CREDIT GUARANTEE FUNDS: AN INSTRUMENT IN SUPPORT OF SME FINANCING

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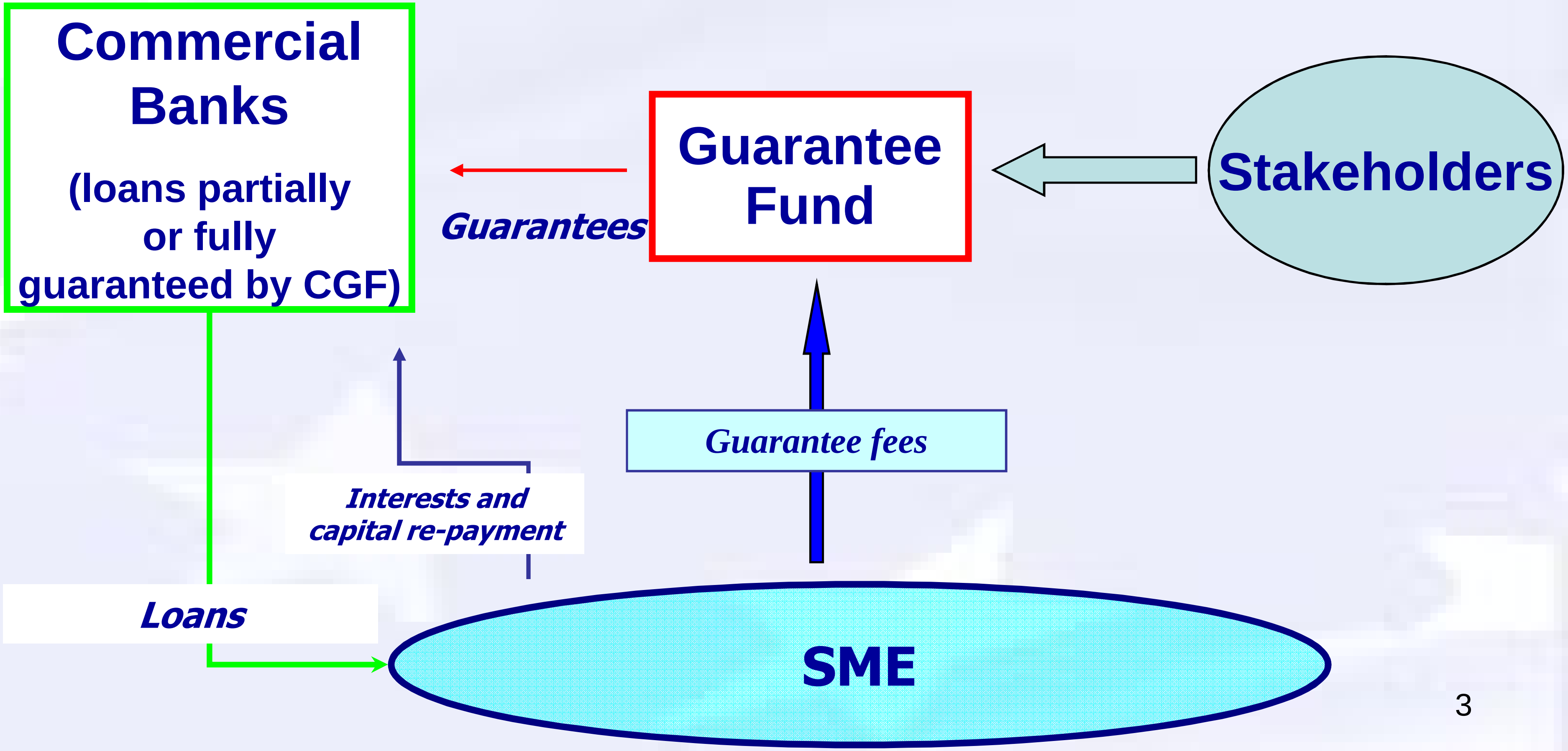
Guarantee

- irrevocable commitment by the **guarantor** (Credit Guarantee Fund – CGF) on behalf of the **borrower** (the SME) in favor of the **lender** (the Bank)
- if the SME fails to repay the loan, the CGF will cover (fully or, more often, partially) the borrower's obligations vis-à-vis the bank
- the guarantee is typically partial (i.e. up to a certain percentage of the loan) and could be "first demand" or "subordinate"

CREDIT GUARANTEE FUND overview



A Widespread Phenomenon

Why CGF are so common?

Two main reasons:

- CGF address **“informational asymmetries”** between borrower and lender
- CGF have a **greater impact** than direct lending (the “multiplier”)

Informational asymmetries

- CGF are **close to the business community** (business associations, enterprises are often promoters of CGF)
- Therefore CGF can provide comfort to bankers through the provision of an **informed, additional opinion** about borrowers

The "multiplier"

- The multiplier is the ratio between the GCF **own resources** and the **amount of guarantees issued** in favor of SME
- For example:

CGF OWN RESOURCES

€ 1 M

→

AMOUNT OF GUARANTEES ISSUED

€ 3 M

- Means a multiplier of 3
- In addition, some **"financial leverage"**

The "size" of the multiplier depends upon

- **Prudential regulations** issued by Central Banks (i.e. capital adequacy ratios – impact of Basel II)

- **Reputation of the CGF** in doing its business with commercial banks (the more serious the CGF the greater the multiplier)

See data in hand out

CGF: a wide range of models

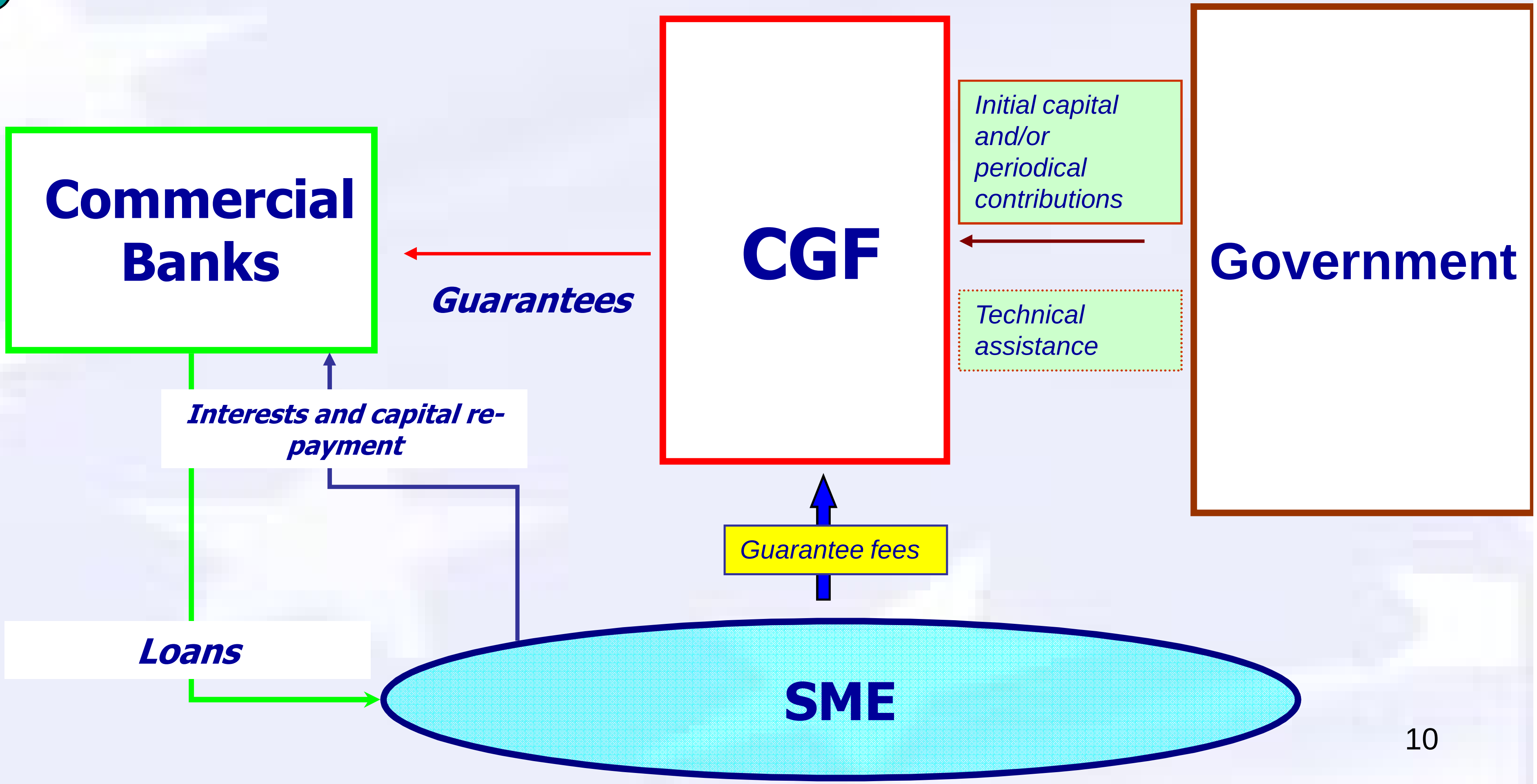
Different business environments determine different typologies of CGF

In the EU **three main models**:

- Public CGF (e.g. Finland's Finnvera)
- Mutual CGF, self help organizations established by SME and their associations (e.g. Confidi in Italy)
- CGF created by banks & chambers of commerce (e.g. "guarantee banks" in Germany).

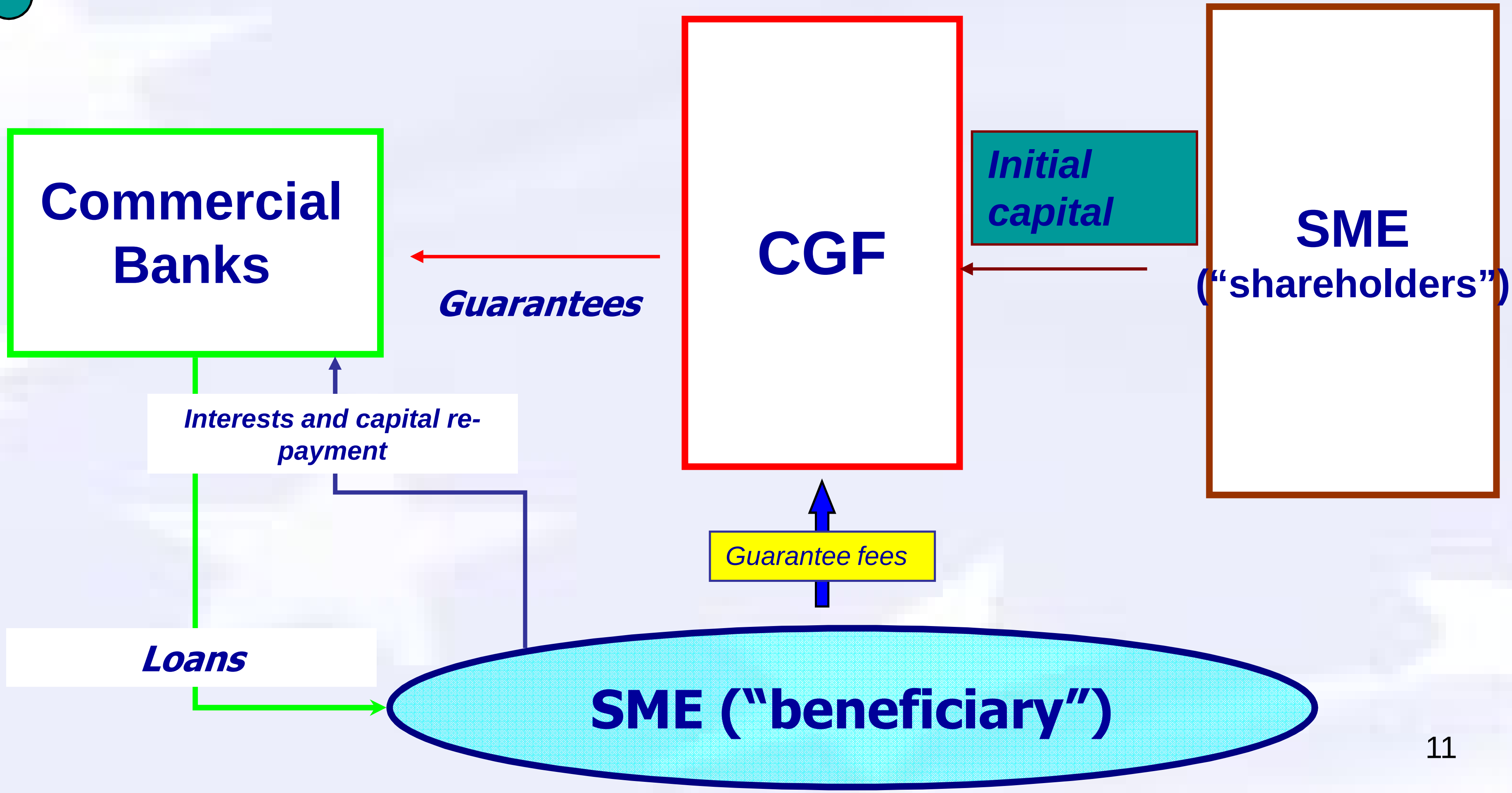
But also **hybrid** solutions (Portugal, Eastern Europe)

Public CGF

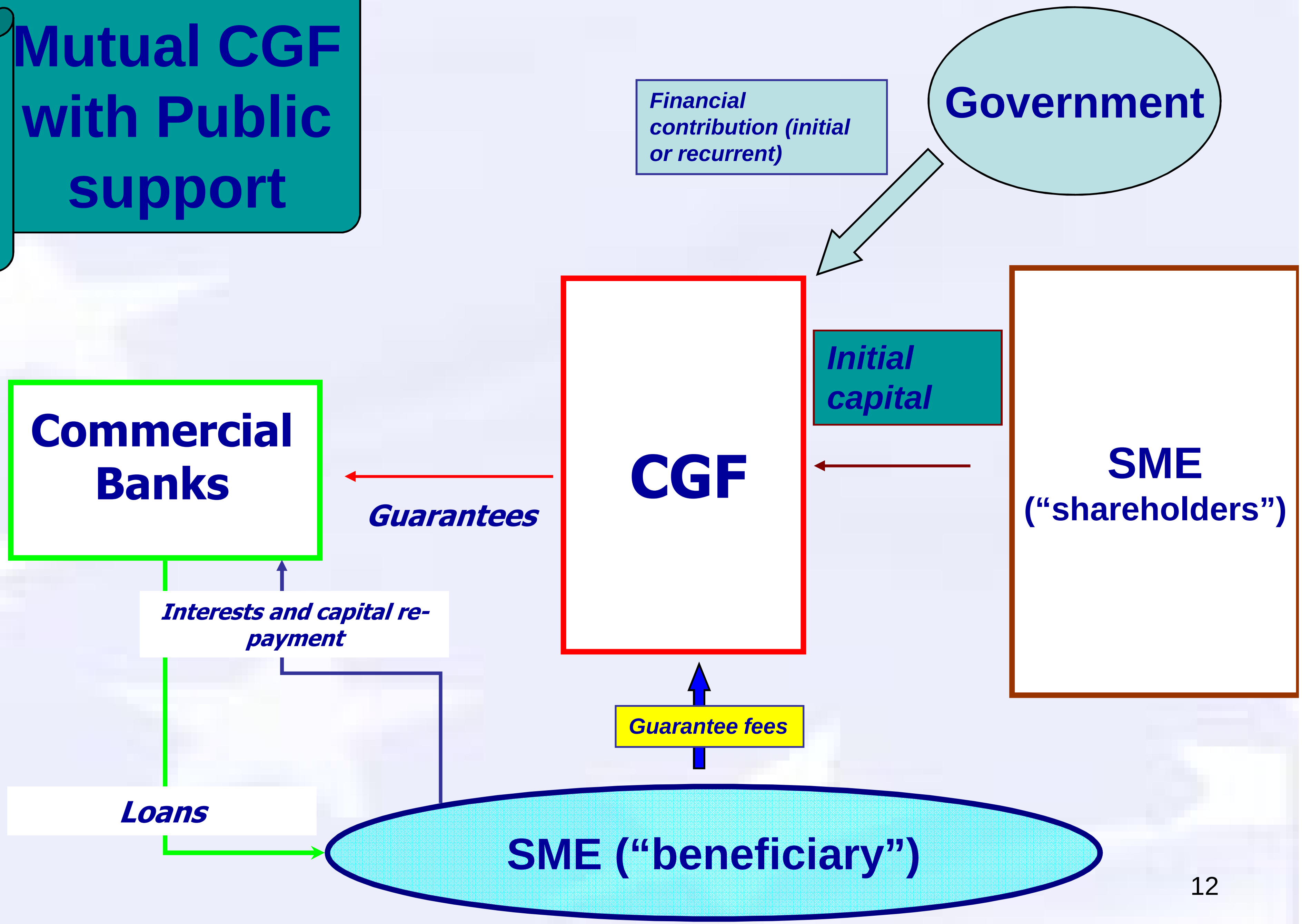

Commercial Banks
Guarantees
CGF
Initial capital and/or periodical contributions
Technical assistance
Government
Interests and capital re-payment
Guarantee fees
Loans
SME

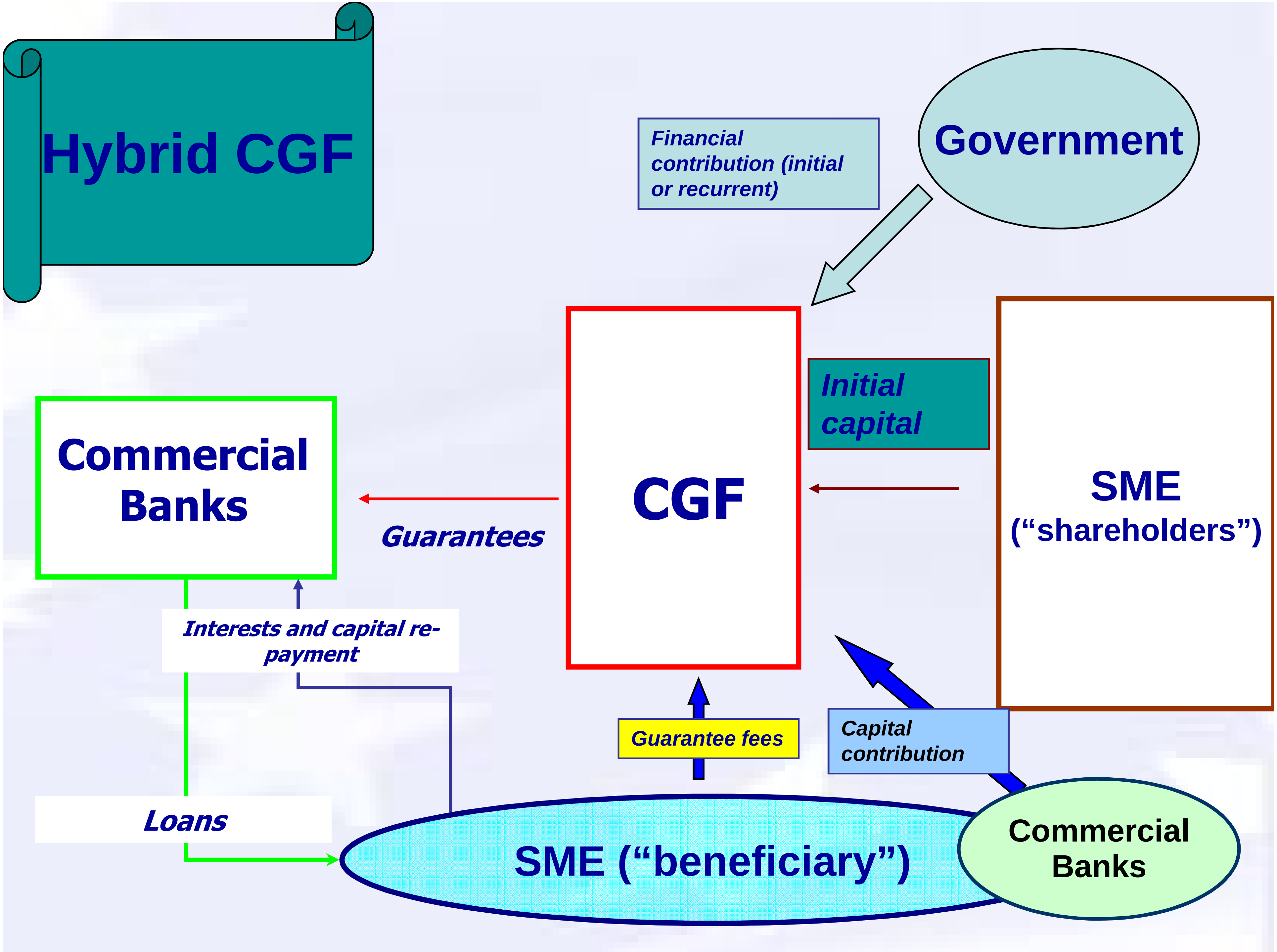
Mutual CGF

(self help organization)

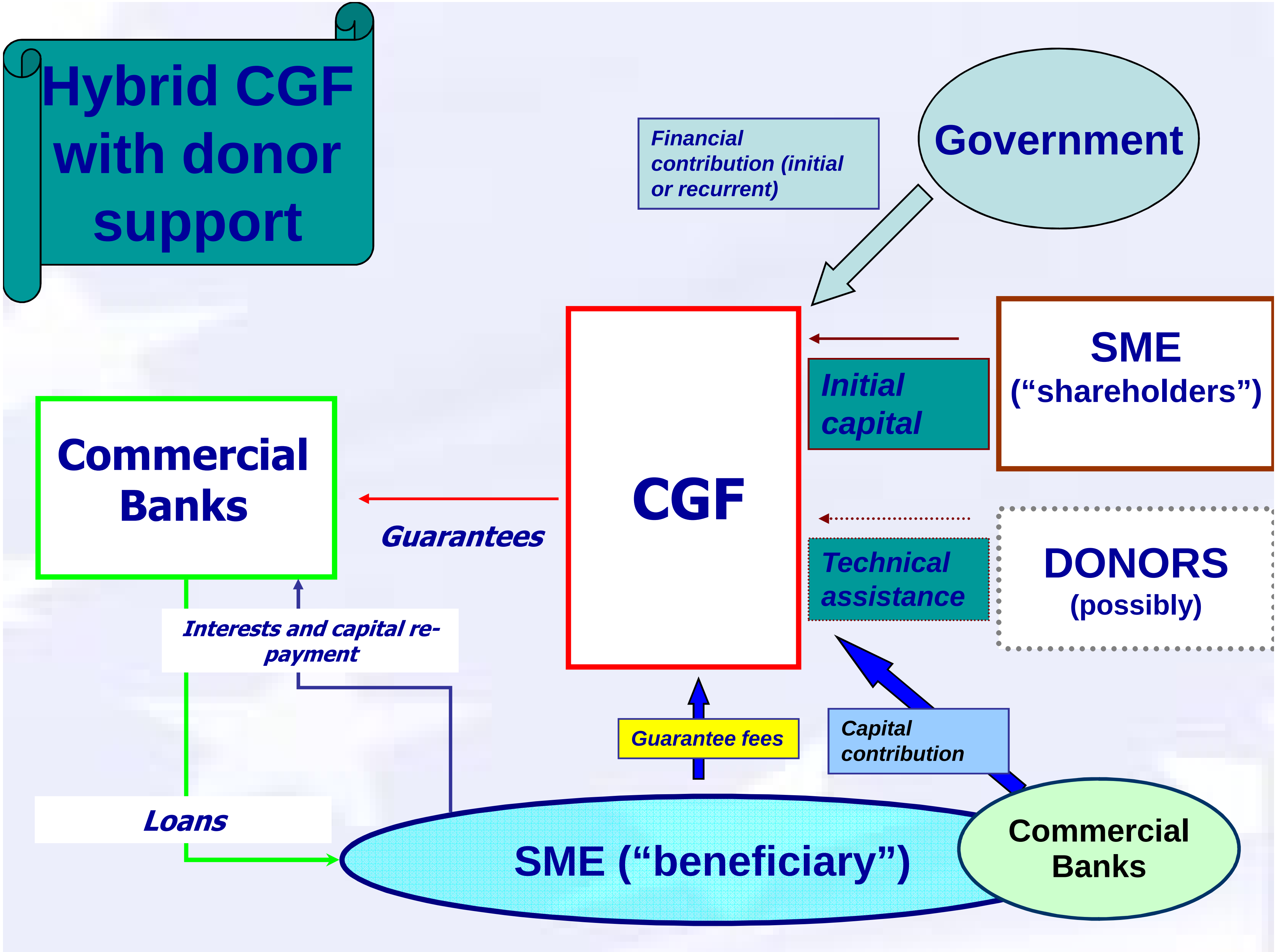


Mutual CGF with Public support





Hybrid CGF
Financial contribution (initial or recurrent)
Government
Initial capital
Commercial Banks
CGF
SME ("shareholders")
Guarantees
Interests and capital re-payment
Guarantee fees
Capital contribution
Loans
SME ("beneficiary")
Commercial Banks


Hybrid CGF with donor support
Financial contribution (initial or recurrent)
Government
SME ("shareholders")
Initial capital
Commercial Banks
CGF
Guarantees
DONORS (possibly)
Technical assistance
Interests and capital re-payment
Guarantee fees
Capital contribution
Loans
SME ("beneficiary")
Commercial Banks

CGF in Montenegro: issues to be analyzed

- Who is willing to contribute the money?
- Which kind of guarantee?
- What is an affordable cost for SME?
- What could be the impact of guarantees on lending decisions?
- Which legal form for the CGF?
- What does it take to make it self-sustainable?

THANK YOU FOR YOUR ATTENTION

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