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)

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

- 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 focused 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 focused 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.