000	2,000	1,800	1,400
Other liabilities	88	134	46	146	19
Total Liabilities	62,376	67,573	6,825	7,070	6,323
Paid-in Capital	9,935	18,208	2,500	2,500	2,500
Retained earnings	(6,851)	(13,737)	178	961	2,608
Net Worth	3,084	4,471	2,678	3,461	5,108
TOTAL LIABILITIES AND NET WORTH	65,460	72,044	9,503	10,531	11,431
Guarantees outstanding	20,032	18,254	20,757	24,412	a/
Trust Funds Administered	1,534	1,923	2,119	3,040	

a/ As part of the DBP rehabilitation program, contingent liabilities arising from the guarantees issued by the Bank have been transferred to the Government.

PHILIPPINES

INDUSTRIAL INVESTMENT CREDIT PROJECT

Development Bank of The Philippines

Income Statements 1984-1988
(Pesos Million)

	YEAR ENDED DECEMBER 31				
	1984	1985	1986	1987	1988
	Audited				
Operating Revenues					
Interest on loans and advances	1,131	1,296	724	587	795
Earnings on securities investments	356	532	563	687	470
Other income	1,183	1,312	852	503	1,303
Total Operating Revenues	2,670	3,140	2,139	1,777	2,568
Operating Expenses					
Interest and other financial expenses	7,995	8,007	4,095	253	214
Salaries and Personnel	290	321	353	265	292
Other administrative expenses	323	449	229	304	371
Taxes and licenses	-	-	50	9	7
Provision for losses a/	0	0	3,050	135	0
Total Operating Expenses	8,608	8,777	7,777	966	884
OPERATING INCOME (LOSS)	(5,938)	(5,637)	(5,638)	811	1,684
Capital gains (losses) from Equity Sales	(1,841)	(1,235)	(1)	1	(1)
GROSS INCOME (LOSS)	(7,779)	(6,872)	(5,639)	812	1,683
Provision for Taxes	(8)	(14)	-	(30)	(37)
NET INCOME (LOSS)	(7,787)	(6,886)	(5,639)	782	1,647
Gov't Contribution a/	5,400	7,445	-	-	-
Net Income after Gov't contribution	(2,387)	559	-	-	-

a/ In 1984 and 1985, funding responsibility for DBP's non-performing accounts (NPAs) was assumed by the Government by way of equity contributions equal to the total losses on NPAs over the preceding year. Consequently, no provisions for losses were made in those years; the item "Government Contribution" represents the Government's equity contribution and is, in effect, an extraordinary adjustment to the 1984 and 1985 accounts made after computation of net income. In 1986 and 1987, DBP made loan loss provisions. DBP did not make additional provisions in 1988 because the very substantial provisions made in 1986 and 1987, combined with the work-out of non-performing loans, has left DBP with a high level of provisions which is fully adequate: as of December 31, 1988, provisions for doubtful accounts represented 28.6% of total loans outstanding.

PHILIPPINES

INDUSTRIAL INVESTMENT CREDIT PROJECT

Development Bank of The Philippines

Projected Balance Sheets, 1989-94
(Pesos Million)

ASSETS	1989	1990	1991	1992	1993	1994
Cash and deposits with banks	321	317	386	452	421	493
Wholesale loans	3,851	13,230	18,028	23,900	31,131	39,761
Retail loans	7,881	9,003	11,344	13,307	15,174	16,903
Investments in securities	2,594	2,286	2,231	2,478	2,633	2,596
Fixed assets	411	310	279	250	227	209
Other assets	338	174	174	174	174	174
TOTAL ASSETS	15,396	25,320	32,442	40,561	49,760	60,136
Liabilities and Stockholders Equity						
Liabilities						
Short-term borrowings	328	191	86	1	1	1
Time and savings deposits	1,224	964	1,139	1,314	1,489	1,664
Interest due and other payables	1,526	1,748	1,913	1,818	2,037	2,244
Deferred credits	581	397	397	397	397	397
Long-term borrowings	5,491	14,963	21,125	28,231	35,758	44,601
Other liabilities	1,089	943	792	985	771	155
Total Liabilities	10,239	19,206	25,452	32,388	40,095	49,062
Paid-in Capital	2,500	2,500	2,500	2,500	2,500	2,500
Retained earnings	2,657	3,614	4,490	5,673	7,165	8,574
Net Worth	5,157	6,114	6,990	8,173	9,665	11,074
TOTAL LIABILITIES AND NET WORTH	15,396	25,320	32,442	40,561	49,760	60,136
Ratios:						
Debt/Equity	1.9	3.1	3.6	3.9	4.1	4.4
Liquid Assets/Deposits and Short Term Borrowings (%)	20.7	27.4	31.5	34.4	28.3	29.6
Liquid Assets/Deposits (%)	26.2	32.9	33.9	34.4	28.3	29.6
Provisions for Doubtful Accounts/ Total Loans (%)	8.1	3.9	4.0	3.7	3.8	3.2
Net Interest Margin/Total Assets (%)	6.6	6.7	6.6	6.4	6.3	5.2
Return on Average Net Worth (%)	17.7	17.0	13.4	15.6	15.8	13.6
Administrative Expenses/ Average Total Assets (%)	4.6	2.6	1.9	1.6	1.4	1.2

PHILIPPINES

INDUSTRIAL INVESTMENT CREDIT PROJECT

Development Bank of The Philippines

Projected Income Statements, 1989-94
(Pesos Million)

	1989	1990	1991	1992	1993	1994
Operating Revenues						
Interest on loans	1,234	2,643	3,882	5,000	6,228	7,072
Earnings on securities investments	147	204	189	204	229	239
Miscellaneous bank fees	23	67	71	74	78	82
Other income	747	344	373	471	416	404
Total Operating Revenues	2,151	3,259	4,515	5,659	6,950	7,796
Operating Expenses						
Interest and other fin. expenses	369	1,160	1,930	2,601	3,335	4,165
Salaries and Personnel	409	343	360	378	397	417
Other Administrative expenses	209	186	195	205	215	226
Prov. for doubtful accounts	180	89	636	708	793	869
Depreciation	53	88	65	59	53	48
Total Operating Expenses	1,219	1,865	3,187	3,951	4,794	5,725
Income before taxes	932	1,394	1,328	1,708	2,157	2,072
Gross receipts taxes	60	114	158	198	243	273
Provision for income tax	37	323	294	327	422	390
NET INCOME	835	957	876	1,183	1,492	1,409

Main Assumptions Used in Projections

1) Projected Disbursements

	1989	1990	1991	1992	1993	1994
			(Pesos million)			
Retail:						
Short-term	966	773	811	852	873	895
Long-term	3,284	2,627	2,759	2,896	2,969	2,969
Regional Development Fund	512	362	365	357	460	572
Total Retail	4,762	3,762	3,935	4,105	4,302	4,436
Wholesale	3,344	7,006	5,451	7,227	9,130	11,252

2) Term Funding Sources

	Projected Availments (million)					
	1989	1990	1991	1992	1993	1994
IGLF	$ 25.0	$ 40.0	$ 60.0	$ 70.0	$ 25.0	-
AJDF	140.0	210.0	-	-	-	-
Multilateral 1/	10.0	55.0	70.0	130.0	100.0	50.0
KFW	5.7	16.9	14.0	-	-	-
Swiss Line	40.0	-	-	-	-	-
Add'l Fin. Gap	-	-	100.0	100.0	200.0	300.0
	$220.7	$321.9	$244.0	$300.0	$325.0	$350.0
Domestic Bonds	-	₱300.0	₱500.0	-	-	₱700.0

1/ Includes IBRD and ADB

3. Interest Income

a. Existing performing accounts as of 12-31-88: average interest rate of 18% p.a.

b. Existing non-performing accounts as of 12-31-88 assumed phased out by 1989; average interest rate of 16% p.a.

c. Wholesale loans: average interest rate of 13% p.a.

d. Retail short-and long-term loans: average interest rate of 18% p.a.

e. Regional Development Fund loans: average interest rate of 12% p.a.

4. Cost of Borrowed Funds

Average Cost of Foreign Funds = 10%
Average Cost of Domestic Funds = 15%

5. Operating Expenses

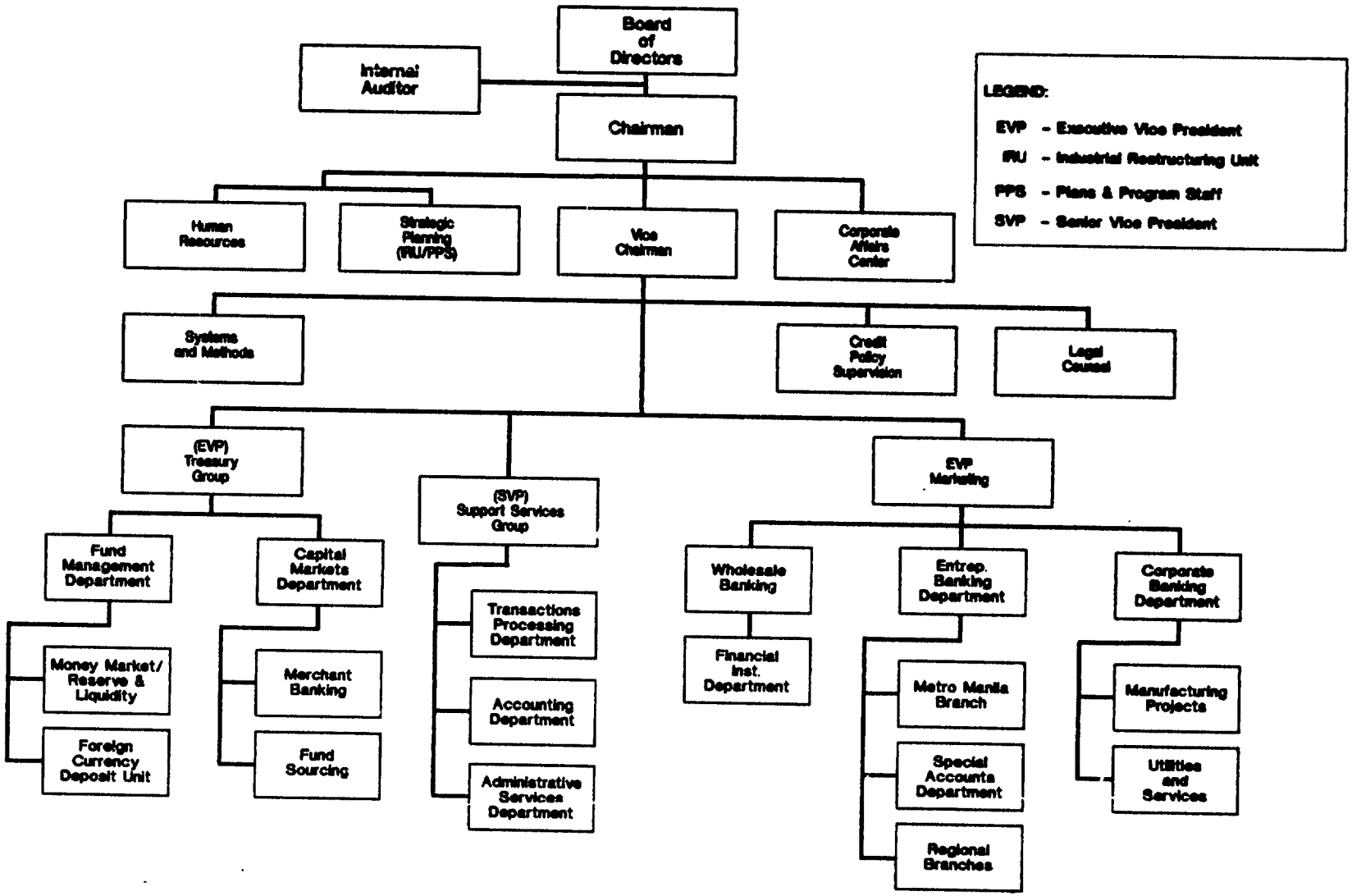
Operating expenses (interest, personnel and other administrative expenses) of the regional branches are excluded beginning in 1990 when DBP's equity shareholdings are assumed to be down to 30%. The personnel reduction which will result from the branch privatization will lead to reduction in salaries and other personnel expenses in 1990. Thereafter, a 5% growth in administrative expenses is assumed.

6. Provisions for Doubtful Accounts

a. Equal 5% of loans outstanding, except for Regional Development Fund loans where the amount is set equal to 15%.

b. Non-performing accounts of pre-rehabilitation period: 20% collected by end-1989; 80% written off.

PHILIPPINES
INDUSTRIAL INVESTMENT CREDIT PROJECT
DEVELOPMENT BANK OF THE PHILIPPINES
Organizational Chart



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Annex 3.03

DEVELOPMENT BANK OF THE PHILIPPINES

POLICY STATEMENT

Objectives

1.01 The Development Bank of the Philippines (DBP) has substantially completed its rehabilitation and financial strengthening program which aimed at making it a viable and self-sustaining financial institution. The principal objective of DBP is now to provide medium and long-term financing to the private sector. The DBP hopes to attain this objective by evolving into primarily a wholesale bank, i.e., an institution channelling funds to other financial institutions for on-lending to private business enterprises. As a wholesale bank, DBP shall help fill a major gap in the financial system of the country: the provision of long-term credit to the private sector.

1.02 More specifically, DBP will:

a. bring together providers and users of medium and long- term capital;

b. help develop the capital markets by promoting medium and long-term capital market instruments (e.g. bonds) to which institutional and individual investors can subscribe;

c. relend the funds it mobilizes primarily to accredited financial institutions which will act as lending conduits for on-lending to enterprises;

d. act as a major conduit for, and manage, official development assistance funds which the private sector will use;

e. manage industrial sector credit programs funded by multilateral development financial institutions; and

f. undertake all other activities which are conducive to achieving its broad aims and objectives.

1.03 DBP will gradually expand its wholesale lending activities in line with the objectives stated above; the gradual reduction of its retail lending in relative terms will be undertaken in an orderly manner. Over time, DBP plans to leave most retail development lending to other financial institutions such that DBP's outstanding portfolio will have a predominantly wholesale configuration by the end of 1993.

General Operational Principles

1.04 As a development bank, DBP has to submit to the test of financial viability. Thus, it will pursue policies that will ensure a sound capital structure and the generation of sufficient earnings to cover costs, earn a profit margin, build up appropriate reserves and protect its equity base from erosion.

1.05 The wider social consequences from the developmental role the DBP must play dictate that while it has to pass standard market tests, it also has to assess its operational and financial results in terms of their economic and developmental impact.

1.06 DBP will operate on an equal market footing with its private sector counterparts. These two fundamental principles of ensuring financial viability within a competitive market framework and of continuing to play a development role jointly define the place DBP will occupy within the financial system. As a financial institution with a development mission and as a development institution with financing responsibility and viability, DBP is a development bank with the usual functions and duties of banks under the thrift category.

1.07 DBP shall increasingly concentrate on wholesale lending activities in close partnership with private financial institutions duly accredited by the Central Bank according to pre-agreed criteria from. The accreditation criteria shall include: (a) a track record of profitable operations and sound capitalization; (b) an ability to maintain a sound and healthy portfolio as shown by the institution's level of arrearages; (c) a qualified management team of good reputation and (d) adequacy of trained staff, established systems and procedures to be an efficient and reliable purveyor of retail credits. DBP shall be active in syndication with private banks and shall work closely with them to efficiently on-lend development funds to the private sector. DBP will premise its participation in the syndicate on the need to ensure that program lending is fully carried out and to cover gaps that private banks may not be able to fill.

1.08 Except when specifically allowed under Monetary Board (MB) regulations or by virtue of agreements that the Government and DBP will enter into with multilateral or bilateral institutions, DBP will not enjoy special privileges. Thus,

a. Its obligations will not enjoy government guarantees;

b. It will have no preferential access to the funds of the Central Bank;

c. It will not benefit from special tax privileges;

d. It will not enjoy undue preferential treatment for deposits of the Philippine government and of Philippine government corporations;

e. It will not receive additional government equity to cover losses that DBP might incur in the future.

This would not preclude DBP however, from arranging for equity increases from the National Government which may become necessary to maintain a sound capital structure as its development lending activities increase.

1.09 DBP will have a private sector orientation with autonomy in its decision-making within the regular regulatory framework and significant private sector representation in its Board of Directors.

1.10 DBP will avoid lending to the public sector.

Rehabilitation Period

1.11 Although its rehabilitation has been substantially completed, DBP reiterates its commitment to carry out the remaining elements of its rehabilitation plan. DBP will scale down the number of wholly-owned branches, agencies and offices it will maintain from the current level of 70 to 15. The pooling of its remaining branch network into five regional development banks for privatization is to be given top priority. Through the process of privatization of these regional development banks, DBP shall gradually give way to increasing private sector participation through equity holdings. A target for such private sector participation is set at 25% of the total equity base of the five (5) regional development banks combined in 1989 and 45% in 1990. By the end of 1992, DBP shall have reduced to minority position its holdings in each of the five regional development banks.

Investment Policies

1.12 DBP shall adopt a lending policy that would achieve a balanced regional, sectoral and industrial distribution of its funds consistent with national development priorities. DBP shall gear its financial help towards the promotion of economic development of the country. This will relate to:

a. provision of its funds for investment and working capital purposes; and
b. establishment of new enterprises and expansion/rationalization of existing enterprises.

1.13 In its lending activities, DBP shall adopt an interest rate and fees policy that:

a. ensures full recovery of all its direct and indirect costs, including provisions as required, plus an adequate profit margin; and

b. is consistent with prevailing market rates for loans of similar maturity and risk.

1.14 For its retail lending, DBP shall base its investment decisions on its own analysis of the viability of the project and the enterprise. Towards this end, DBP will apply specific lending criteria that include lending only to projects with (a) proponents of good credit standing; (b) sound management; (c) satisfactory financing and marketing plans; (d) adequate financial rates of return; (e) technical soundness. DBP shall maintain a Risk Asset Management Manual(RAMM) that sets out credit policies and procedures embodying these lending criteria.

1.15 For its wholesale lending operations, DBP shall lend only to duly accredited institutions. It will develop and apply uniform guidelines, policies and procedures for each loan program to ensure a consistent approach in dealing with accredited institutions. DBP will rely on the credit judgment of the accredited institutions and not pass upon individual loan applications, except for large projects involving amounts beyond a threshold loan amount of not less than 85 million pesos.

1.16 DBP will carry out adequate monitoring of borrowers and will require these borrowers to keep proper records of accounts and furnish operational and financial data to DBP as it may reasonably request.

Financial Prudence Limits

1.17 Within the broader limits provided for by law and by the DBP Charter (Executive Order No. 81), DBP establishes the following exposure limits in order to maintain a prudent and diversified loan portfolio:

Except as otherwise agreed by the Monetary Board,

a. DBP shall limit its total exposure to a single client or group of companies, retail or wholesale, inclusive of loans, guarantees and equity investment, to 15 per cent of DBP's unimpaired capital and surplus.

b. DBP shall limit its total equity investments in a single enterprise to no more than 15% of DBP's own total equity and shall not seek majority ownership or management control of any entity except in cases where its exposure in the enterprise is in jeopardy. DBP's investments in its operating subsidiaries will be exempt from these limits.

c. Rules fully consistent with prudent banking transactions shall govern issuance of guarantees or similar commitments.

1.18 DBP agrees to the transfer to it of the IGLF and Apex Loan programs which the Central Bank is now managing. After the transfer of the IGLF and Apex loan programs, DBP shall manage the acquired portfolios on an agency basis and undertake for its own account new lending under the programs, applying its normal investment policies and lending criteria, including protection against foreign exchange risk.

Operations on An Agency Basis

1.19 DBP may undertake specific lending operations at the request of the Government in support of government programs/projects. Such operations will be undertaken only if (i) the Government earmarks funds for such projects; (ii) the Government pays the DBP an appropriate fee for undertaking that function and (iii) such lending does not entail any financial risk for DBP's own account and the resultant loans are kept off DBP books.

Socio-Economic Projects

1.20 DBP may constitute each year a portion not exceeding 30% of its net income after tax for the previous year into a special fund for loan, equity and quasi-equity financing of projects of great socio-economic benefit but which do not fully meet the financial return criteria of DBP's regular loans. This is clasified as Window III lending. DBP may add back to the special fund any loan or investment exclusive of earnings, previously made from the fund and subsequently repaid. DBP will charge an interest rate for projects in this category that will cover the overhead cost and the projected inflation rate for the year to preserve the real value of the fund.

1.21 Within the framework of Window III lending and consistent with its development mission, DBP seeks to establish long-term relationships, mainly by lending medium and long-term funds to entrepreneurs engaged in projects with high developmental impact, but subjected to market discipline. Some of these projects may be in newer fields and with higher risks such that private financial

institutions may be less willing to commit their resources into such projects over the medium and long haul.

Retail Operations

1.22 Subject to the predominantly wholesale nature of its operations, DBP shall continue to engage in direct lending operations where it shall simply serve as a catalyst, especially in the strategic sectors where the private sector may still be hesitant to enter fully. But it must ensure that it does not erode its equity base and that it gradually withdraws from the economic areas which the private sector can take over.

Financial Policies

1.23 DBP will ensure a prudent interest rate and maturity match between its assets and liabilities.

1.24 To ensure high standards of financial management, DBP will maintain a planning and budgeting system, an effective and efficient system of asset and liability management, and a liquidity management system.

1.25 To finance its operations, DBP shall mobilize private sector funds and funds from other government financial institutions such as SSS and GSIS on market terms.

1.26 To diversify fund sources by investor type and maturity, the bank shall introduce appropriate term instruments.

Capital Structure

1.27 The debt-equity ratio for DBP consolidated with that of its subsidiaries and taking into account contingent liabilities, shall not exceed 5:1.

1.28 The Bank shall not expose itself to uncovered foreign exchange risks.

Organization and Staff Development

1.29 DBP will have an effective system of controls, a sensitive and responsive monitoring mechanism, and a decision-making process that assigns accountabilities and responsibilities.

1.30 It will also develop technically qualified staff, taking into account the special skills required for effective fulfillment of its functions. It will provide a compensation package commensurate with responsibilities discharged and competitive with

private sector remuneration to attract and retain competent staff members.

1.31 DBP shall maintain its credit committee to undertake evaluation of all loan proposals which require the approval of the Chairman or the Board, before submission to either of the latter, without in any manner affecting the prerogatives of the Chairman or the Board.

Accounts and Audit

1.32 The Bank shall use generally accepted accounting principles in recording its transactions, consistent with Central Bank regulations. It will have a private external audit conducted annually.

Modification to the Policy Statement

1.33 The DBP will not change this Policy Statement without prior consultation with, and approval of, the proper relevant authorities.

1.34 This Policy Statement and any modification thereof, and its implementation shall be subject to Philippine laws and the rules and regulations of the appropriate regulatory government entities.

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INDUSTRIAL INVESTMENT CREDIT PROJECT

Participating Financial Institutions

Far East Bank and Trust Company
Key Financial Data
(Pesos million)

	Audited 1985	Audited 1986	Audited 1987	(Unaudited) 1988
Total Assets	12,707.1	15,375.8	19,149.10	28,093.00
Liquid Assets	7,030.2	8,410.6	9,057.50	12,168.20
Outstanding Loan Portfolio	5,000.2	6,096.7	9,791.60	13,709.60
Equity Investments	205.3	32.2	41.20	350.60
Provisions for Losses	884.2	733.4	741.90	737.90
Total Deposits	8,561.3	11,734.0	15,351.10	21,111.60
(Short-Term)	6,447.5	8,835.7	11,371.90	16,412.30
(Long-Term)	2,113.8	2,898.3	3,979.20	4,699.30
Long-Term Debt	-	-	-	33.70
Net Worth	1,202.1	1,460.6	1,788.70	2,235.00
Gross Income	1,912.9	1,686.0	1,915.20	2,798.50
Interest Expenses	923.0	851.4	848.90	1,336.10
Net Income After Tax	290.1	311.3	380.90	500.20
Dividends	46.2	52.8	52.80	66.00
Ratios				
Gross Income/Average Total Assets (%)	15.7	12.0	11.10	11.80
Gross Spread (%)	6.2	5.6	6.20	6.10
Net Income/Average Net Worth (%)	26.9	23.4	23.40	24.90
Debt/Equity Ratio (times)	9.6	9.5	9.70	11.60
Provisions/Total Loan Portfolio (%)	17.7	12.0	7.60	5.40
Administrative Expense/Average Total Assets (%)	3.5	3.4	3.90	4.10
Liquid Assets/Total Deposits (%)	82.1	71.7	59.00	57.60
Cash Collection Ratio a/				
Apex Loan Portfolio	-	-	-	100%

a/ Cash collection on interest and principal divided by current dues on interest and principal.

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INDUSTRIAL INVESTMENT CREDIT PROJECT

Participating Financial Institutions

Bank of Philippine Islands
Key Financial Data
(Pesos million)

	Audited 1985	Audited 1986	Audited 1987	(Unaudited) 1988
Total Assets	16,210.2	18,386.3	20,661.8	26,280.4
Liquid Assets	7,272.5	8,752.7	9,805.7	13,373.0
Outstanding Loan Portfolio	6,718.5	7,631.8	8,682.7	10,620.0
Equity Investments	459.8	504.6	772.1	942.0
Provisions for Losses	240.2	343.8	377.0	444.0
Total Deposits	12,267.0	14,630.0	16,972.0	21,333.9
(Short-Term)	12,094.5	14,203.7	16,402.1	20,780.9
(Long-Term)	172.5	426.9	569.9	553.0
Long-Term Debt	26.2	95.8	104.9	80.6
Net Worth	1,161.2	1,382.7	1,607.4	1,898.0
Gross Income	2,613.7	2,357.3	2,086.6	2,541.4
Interest Expenses	1,511.8	1,168.0	793.2	1,203.0
Net Income After Tax	253.4	246.8	303.1	394.2
Dividends	48.0	232.4	71.2	340.8
Ratios				
Gross Income/Average Total Assets (%)	17.1	13.6	10.7	10.2
Gross Spread (%)	6.3	6.5	6.1	4.5
Net Income/Average Net Worth (%)	23.9	19.4	20.3	22.5
Debt/Equity Ratio (times)	13.0	12.3	11.9	12.8
Provisions/Total Loan Portfolio (%)	3.6	4.5	4.3	4.2
Administrative Expense/Average Total Assets (%)	4.7	4.6	4.2	4.1
Liquid Assets/Total Deposits (%)	59.3	59.8	57.8	62.7
Cash Collection Ratio a/				
Apex Loan Portfolio	-	-	-	100%

a/ Cash collection on interest and principal divided by current dues on interest and principal.

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INDUSTRIAL INVESTMENT CREDIT PROJECT

Participating Financial Institutions

Metropolitan Bank and Trust Company
Key Financial Data
(Pesos million)

	Audited 1985	Audited 1986	Audited 1987	(Unaudited) 1988
Total Assets	16,441.2	16,175.40	19,368.0	26,049.0
Liquid Assets	7,397.0	7,288.0	7,550.0	11,238.0
Outstanding Loan Portfolio	6,785.0	6,848.30	9,724.0	12,338.0
Equity Investments	322.1	434.00	556.0	504.0
Provisions for Losses	217.0	267.30	346.0	410.0
Total Deposits	11,395.6	12,452.50	15,125.0	19,723.0
(Short-Term)	9,813.6	11,142.70	14,110.9	18,476.1
(Long-Term)	1,582.0	1,309.80	1,014.1	1,246.9
Long-Term Debt	40.7	64.20	87.8	47.5
Net Worth	869.5	923.80	1,101.0	1,502.0
Gross Income	2,004.2	1,731.00	1,633.0	2,407.0
Interest Expenses	1,281.5	979.80	670.0	1,025.0
Net Income After Tax	138.7	120.20	250.4	353.0
Dividends	36.6	52.10	37.3	251.9
Ratios				
Gross Income/Average Total Assets (%)	12.5	10.60	9.2	10.6
Gross Spread (%)	4.2	3.80	4.7	5.0
Net Income/Average Net Worth (%)	16.8	13.40	24.7	27.1
Debt/Equity Ratio (times)	17.9	16.50	16.6	16.3
Provisions/Total Loan Portfolio (%)	3.2	3.90	3.6	3.3
Administrative Expense/Average Total Assets (%)	3.1	3.10	3.3	3.4
Liquid Assets/Total Deposits (%)	64.9	58.50	49.9	57.0
Cash Collection Ratio a/				
Apex Loan Portfolio	100%	100%	100%	100%

a/ PFI's cash collection on interest and principal divided by current dues on interest and principal.

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INDUSTRIAL INVESTMENT CREDIT PROJECT

Participating Financial Institutions

Philippine Commercial International Bank
Key Financial Data
(Pesos million)

	Audited 1985	Audited 1986	Audited 1987	(Unaudited) 1988
Total Assets	16,406.40	14,263.30	17,267.90	19,676.00
Liquid Assets	7,850.70	5,177.20	6,345.50	7,773.00
Outstanding Loan Portfolio	6,765.60	6,961.90	8,530.00	9,372.00
Equity Investments	179.80	137.60	150.80	203.00
Provisions for Lossesu	145.40	153.10	211.90	146.00
Total Deposits	10,855.00	10,449.80	11,542.80	14,237.00
(Short-Term)	5,113.50	7,024.60	8,514.00	10,854.00
(Long-Term)	5,741.50	3,425.20	3,028.80	3,383.00
Long-Term Debt	-	23.40	26.70	46.80
Net Worth	980.40	928.20	1,620.50	2,196.00
Gross Income	1,502.00	1,877.30	1,704.70	2,162.00
Interest Expenses	789.00	896.40	567.90	647.00
Net Income After Tax	120.40	202.50	278.40	404.00
Dividends	36.30	77.00	90.80	
Ratios				
Gross Income/Average Total Assets (%)	11.30	12.20	10.80	11.70
Gross Spread (%)	4.50	5.90	6.70	7.10
Net Income/Average Net Worth (%)	12.90	21.20	21.80	21.20
Debt/Equity Ratio (times)	15.70	14.40	9.70	8.00
Provisions/Total Loan Portfolio (%)	2.10	2.20	2.50	1.60
Administrative Expense/Average Total Assets (%)	3.60	4.60	5.10	4.90
Liquid Assets/Total Deposits (%)	72.32	49.54	54.97	54.60
Cash Collection Ratio a/				
Apex Loan Portfolio	-	100%	100%	100%

a/ Cash collection on interest and principal divided by current dues on interest and principal.

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INDUSTRIAL INVESTMENT CREDIT PROJECT

Participating Financial Institutions

Citytrust Banking Corporation
Key Financial Data
(Pesos million)

	Audited 1985	Audited 1986	Audited 1987	(Unaudited) 1988
Total Assets	5,056.7	5,442.0	6,095.70	8,091.00
Liquid Assets	2,760.9	3,198.0	3,182.80	4,037.00
Outstanding Loan Portfolio	1,935.9	1,786.3	2,390.40	2,765.90
Equity Investments	170.1	197.5	212.80	213.20
Provisions for Losses	228.9	198.4	127.90	81.80
Total Deposits	2,332.8	3,075.0	3,919.10	4,237.00
(Short-Term)	1,712.5	2,508.2	3,117.80	3,060.20
(Long-Term)	620.3	566.8	801.30	1,176.80
Long-Term Debt	-	37.2	47.80	69.90
Net Worth	687.6	810.2	901.60	904.90
Gross Income	888.4	697.5	655.30	758.20
Interest Expenses	390.9	257.2	187.70	228.50
Net Income After Tax	153.4	163.4	155.40	152.60
Dividends	33.0	105.9	63.10	73.70
Ratios				
Gross Income/Average Total Assets (%)	17.9	13.3	11.40	10.70
Gross Spread (%)	7.9	8.3	8.10	7.50
Net Income/Average Net Worth (%)	24.5	21.8	18.20	16.90
Debt/Equity Ratio (times)	6.4	5.7	5.80	7.90
Provisions/Total Loan Portfolio (%)	11.8	11.1	5.40	3.00
Administrative Expense/Average Total Assets (%)	5.1	4.9	4.80	5.00
Liquid Assets/Total Deposits (%)	118.4	104.0	81.21	95.30
Cash Collection Ratio a/				
Apex Loan Portfolio	-	100%	100%	100%

a/ Cash collection on interest and principal divided by current dues on interest and principal.

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INDUSTRIAL INVESTMENT CREDIT PROJECT

Participating Financial Institutions

International Corporate Bank
Key Financial Data
(Pesos million)

	Audited 1985	Audited 1986	Audited 1987	(Unaudited) 1988
Total Assets	5,388.70	4,205.70	5,160.40	7,273.00
Liquid Assets	1,972.70	2,300.10	2,695.40	3,329.20
Outstanding Loan Portfolio	3,021.90	1,726.20	2,104.30	3,350.10
Equity Investments	-	3.00	3.90	4.10
Provisions for Losses	66.20	62.00	52.70	79.50
Total Deposits	1,553.40	1,331.60	1,625.30	2,866.20
(Short-Term)	584.90	492.60	704.70	1,571.90
(Long-Term)	968.50	839.00	920.60	1,294.30
Long-Term Debt	-	-	-	-
Net Worth	740.80	909.30	1,001.80	1,108.10
Gross Income	570.00	529.90	534.60	824.10
Interest Expenses	244.70	215.90	193.70	333.60
Net Income After Tax	89.80	120.40	140.40	162.40
Dividends	-	-	48.20	56.20
Ratios				
Gross Income/Average Total Assets (%)	11.4	11.04	11.42	13.26
Gross Spread (%)	-	6.24	7.17	7.44
Net Income/Average Net Worth (%)	12.8	14.60	14.93	15.40
Debt/Equity Ratio (times)	6.30	3.60	4.20	5.60
Provisions/Total Loan Portfolio (%)	2.2	3.60	2.50	2.40
Administrative Expense/Average Total Assets (%)	n.a.	3.73	3.52	4.94
Liquid Assets/Total Deposits (%)	126.99	172.73	165.84	116.15
Cash Collection Ratio a/				
Apex Loan Portfolio		-not applicable-		

a/ Cash collection on interest and principal divided by current dues on interest and principal.

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INDUSTRIAL INVESTMENT CREDIT PROJECT

Participating Financial Institutions

Anscor Capital and Investment Corporation
Key Financial Data
(Pesos million)

	Audited 1985	Audited 1986	Audited 1987	(Unaudited) 1988
Total Assets	320.00	371.20	381.90	288.80
Liquid Assets	79.60	128.50	143.50	92.70
Outstanding Loan Portfolio	169.60	163.00	143.40	117.90
Equity Investments	29.60	37.60	47.80	48.20
Provisions for Losses	9.10	10.50	17.00	18.90
Total Deposits	-	-	-	-
(Short-Term)	-	-	-	-
(Long-Term)	-	-	-	-
Long-Term Debt	102.70	100.00	64.00	46.10
Net Worth	98.60	115.60	150.20	162.60
Gross Income	77.50	64.50	89.80	75.90
Interest Expenses	47.10	24.70	28.00	29.10
Net Income After Tax	11.10	22.10	34.60	21.10
Dividends	2.20	5.00	-	48.80
Ratios				
Gross Income/Average Total Assets (%)	25.00	18.70	23.80	22.60
Gross Spread (%)	8.90	11.00	14.60	13.40
Net Income/Average Net Worth (%)	12.10	20.60	26.00	13.50
Debt/Equity Ratio (times)	2.20	2.20	1.50	0.80
Provisions/Total Loan Portfolio (%)	5.40	6.40	11.90	16.00
Administrative Expense/Average Total Assets (%)	5.30	4.60	5.50	6.60
Cash Collection Ratio a/				
Apex Loan Portfolio	100%	100%	100%	100%

a/ Cash collection on interest and principal divided by current dues on interest and principal.

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INDUSTRIAL INVESTMENT CREDIT PROJECT

Supervision Plan

1. Bank Supervision Input: The staff input indicated in the table below is in addition to regular supervision needs for the review of progress reports, subloans above the free limit, correspondence etc. estimated at four staff-weeks during the first project year, three staff-weeks during the two following project years, and one staff-week per year thereafter.

Approximate Dates	Activity	Skill Requirements	Staff Weeks
October 1989	Supervision Mission -Expedite start-up -Review: implementation of organizational arrangements; marketing of program -Provide direction to consultants and study teams on subsector studies.	Financial Analysis Industrial Economics	3
January/February, 1990	Supervision Mission -Review: DBP's 1989 performance and 1990 workplan; implementation of training program; performance of PFIs. -Verify adherence to Operating Policy Guidelines of Project and DBP's Policy Statement. -Comments on drafts of first set of subsector studies and discussions on detailed TORs of second set of subsector studies.	Financial Analysis Industrial Economics Capital Markets	3

September, 1990	Supervision Mission -Review progress on subloan commitments and disbursements -Comments on final draft of subsector studies. -Discuss follow-up on sub-sector studies.	Financial Analysis Industrial Economics Environmental Specialist	3
January/February, 1991	Supervision Mission Review: DBP's 1990 performance and 1991 work plan; subloan commitments and disbursements.	Financial Analysis	2
September 1991	Supervision Mission	Financial Analysis Environmental Specialist	2
1992	2 Supervision Missions	Financial Analysis	2
1993	2 Supervision Missions	Financial Analysis	2
1994	1 Supervision Mission	Financial Analysis	1
June 1995	1 Supervision Mission.	Financial Analysis Industrial Economist	2

2. Borrower's Contribution to Supervision:

(a) During project implementation, DBP will provide the Bank with the following information at the end of April and October of each year:

- Operational and Financial Performance of DBP.
- Operational and Financial Performance of PFIs.
- Lending operations: Commitments and Disbursements by
  - . Financial intermediary (PFI)
  - . Type of financial instrument
  - . Size of Operation
  - . Industrial Subsector

- Subproject performance
  - . Financing composition of subprojects
  - . Subproject costs and items financed through the loan
  - . Employment impact
  - . Sales
  - . Foreign exchange generation
  - . Company profits
  - . Implementation delays

- Technical Assistance Program
  - Progress report on subsectoral studies
  - Progress report on consultant assistance to DBP

(b) DBP will be responsible for coordinating arrangements for Bank supervision missions, and for providing information required by missions.

(c) Mission briefing meetings on arrival will normally be chaired by the Chairman of DBP. Mission wrap-up meetings will normally be chaired by the Chairman of DBP with the participation of an UnderSecretary from Department of Finance, an UnderSecretary from the Department of Trade and Industry and representatives of the PFIs.

ANNEX 5.01

PHILIPPINES

INDUSTRIAL INVESTMENT CREDIT PROJECT

DOCUMENTS IN THE PROJECT FILE

1. DBP Annual Reports

2. DBP Institutional Development Plan, March 1989.

3. A Resource Mobilization Strategy for DBP, December 1988.

4. Draft Project Completion Report on the Philippines Industrial Finance Project (Loan No. 1984-PH), March 1989.

5. Central Bank of the Philippines, Annual Report, 1988.

6. Reports of the Apex Unit on Participating Financial Institutions.

7. A Profile on the Philippine Cement Industry (Board of Investments, Department of Trade and Industry, January 1988).

8. Ten-Year Development Plan for the Pulp and Paper Industry (Leverage International Inc., June 30, 1988).

9. A Review of the Textile Sector with Proposed Plans and Strategies 1986-95 (Tootal Consultants, October 1986).

10. A Review of the Textile Sector with Proposed Plans and Strategies 1989-95 (Tootal Consultants, May 1989).

11. The Inter-Island Shipping Industry: Problems, Prospects and Policy Agenda (Center for Research and Communication, December, 1987).

12. Industrial Restructuring Program of the Philippines: Action list, Background Information on the Philippine Economy, and Supplementary Information for Consultants (Development Bank of the Philippines, March 1989).

13. Terms of Reference - Cement Restructuring Program (DBP, March 1989).

14. Terms of Reference - Inter-Island Shipping/Shiprepair Subsector Restructuring Program (DBP, March 1989)

15. Terms of Reference - Training Program (DBP, March 1989).

16. Terms of Reference - Pulp and Paper Restructuring Program (DBP, March, 1989).