Study project on "*The importance of Financial Intermediaries in SME financing and assessment of different economic effects especially of EU Financial Instruments in light of direct guarantee vs. counter-guarantee contracts*"

European Association of Guarantee Institutions

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Study Project

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Introduction and objectives

Where are we are at?

Phases and activities for the Study

	1 Phase 1: Preliminary investigation and desk analysis	2 Phase 2: Empirical analysis	3 Phase 3: Impact analysis	4 Phase 4: Policy recommendations
Description	**Investigation of the efficiency of different types of guarantee models, based on a literature review of the following topics:** - role of guarantee system - efficiency of different guarantee chains - impact of direct guarantees on Guarantee Institutions - role of Guarantee Institutions - relationship between different guarantee programmes - impact of state aid regulations on different guarantee models and policy insights	**Empirical analysis of the effects of Direct Guarantees and EU Counter-Guarantees by:** - data gathering and dataset preparation (cleaning, selection, setting) - "status quo" and benchmarking analysis - descriptive statistics analysis	**Impacts of guarantee and guarantee institutions on the wider socio-economic environments of the member States by:** - econometric models selection - analysis of the effects of guarantee system - analysis of added-value of guarantee institutions - identification of relationships between different guarantee programmes (e.g. direct guarantees vs EU counter-guarantees)	**Provision of policy oriented keys to analytical insights:** - policy recommendations - knowledge and insights sharing with AECM - elaboration of final write-up - preparation of supporting documents for concluding seminar
Milestones	●●●	●●	●●	●

●●● Completed ●● In progress ● Not started

Role of the guarantee system

Key Points

	Main evidence	Supporting literature
Firms	▪ SMEs **access to credit** is improved, according to high-level **principles on SME financing**, especially thanks to the role played by **Guarantee Institutions**; they have deep knowledge of the local market and play a crucial role in reducing the **informational asymmetry** between firms (borrowers) and banks (lenders) ▪ **Firms' investments increase** thanks to **lower interest rates** ▪ SMEs are more willing to adopt riskier strategies (**moral hazard problem**)	▪ OECD (2015). G20/OECD High-level principles on SME financing ▪ Asdrubali, P., Signore, S. (2015). *The economic impact of EU Guarantees on Credit to SMEs*, July, European Economy Discussion Paper ▪ D'ignazio, A., Menon, C. (2013). *The causal effect of credit guarantees for SMEs: evidence from Italy*, February, Banca d'Italia Working Paper No. 900 ▪ Schmidt, A.G., Van Elkan, M. (2006). *Macroeconomic Benefits of German Guarantee Banks*, Inmit Discussion Paper ▪ Schmidt, A.G., Van Elkan, M. (2010). The *Macroeconomic Benefits of German Guarantee Banks*, June, Inmit Discussion Paper ▪ Riding, A.L., Haines, G. (2001). *Loan Guarantees: Costs of Default and benefits to small firms*, January, Journal of Business Venturing ▪ Gropp, R., Gruendl, C., Guettler, A. (2010). *The Impact of public guarantees on bank risk taking: evidence from a natural experiment*, December, ECB Working Paper ▪ Lelarge, C., Sraer, D., Thesmar, D. (2008). *Entrepreneurship and Credit Constraints: Evidence from a French Loan Guarantee Program*, Mimeo, University of California Berkeley ▪ Columba, F., Gambacorta, L., Mistrulli, P.E. (2009). *The effects of mutual guarantee consortia on the quality of bank lending*, April, Revue Bancaire et Financière ▪ Busetta, G., Presbitero, A.F. (2007). *Confidi, piccole imprese e banche: un'analisi empirica*, December, Working Paper
Banks	▪ **More money is avaliable** to firms (and to the wider economy) to re-invest it; hence, actively **contributing to economic growth** ▪ **Thanks to the guarantee, banks tend to ask lower interest rates** than would otherwise do ▪ Banks are **less concerned with evaluating the quality** of the borrowers	
Socio-economic environment	▪ An increase in investments and, consequently, firms' volumes of sales generate an **increase in employment levels** ▪ Potential, positive **indirect impacts** on **key macroeconomic indicators** (e.g. GDP, Export)	

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Direct guarantees and relationship with other schemes

Key Points	Main evidence	Supporting literature
Impacts of direct guarantees on Guarantee Institutions	▪ The number of guarantees granted by **guarantee institutions** lowers due to a **decreasing demand from commercial banks** ▪ The relatively **higher percentage of guaranteed amount** (over the total amount not guaranteed) and **smaller fees** for direct guarantees leads to a "**deadweight effect**"* that worsen the quality of the outstanding guarantee for the Guarantee Institutions	**__Deadweight effect__: According to the guarantors' experience, the cost of the guarantee prevents banks to use it when unnecessary. When the guarantee is free or quasi-free (fees are very low), the deadweight effect can appear when the bank takes a guarantee on the loan which it could have accepted without it.* *Two motives can lead banks to this deadweight effect:* ▪ *either to reduce capital adequacy needs, or* ▪ *to replace available securities for commercial reasons*
Counter-cyclical effects	▪ Public intervention could **alleviate the highly procyclical nature of private capital flows** globally ▪ The **European Investment Bank (EBI) Group** responded rapidly to the crisis by providing an **anti-cyclical response** (via securitisation, guarantees, risk-sharing loans and investments in venture and growth capital funds) **in banking and capital markets**, including those for SMEs ▪ **A combination of private and public schemes** might thus be **more efficient** and beneficial to the economy than a private one, because of the added value of boosting private capital flows during downturns	▪ OECD (2015). G20/OECD High-level principles on SME financing ▪ Bartoli, F., Ferri, G., Murro, P., Rotondi, Z. (2012). *Bank-firm relations and the role of Mutual Guarantee Institutions at the peak of the crisis*, February, Working Paper ▪ D'Auria, C., Porretta, P. (2015). *La garanzia consortile e le regole di vigilanza prudenziale*, June, Working Paper Spazio Confidi ▪ Zecchini, S., Ventura, M. (2007). *The impact of public guarantees on credit to SMEs*, November, Working Paper Small Business Economics
Public role	▪ **The design of public programmes** to enhance SME access to finance **should ensure financial and economic additionality**[1] paying attention to the target population, eligibility criteria, credit risk management and **fees structure** ▪ Public programmes for SME finance **should help catalyse and leverage the provision of private resources**, especially in risk capital markets	▪ Griffith-Jones, S., Tyson, J., Calice, P. (2011), *The European Investment Bank and SMEs: key lessons for Latin America and the Caribbean*, January, Serie Financiamento para el Desarrollo ▪ Beck, T., Klapper, L.F., Mendoza J.C. (2008), *The Typology of Partial Credit Guarantee Funds around the World*, November, World Bank Policy Research Working Paper

Evidence is currently scarce; more empirical investigation is needed

1) Financial additionality means that public support reaches viable enterprises which would not otherwise have had access to finance or would have accessed finance at tighter conditions (e.g. higher financing cost, shorter debt maturity). Economic additionality implies that the intervention produces a net positive impact on the economy

Literature review

Role of Loan Guarantee Institutions

Key Points

	Main evidence
Rationale	▪ The basic intuition is that the **foundation for Loan Guarantee Institutions lies in the inefficiencies created by adverse selection**, when borrowers do not have enough collateralisable wealth to satisfy collateral requirements and induce self-selecting contracts ▪ In this setting, Loan Guarantee Institutions could be seen as **a wealth-pooling mechanism that allows otherwise inefficiently rational borrowers to obtain credit**, and that provide additional qualitative information to banks, **helping to overcome the market failure**
Higher leverage effect	▪ The leverage of a Guarantee Institution is the **ratio of the outstanding guarantee commitments to the underlying own funds of the guarantee scheme** ▪ Part of the literature **states that Guarantee Institutions have a higher leverage effect*** compared to other types of schemes ▪ A high leverage effect is a favourable element as long as it is managed properly ▪ The leverage effect is dependent on whether credit is short-term or long-term credit
Effects on SMEs	▪ SMEs **access to credit** is improved thanks to the role played by **Guarantee Institutions**; they have deep knowledge of the local market and play a crucial role in reducing the **informational asymmetry** between firms (borrowers) and banks (lenders) ▪ Firms guaranteed by Guarantee Institutions obtain **interest rates which are almost 0.2 percentage points lower** than non guaranteed entities

Supporting literature

**Leverage effect*: Multiplier effect generated within the guarantee system. Guarantee institutions can grant more than they actually have, because they have to pay for the actual amount granted to SMEs if and only if SMEs do not pay their debts back to financing banks.*

- Busetta, G., Zazzaro, A. (2006). *Mutual Loan-Guarantee Societies in Credit Markets with adverse selection: Do they act as a sorting device?*, Working Paper
- Columba, F., Gambacorta, L., Mistrulli, P.E. (2009). *Mutual guarantee institutions and small business finance*, October, BIS Working Papers No. 290
- OECD, (2013). *SME and Entrepreneurship Financing: The Role of Credit Guarantee Schemes and Mutual Guarantee Societies in supporting finance for small and medium-sized enterprises*, January, Centre for entrepreneurship, SMEs and local development
- Ferrari A. et al., (2014). *Credit Guarantee Schemes, Credit Guarantee Schemes for SME lending in Central, Eastern and South-Eastern Europe*, November, Working Paper, Vienna Initiative
- Columba, F., Gambacorta, L., Mistrulli, P.E. (2009). *The effects of mutual guarantee consortia on the quality of bank lending*, Revue Bancaire et Financière

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Guarantee Schemes: overview of main features

A global perspective

Sustainability	▪ Prevalence of simple and sustainable schemes that avoid duplication and financial support overlapping ▪ The optimal size is closest to the one of the public body supporting the guarantor	**Simple and sustainable schemes**
Constant and stable support	▪ The capitalisation mechanisms focus on regular interventions (South Korea is a best practice) ▪ Without strong intervention on the capital structure, it is very difficult to generate and maintain growth (China is a best practice)	**Regular intervention**
Additionality	▪ Financial additionality, relating directly to the rationale for developing or supporting guarantee schemes ▪ Economic additionality, describing the effect of increased access to finance on the economy as a whole ▪ Multiplier effect from the compound effect of public and private schemes	**Financial and economic additionality**
Planning and measurement "Pay attention to social performance"	▪ The economic policy goals and investment priorities (e.g. innovation, research, IT, export) are selected and set at national level (France, Malaysia are best practices) ▪ Need for constant and reliable assessment and monitoring of the economic and "wider" socio-economic impacts generated by the guarantee (e.g. Germany, Inmit Model 2009-2015) – see Our Study later on	**Reliable assessment and monitoring**
Hybridisation	▪ Ongoing hybridisation of guarantee products towards patrimonialisation (e.g. equity and microequity) and small financing (e.g. microcredit) (South America, France, Malaysia, the Netherlands, Belgium, Morocco, Lebanon are best practices)	**Patrimonialisation and small financing**

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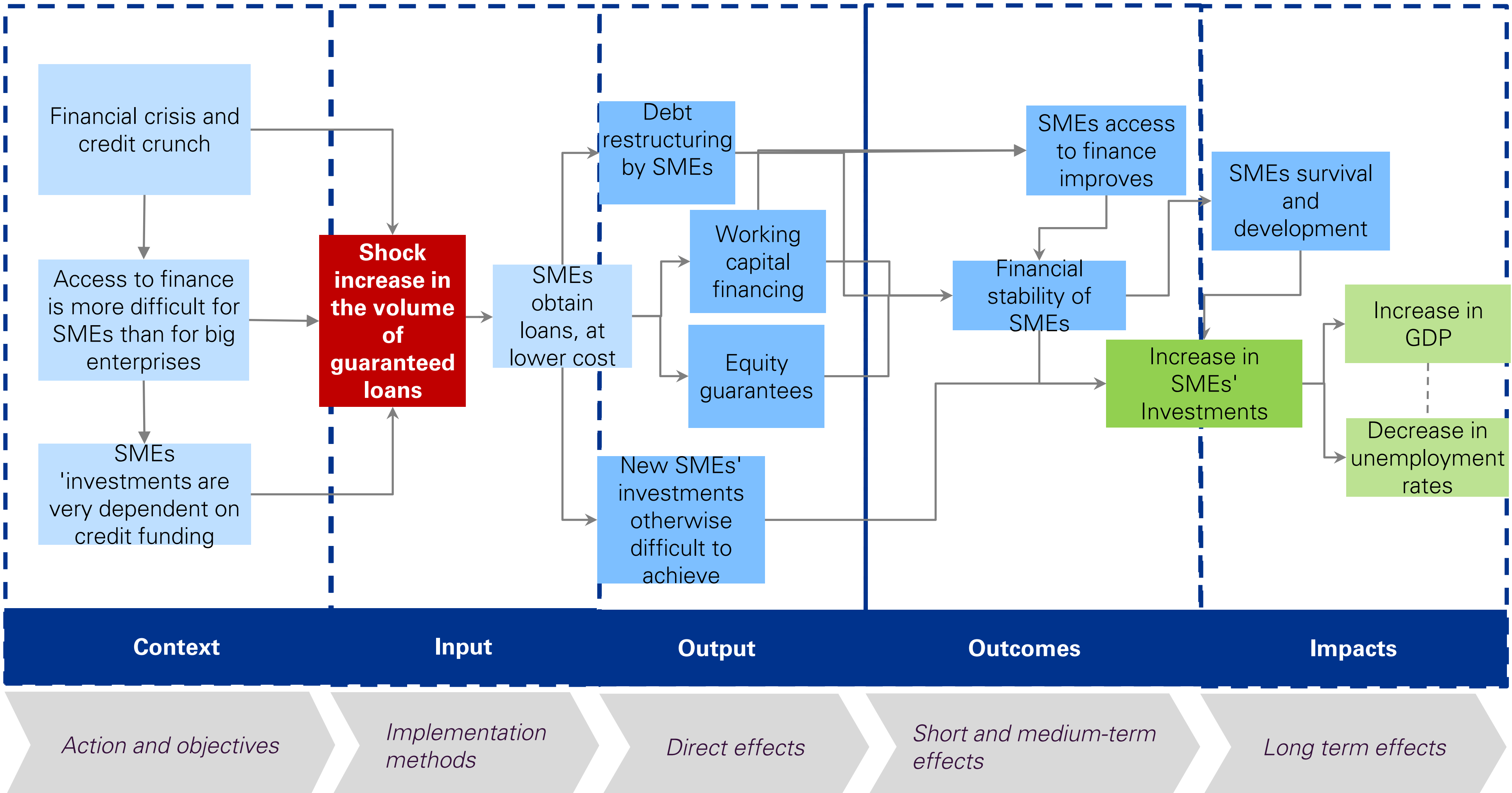
Logic chain of the impacts of the guarantee system (1/2)

Key information

- The guarantee granted could serve different purposes, such as:
  - new investments on Property, Plant,Equipment and Real Estate
  - new investments on Agricolture/Biologic
  - new investments in intangible assets: R&D and innovation
  - debt restructuring
  - working capital financing, equity guarantees
- Regardless of whether the guarantees granted to SMEs are conveyed to **debt restructuring**, **working capital financing**, **equity guarantees** or directly to **new investments**, in the medium term they are expected to be transformed into **new investments**
- The increase in investments is ultimately beneficial to the economy in terms of **GDP growth** and **reduction of unemployment**

Impact analysis: preliminary results

Logic chain of the impacts of the guarantee system (2/2)



Conclusions
Preliminary evidence of the Study

The foundation for Loan Guarantee Institutions lies in the **market failure** and in the inefficiencies created by **adverse selection** (also because of collateral issues). Intermediaries' information asymmetry is **reduced thanks to in-depth market/industry knowledge.** Guarantee Institutions have **a higher leverage effect** than other schemes

In all the major economies there is a guarantee system, with **great heterogeneity across guarantee schemes**. Access to credit is a "public good" and the **guarantee system is supported in different forms (directly and indirectly) by the public**. Direct guarantees might produce a "Deadweight effect"

SMEs undertake the majority of private economic activity and **contribute significantly to broadening employment opportunities, social inclusion and poverty reduction**. In practice, **the severe and long-lasting impacts of the economic crises determine a financing gap for SMEs**

The guarantee system improves **access to credit for SMEs**, **lowers interest rates** asked by banks and has **positive indirect impacts on key macroeconomic indicators**

Regardless of whether the **guarantees granted** to SMEs are addressed in the medium term they **are expected to be transformed into new investments, with positive effects on GDP and the labour market** (employment and unemployment)

Project Plan and Next steps

Next steps

1 **Dataset completion**

- Completion of the dataset in accordance with the reception of the missing data by AECM's Members

2 **Impact analysis improvement and completion**

- Improvement and conclusion of the First Phase of the Impact analysis

3 **Impact Analysis of the differences between direct guarantee vs EU counter-guarantees**

- In depth review of the literature
- Relevant case studies

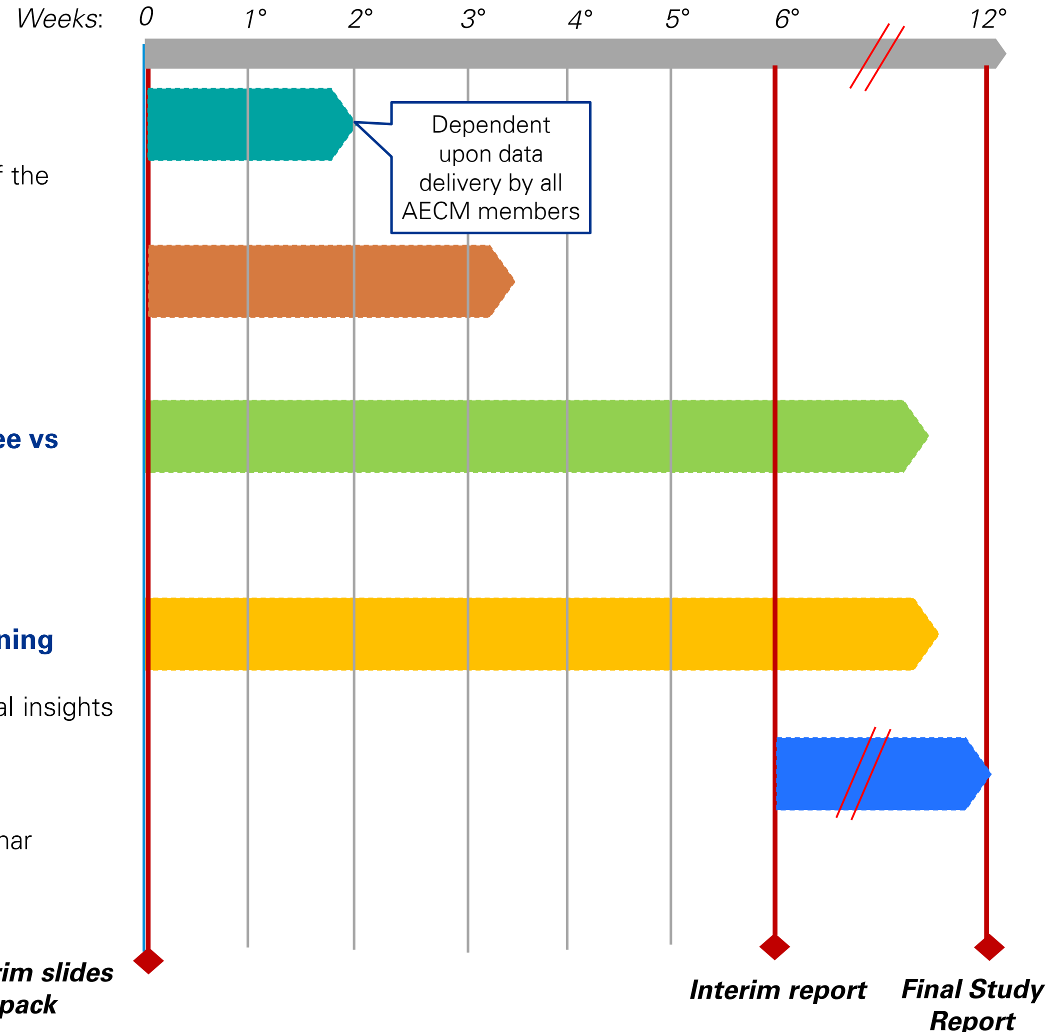
3 **Sharing of the agreed policy recommendations and fine tuning**

- Elaboration of policy oriented keys to critically assess analytical insights

4 **Final write-up of the Final Study Report**

- Preparation of supporting documents for the concluding seminar
- Delivery of the Final Study Report

Project Plan



Project Activities

Deadlines can be negotiated and adapted to reflect AECM needs kpmg.com/socialmedia

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