



Peer analysis of success factors for loan guarantee schemes

**THE 4TH MENA CONFERENCE OF GUARANTEE INSTITUTIONS
BEYROUTH, LEBANON, APRIL 3RD & 4TH 2019**

How to appreciate success?

- **Effect**

- obtaining a **large outreach** (number of beneficiaries, and volume of covered lending), reducing significantly obstacles to access to finance
- Supporting credit constrained categories.

- **Harmony:**

ensuring a **stable business model** (risk cost and operating expenses) under control, and corresponding to expectations).

- Sustainability as an objective.

- But to support high risk categories, a partial coverage of **default cost** by regular public funding can be necessary.

Appreciating success factors requires careful approach

- Context differences

- Create important variations in the environment: importance of SME population, historical background in SME development, structure and evolution of the banking sector,
- Support addresses variable target groups, defined by size, sector of activity, project type
- A common goal, but tackled with varied intensity
- Resulting from shareholders' nature (public/ banking sector/ mutual)
- Reflecting the type of resources made available to the scheme (budgetary resources, funding by donors, counter guarantees...)
- Each country's history reflects in the evolution of a guarantee scheme.

Consequently:

- The wide scope of situations (MENA and Europe) offers **extreme variations**.
- All success factors might not be needed or applicable in every country.

Factors related to the guarantee offer

- The offer should reflect a clear, defined and well controlled « **SME development orientated** » **risk strategy**.
- It must address existing market gaps, for credit constrained categories, in a process **compatible with banks development strategies and motivations**.
 - Guarantees must be proposed at **attractive conditions**: cost, adequate guarantee quota and have a real impact on banks' regulatory ratios.
 - Offering a **streamlined process, causing minimal additional administrative work to banks**, allowing **rapid** decisions and swift payments for called guarantees.

Factors building attractiveness for customers

- SMES are the beneficiaries. Banks and financial intermediaries are our customers.

Guarantees are a difficult product to offer :

- Core of banks strategy, : concentrate on profitable and risk limited operations . SME financing is far from being a priority.
- Making banks take risks on reputedly « hazardous clients » is no easy matter. Defaults are unpleasant situations, meaning trouble and additional transaction costs.
- Risks are not totally covered.
- **The indispensable confidence factor**

Doing active business with banks, leasers, equity investors... will depend on the **image** the guarantor will create among his customers:

Credibility (financial sustainability), specially for long term risks.

Reliability: rapid payments when due, no artificial legal obstacles raised.

Importance of the human factor

- Business is based on personal **relationships** :

Setting the confidence factor for an institution results from the addition of multiple « man to man » deals on loans to be guaranteed.

The price for successful relations represents an important **immaterial investment** for the guarantor, in active labour, toil and expenses.

- Three concentric aspects of activation of the working force:

> First level: to be known, via active communication : messages, relevant means, and relevant interlocutors.

> Second level: set a streamlined process on guarantee applications, simple but adapted.

> Third level: engage active partnership with banks staff, when preparing guarantee decisions.

Risk mitigation: the « driving effect » of guarantees

- Scheme's attraction increases considerably when guarantor's decisions are known to be based on **recognized experience** and **risk analysis reliability**,
 - A **second opinion, bringing a »quality label «** on projects, increases risk mitigation,
- To obtain such a consideration requires a substantial amount of time, practice and training.

But represents a **very performing asset**.
- Active schemes accumulate know how on specific types of risks and projects ; they provide better risk analysis than most bankers, thanks to **visibility and expertise** obtained from a number of cases,
- Guarantees supplied via automatic decisions (portfolio agreements) have a lesser impact on banks' decisions. This process should be reserved to large populations of small risks offering well known profile, proposed by reliable partners.

The possible double impact of a Loan Guarantee scheme

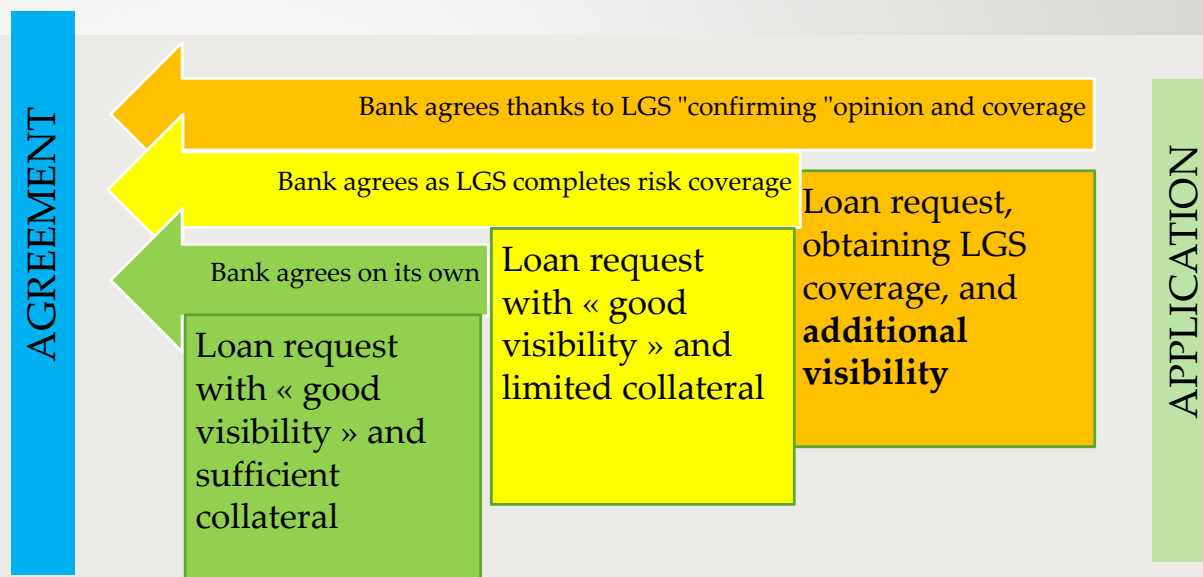
A guarantor which has proven in its past activity the quality of its risk assessment can play a double incentive effect on banks:

Beyond « good borrowers »,  two additional populations of loans can obtain the requested financing:

 Loans to SMEs with good viability profile, but insufficient collateral

And

 Loans to SMEs for which bank's own diligences were insufficient to obtain a positive decision, but which gain credibility from LGS risk assessment



The ways and means to run active relation

➤ Existence of adequate financial resources:

Their volume define potential liabilities (with use of a multiplier).

Ressources should make it possible to bear the cost of a reasonable « non-conservative » policy.

➤ A well controlled risk management is essential to limit risk cost at the level allowed by resources.

➤ Set the necessary operational resources and organization:

-Human resources are essential to adress the needs of the institution:

Quantitative aspects: Staff dimension should be adapted to country size, importance of banks networks and expected amount of files.

Qualitative aspects : Staff skills should be high on SME risk appreciation, and show real motivation.

➤ Use a network

improve and densify relations with banks,
help taking right decisions by collecting facts, data, opinion on projects, close to local reality.

Thinking about « quality of service »

- The design of guarantee offer must **comply with banks' products and processes**.
 - avoid « one size fits all » for offer and operating conditions:
 - adapt a frame of general conditions, but with negotiated specificities when needed to fit to the bank's objectives.
- Adaptation to various target categories goes to:
 - application support (paper or electronic) , and data requested
 - risk analysis (ratios, risk rating instruments)
 - decisional process
 - nature of the targeted SMEs.
- Use proper digitization on all processes, obtaining speed and efficiency.
- Adapt to FINTECH and to banks new processes when applicable
example: Mobile finance already serves investment financing

Mastering the cost of risk

➤ Good risk management, core of guarantor's business

A subtle balance between risk cost and active support to entrepreneurship.

- The logic of a guarantee scheme is to accept projects with mixed features (strengths and weaknesses), and going beyond the limit set by risk-adverse lenders.
- Zero default is not the objective. Risk acceptance is necessary, but requires qualitative approach and measurement of this risk.

Compare guarantors with **tight rope walkers**: it can be done safely, but it requires skill and experience.

➤ IT support for risk management is essential:

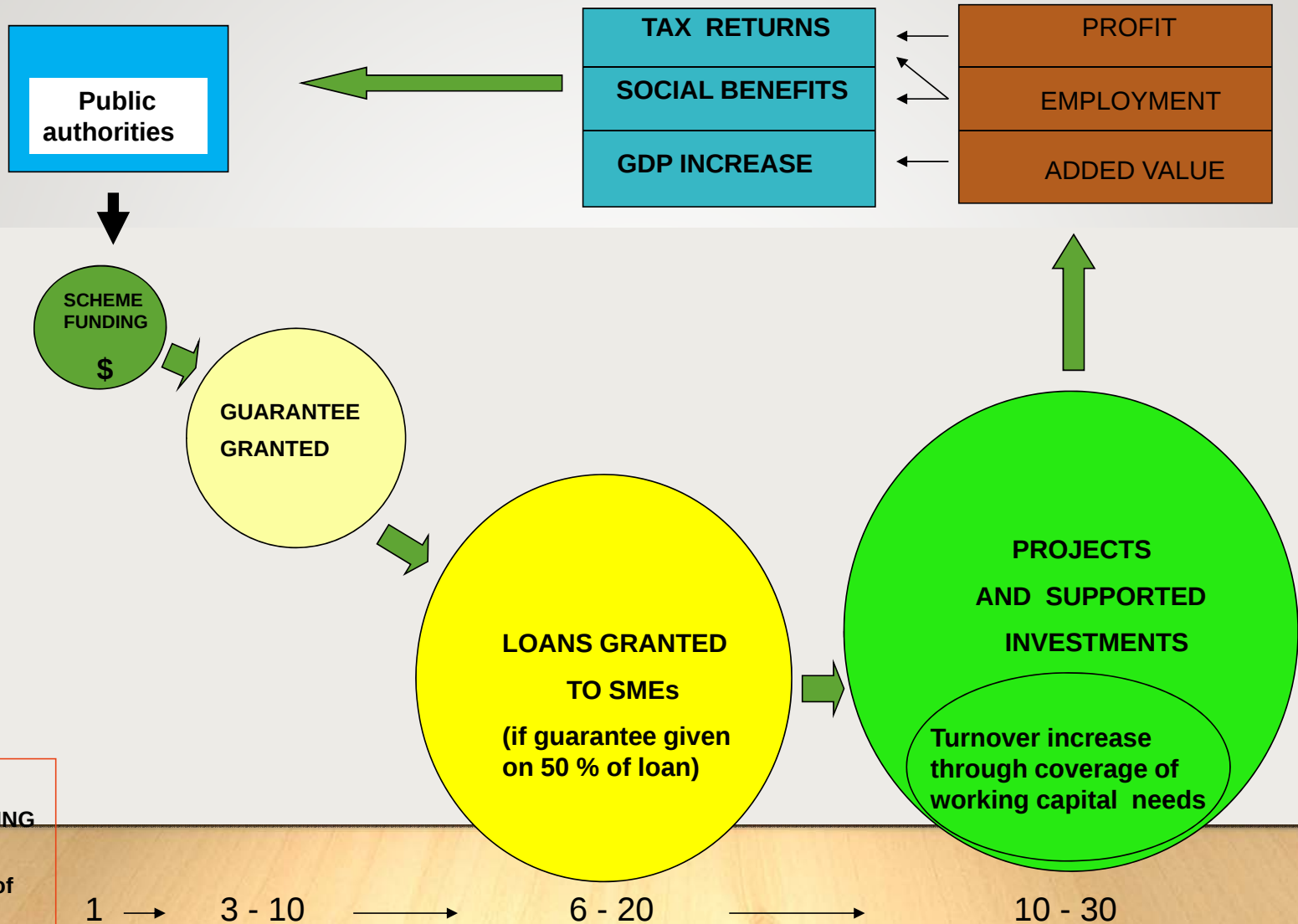
- Risk rating instruments: gives vision on profile of risks. justification of scheme mission.
- Risk policy definition must be clear and explicit for staff
- Collective decisions (committees) are a must to tackle large risks
- Management must be fed with detailed reporting, alerts, and segmentation of portfolios into categories.

For public schemes, a strong political involvement must ensure the scheme objectives

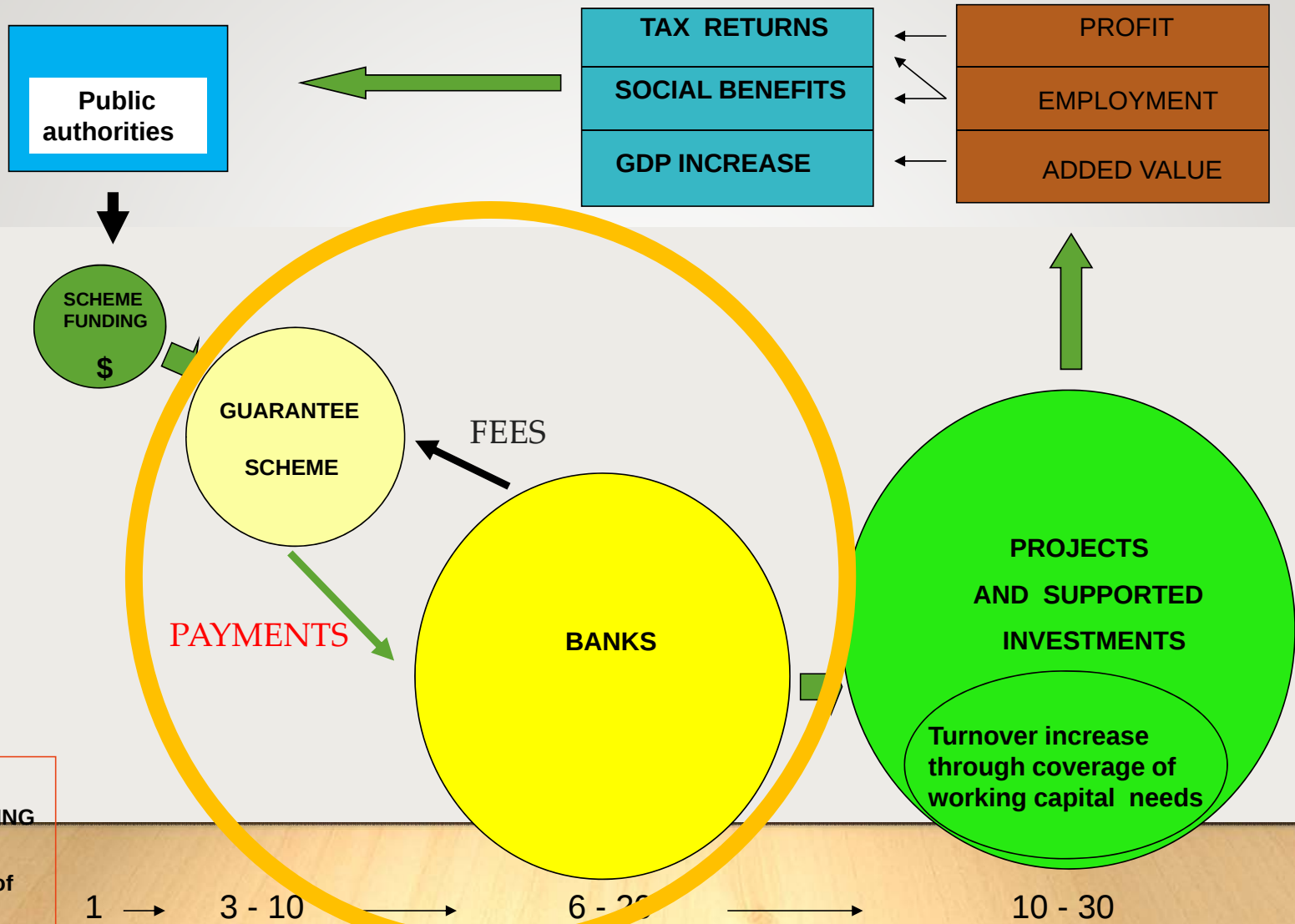
- Guarantee scheme : a development tool:
 - When reaching efficiency, channelling financing in sound and efficient conditions, **a public guarantee scheme becomes similar to an infrastructure investment:**
 - Building a bridge, a motorway, a railway line stimulate the economy of an underdeveloped province. So does a guarantee scheme.
- **Economic justification:** Stimulation to financing SMEs allows development and creation of wealth
- **Financial justification** for the State to fund it:
Budget expenses have a positive return from the successful projects.

Also, social positive returns are considerable.
- **Only public authorities can carry the financial weight of a guarantee scheme**
Banks are preoccupied by short term profit,
Guarantee scheme needs initial and continuous funding until reaching sustainability.

THE VIRTUOUS CIRCLE OF PUBLIC GUARANTEE FUNDING: TAX AND ECONOMIC RETURNS



WHY SHOULD PUBLIC GUARANTEE SCHEMES BE SUPPORTED BY SPECIFIC RESOURCES



Symbiosis with other actors supporting entrepreneurship

Entrepreneur's insufficient skills and knowledge in management and finance techniques is a strong negative factor for access to finance.

- **Coordination of different actors** correcting such weaknesses is necessary to obtain coherence and synergies.
- A guarantee scheme must be acting within a group of complementary means, creating a favorable environment.

Four directions should be attended:

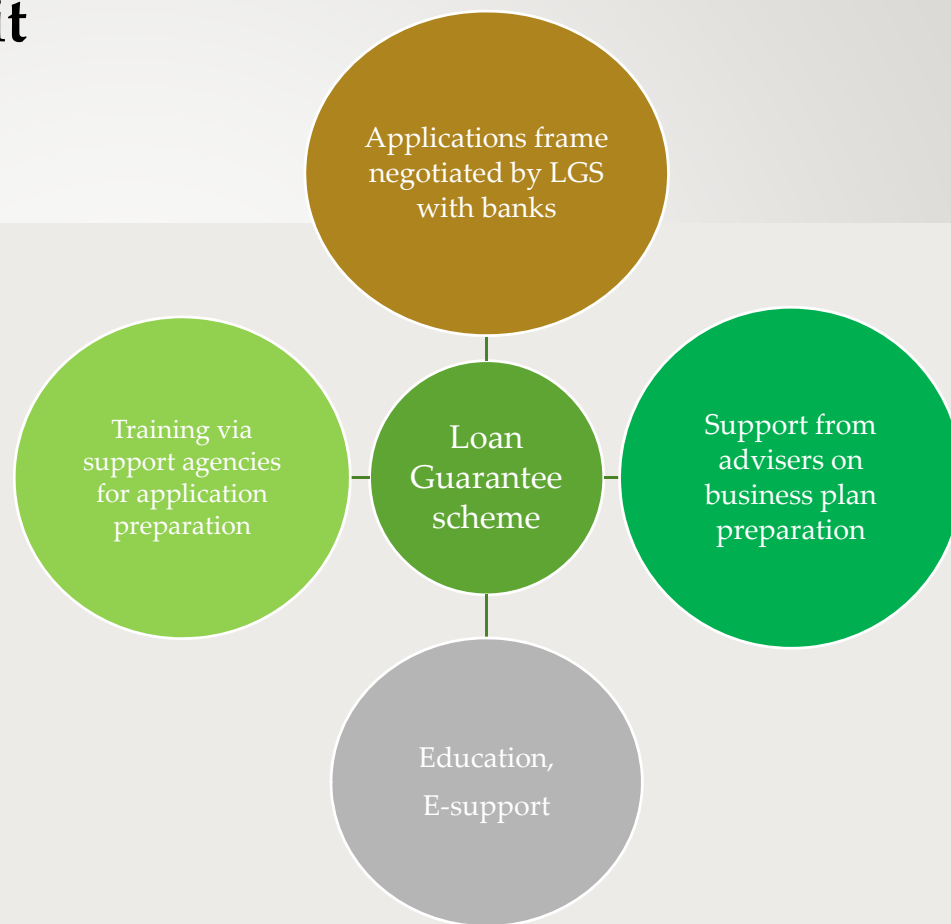
- Public Education to provide early some basic knowledge on entrepreneurship and finance.
- Business associations, chambers of commerce, agencies from local authorities, ... offer additionnel training at the stage of project preparation
- Advisers, mentors, consultants in the preparation of applications are necessary. Whenever suitable, they should be subsidized if needed. Mentoring and tutoring by established entrepreneurs should be promoted.
- Equity partners. For the happy few.

Coordination with other supporting actors increases access to credit

Support agencies, advisers and LGS network should set in **common practical relationship** and exchange of information and advice.

They should have **common definition (in liaison with banks)** of what is needed to improve credit applications: training content, business plan presentation, basic skills adaptation ...

- > Standards should adapt to different size and projects categories
- > Respecting guarantor information needs
- > And allowing common risk analysis elements and rating





Thank you for your attention

“The **ideal** is for us what the star is for the sailor; it cannot be reached, but it is a guide”.

Albert Schweitzer

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