

Credit Guarantee Schemes: a tool to promote SME growth and innovation in the MENA Region

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Presentation structure

- On SME growth and innovation

- International experience and best practice

 - Loan guarantee schemes – evaluation evidence

 - Equity guarantee schemes – operation and evidence

- Policy guidelines

 - Loan guarantee schemes

 - Equity guarantee schemes

 - Guarantee schemes as part of the innovation system

On SME growth and innovation

- ❑ Innovative SMEs can make a substantial contribution to economic growth, job creation and economic restructuring
- ❑ For these SMEs financial issues are compounded by the technological and market risks associated with innovation
- ❑ Innovating SMEs may find it particularly difficult to present a robust business case to potential finance providers with acceptable levels of investment risk
- ❑ Important to realise that innovation can be technological or non-technical – improvements in services or business models. Support often favours technological innovation.
- ❑ Guarantee schemes can increase lender confidence in making innovation-enabling investments by supporting either debt or equity finance

International experience and the key lessons for policy development

Loan guarantee schemes – international experience (World Bank, 2008)

	No. of Obs.	Median Age	Total Outstanding Guarantees (US\$ million)	Total Outstanding Guarantees/ GDP	No. of Employees
<i>All schemes</i>	76	15	3,700	0.61	18
<i>By Income</i>					
High	34	27	909	0.21	15
Middle/Low	42	13	360	0.30	21
<i>By Region</i>					
Asia	6	23	41,143	4.7	179
Latin America	24	11	682	0.06	11
Transition	11	14	149	0.35	25

- ⌘ Around half of all schemes targeted at SMEs, far fewer at growth and innovation specifically
- ⌘ Government typically provides around a third of funding
- ⌘ Most schemes are ‘independent’ with 72 per cent undertaking loan level guarantee approval, smaller proportion devolve screening to lenders

Loan guarantee schemes – key learning points

- ❑ Evidence of ‘additionality’ is partial and covers only a few countries in detail

- ❑ Key learning points are:
 - ❑ Targeted schemes are more effective
 - ❑ Dual approval – technical and commercial – can reduce default rates
 - ❑ Markets can be developed for guaranteed loans
 - ❑ Independence of guarantee approval processes are important

- ❑ These are reflected in policy guidelines discussed later

Equity guarantees and other measures to support SME innovation



Equity guarantees for innovation

- ⌘ May be focussed on either institutional investors or business angels or both
- ⌘ Key issue is tendency for guarantees to be sought for low quality investments – negative selection – increasing default rates
- ⌘ Little consistent evaluation evidence but only 7 EU countries with schemes focussed primarily on institutional investors
- ⌘ Limited experience with providing equity guarantees to support angel funding has been less than positive

Other approaches to supporting SME innovation

- ❑ Other forms of support for SME innovation which could be considered can involve either financial, fiscal incentives or upgrades to framework conditions

- ❑ Financial measures (examples):
 - ❑ Direct grant support (strong additionality and useful for non-technical innovation) (Most EU countries)
 - ❑ Co-investment either at fund level or at the level of the specific investment (Ireland, Belgium)

- ❑ Fiscal measures (examples):
 - ❑ Fiscal incentives for R&D and innovation investment – e.g. R&D tax credits (most EU countries)
 - ❑ Tax offset schemes allow tax offsets for R&D by private investors (Netherlands)

Policy guidelines for equity guarantee schemes for SME growth and innovation

Debt guarantees for innovation – policy guidelines

- ❖ For the vast majority of SMEs debt is likely to remain the main form of external finance for funding growth and innovation
- ❖ International experience and evaluation evidence suggests that CGSs can play a significant part in the debt financing of growth and innovation
- ❖ Target specific guarantee measures on supporting SME innovation and growth – a dual approval process (technological/financial) can help to increase additionality (Korea)
- ❖ Create a market for guaranteed loans. This can reduce SME borrowing costs and attract international investment (Malaysia)

Debt guarantees for innovation – policy guidelines

- ⌘ Government should play a catalytic role – co-ordinate partners, set agendas, underwriting initial capital needs to establish credibility (MENA countries)
- ⌘ Establish commercially rigorous and independent guarantee approval mechanisms. Government's exit strategy is important (Korea, Canada, UK)
- ⌘ Establish effective regulation – this will be important in attracting external investment (Malaysia)

Equity guarantee schemes for innovation – policy guidelines

- Equity guarantee schemes for both formal and informal equity are, as yet, an unproven policy instrument – no evaluation evidence
- Only seven EU countries have implemented this type of measure while all have some form of debt based CGS
- Mostly appropriate too for technological innovation where defensible IP is created. Small proportion of all firms (1-2 per cent)
- Focus on pilot projects targeted on specific sectors or geographical areas (e.g. enterprise zones, science parks)

Equity guarantee schemes for innovation – policy guidelines

- Operate similar to debt based CGSs but perhaps with fee and profit share to avoid negative selection (Hungary)
- Focus on pilot projects targeted on specific sectors or geographical areas (e.g. enterprise zones, science parks)
- Ensure clarity in the rights of minority shareholders after business failure and effective implementation
- Consider:
 - Creating a market for guaranteed equity investments to attract external capital (Malaysia)
 - Implementing a portage model such as that operated by SICAR in Tunisia combined with equity guarantees

Final remarks

- ⌘ Guidelines pose significant challenges for a number of the MENA countries in terms of their own CGSs. Key issues are:
 - ⌘ Focus
 - ⌘ Independence
 - ⌘ Market based

- ⌘ Little clear evidence of any evaluation evidence from the MENA region. Does it exist?

- ⌘ Potential exists for sharing of best practice however and potential for learning from established 'growth focussed' schemes: Korea, Kafalat Innovative or Hungarian START scheme.