DIE DEUTSCHEN BÜRGSCHAFTSBANKEN

Inofficial translation of the article of VDB info on the PwC impact study:

Summary of the PWC study on the overall economic benefits and viability of the guarantee banks

(original title: Zusammenfassung der PwC-Studie zum gesamt-wirtschaftlichen Nutzen und zur Zukunftsfähigkeit der Bürgschaftsbanken)

The study was conducted on behalf of the German Federal Ministry for Economic Affairs and Energy (BMWi) by PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft (PwC).

The central task of the 17 regional guarantee banks is to support small and medium-sized enterprises (SMEs) by providing guarantees for subsidiary collateralisation of loans and guarantees for equity-enhancing financing. They are thus an important instrument within Germany's economic development system. The use of guarantee banks to facilitate business growth or start-ups has been repeatedly strengthened in the past against the background of the search for effective economic promotion instruments – here in the form of budget-friendly contingent liabilities. In order to examine the macroeconomic benefits and viability of the guarantee banks a study has been commissioned, the results of which will be summarised below.

In addition to evaluating the application statistics of the guarantee banks, the PwC study comprises three main parts:

- Evaluation of the company survey conducted online,
- Analysis of the economic cost-benefit ratio; and
- future challenges facing the guarantee banks.

I. evaluation of the company survey conducted online

A total of 735 medium-sized enterprises from the current portfolio of the German guarantee banks were surveyed by PwC in an online survey and asked for information on their experience with the guarantee banks. One result of this is that the guarantees provided by the guarantee banks support investment with a regional impact and fulfil the regional promotional objective.

The most common reason for applying for a guarantee is concrete instructions from the bank or fulfilment of security requirements. The optimisation of credit costs plays a minor role here. Rather, it shows that guarantees are suitable for gaining access to bank financing if otherwise insufficient collateral is provided.

According to the companies surveyed, the provision of credit guarantees has produced significantly positive results. 79% of the participating companies stated that their turnover had increased. In addition, 75% of companies were able to see an improvement in their annual results after funding. 77% of farms stated that the number of employees could be increased. A significant positive assessment was also made following the guarantee commitment for the developments in the competitive situation (59%), market shares (47%) and creditworthiness (47%). 62% of the companies surveyed stated that the guarantee was a prerequisite for financing by the house bank and that they would not have received financing without the guarantee – a further 36% would not have received the necessary financing in full or under difficult conditions.

Only 2% of the companies estimate that they would have received financing from the house bank without a guarantee.

- On this basis, it can be concluded that the deadweight effect of guarantees provided by the guarantee banks is rather small. Moreover, guarantees are suitable for realising viable projects that do not dispose of sufficient collateralisation from the bank's point of view and for counteracting market failures in the area of SME finance.
- 78% of the participating companies, which used a guarantee, were satisfied with the support of the guarantee banks. However, the guarantee fee and the collateralisation requirements were considered too high by some respondents and the handling was considered too inflexible on a case-by-case basis.

II. Analysis of economic cost-benefit ratio

In its study, PwC analyses the cost-benefit-relation and reached i.a. the following conclusions:

- The average investment stimulus resulting from EUR 1 of public guarantee is around EUR 2.12. This means that each publicly rewarded euro leads to an additional EUR 2.12 (investment) expenditure.

As a result of the annual new guarantee emission, Germany has an average GDP effect of EUR 2.8 billion per annum. In the period under review (2009-2018), the resulting employment effect is on average more than 40,000 jobs created or secured each year. Annual tax revenue amounts to more than EUR 630 million and social security contributions approximately EUR 460 million. In addition, the state saved almost EUR 80 million of social transfers per annum due to the employment effect.

The public default payments made by the federal and the regional governments amount to around EUR 66 million per annum. If the positive and negative budgetary effects are offset against each other, this results in a monetary net effect of EUR 1.1 billion per annum on average.

The economic benefits for the economy from the activities of the guarantee banks exceed the resulting costs by 17 times, which represents a high cost-benefit ratio of 1:17.

III. Future challenges facing guarantee banks

High margin and competitive pressures force banks to significantly reduce costs, in particular by increasing the efficiency of processes.

Overall, based on the PwC analysis, the guarantee banks in Germany play a crucial role in SME financing. Not only young enterprises in the start-up phase benefit from benefit from the activity of the guarantee sector, but also established enterprises in the context the collateralisation of business transfer finance. Access to the guarantee programme for SMEs benefits from low restrictions and is therefore accessible for a wide range of companies.

One of the main strengths of the guarantee banks' practice is that the applicants' business models are usually assessed individually; this allows guarantee banks to take as many factors as possible into account for their guarantee decisions.

A significant weakness and thus a latent risk to future business development lies in the market access and the high degree of dependence on the house banks.

It appears that collateralisation and documentation requirements of the guarantee banks are sometimes higher than those of the house banks. Furthermore, the additional costs for involving a guarantee in the financing process represent in the current low interest rate environment a disproportionate share of the total credit costs. These factors constitute obstacles to the involvement of the guarantee banks in the financing project by the house bank. There is therefore a risk that the house banks will increasingly rely on the guarantee banks only in the event of poor credit quality and in a more difficult economic environment.

In order to counter this development, changes in market access (strengthening direct distribution) and in the guarantee product should be considered.

Approaches to product change or recommendations for action could include:

- The collateral and documentation requirements should be aligned with the current credit allocation guidelines of the house banks.
- The guarantee fees should be adjusted. This could be achieved by reducing costs through more efficient processes and the use of new technologies, including through a nationwide centralised organisation of certain tasks and functions (instead of a decentralised organisation by the respective regional guarantee banks).
- Decision-making processes in small-scale lending should be more automated or implemented with KPI support.
- KPI-based credit decisions in the segment of smaller loans would also contribute to a more efficient and rapid decision-making process without the prior involvement of the Guarantee Committee.

According to the PwC study, the overall challenge for the guarantee banks is to keep pace with market developments while maintaining important differentiation features. These include in particular the individual and personal risk assessment and advice to final borrowers in the regions.

The study was conducted between 11.07.2019 and 31.01.2020 and was presented due to the coronavirus pandemic in the third quarter of 2021.

Further links:

VDB association report with annual statistics from guarantee banks and guarantee companies: www.vdb-verbandsbericht.de

Overview of local guarantee banks and guarantee companies: www.vdb-info.de/mitglieder

Association of German guarantee banks (VDB): www.vdb-info.de