Proposal for Jobs Summit: A credit guarantee scheme

June 2018

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1 Problem statement

The evidence of a constrained economy has been felt in the manufacturing sector with inadequate rates of investment and several sectors under significant threat. Strengthening and growing the manufacturing sector is an important contribution to job creation both direct and indirect.

The low rates of investment and weakness in the manufacturing sector occurs despite the depreciating currency, efforts by the dti to provide a number of industry incentives, as well as, the industrial finance offering by the IDC and South Africa having a robust banking sector and significant stock market.

While a lot needs to be done and is being done to support and strengthen manufacturing, it is glaring that no significant guarantee scheme has been established for industrial enterprises in South Africa. International experience shows the benefits of such a scheme as both a counter-cyclical measure and as a general measure to support the transformation of industry.

Previous efforts at a credit guarantee scheme in South Africa have been marginal at best and under-utilised by the banking sector. Alternatively they have been focused on supporting existing clients and not offered as a generalised product.

Such a measure if effectively implemented could unlock and crowd in significant private sector investment and flows into the real economy; and would make a contribution to stimulating economic growth and job creation.

2. Jobs impact

Previous TIPS research and economic modelling has shown that a 1% subsidy / support to the manufacturing sector will generate about 3.5% additional employment in manufacturing. From the analysis done through a CGE model that equates to a R18 billion (in 2012 rand) stimulus, which would see almost 60% of that returned directly to the state through increased tax receipts and higher levels of economic activity. In 2018 that stimulus would equate to roughly R25 billion.

A government funded credit guarantee scheme that operates at sufficient scale would support growth in manufacturing and job creation, and should form part of a package of support to stimulate the manufacturing sector.

3. Theory of change

A credit guarantee scheme provides an alternative guarantee to a financial institution for a loan rather than the business providing collateral to support the loan. It allows firms that do not necessarily have collateral or a strong credit record to borrow money from financial institutions.

South Africa through SEFA (Small Enterprise Finance Agency) has a limited credit guarantee fund targeted at small and very small businesses. The IDC provides a credit guarantee to its clients as part of its package of support (where required). Several support institutions (such as USAID) have implemented small scale credit guarantee funds in South Africa over the years.

These funds have either been not been significant or have not 'moved the needle' in improving access to finance.

Based on previous experience and international practice the fund should be:

- Located in the IDC as a credible partner to the banking community
- Well-resourced with at least R4 billion to ensure credibility of the fund
- Priced competitively at 1% (or less) of loan guarantee value to cover operating costs but remain a low cost option
- Targeted at small to medium sized industrial firms in the range of R2million to R200 million turnover
- Use of latest IT systems to ensure smooth flow of documents and approval processes.
- Administratively reduce the processes, with Banks required to undertake the due diligence
- Take first loss on loan defaults
- Used to leverage loans to a multiple of 2.2 i.e. based on a R4 billion fund would total R8.8 billion of increased finance to targeted categories of businesses

4. Existing initiatives/experience

From 1996 until today, the state through Khula Enterprise Finance and later SEFA has administered a Credit Guarantee Fund that guaranteed loans taken by micro to very small businesses from a commercial bank. The range of the guarantee is from R10 000 to R3million. The purpose of the scheme is to share risk with commercial lending institutions that provide funding to SMEs, especially those with limited or no collateral.

The fund has been evaluated several times and at its peak had a moderate impact on small business financing reaching almost 650 guarantees in 2000 (over R600 million) and declining from there. In rand value by 2012 the guarantee fund was down to R22 million. Following the establishment of SEFA, the credit guarantee programme was resuscitated and in 2016/17 was able to issue R120 million in guarantees.

By contrast internationally there has been significant use of credit guarantees as a measure to support small enterprises:

- In India the CGMSE [The Credit Guarantee Fund Scheme for Micro and Small Enterprises] in 2016 / 2017 had issued on average 2 000 guarantee a day for an amount of Rs199.49 billion (valued at R42 billion in August 2017).
- Chile's Fogape guaranteed $1.9bn between 1980 and 2010, which helped firms receive finance totalling $3bn. The fund peaked in 2010 issuing 78 869 guarantees in that year to a total value of Chilean UF41,7 million or $1.7 billion. The number of guarantees has since declined and in 2014 it issued 48 772 guarantees to a value of $876 million or R12billion.
- Malaysia's Credit Guarantee Corporation (CGC)**:** Since its inception in 1972, Malaysia's CGC has implemented 32 different schemes and guaranteed more than 445 000 loans worth approximately $15bn. Between 2000 and 2010 alone the CGC backed RM10bn (R26bn) in loans. The CGC assists SMEs that do not have sufficient collateral and no track record to access a bank loan.
- Equally, developed countries such as the UK and USA have credit guarantee schemes. The United Kingdom has the Capital for Enterprise Limited (CfEL) and United States has the Small Business Administration, which provides loan guarantees amongst other forms of assistance to small businesses.

5. Constituency participation in implementation

The proposal would need to be driven by government and business: government through the allocation of resources to establish and then administer the fund. Business involvement would require the banks to utilise the fund at scale and then small to medium enterprises to be informed about the existence of the fund.

6. Benefits

Group	Job creation	Other benefits	Time frame for success
Small and Medium Business	Yes	Increased rates of investment	2 years
Government		Increased economic activity	2 years
Banks		Increased loans to a new market segment without taking on the risk	Immediate

7. Cost and potential sources of funding

Group	Anticipated costs	Potential sources of funding to implement the project	Time frame for impact
Government	R4 billion initially, and refreshed with new resources periodically	UIF funds; Fiscus	2 years

8. Risks

Risks that could prevent success include:

- Banks do not support the use of the guarantee fund and do not submit applications or do not lower the firm risk profile as a result of receiving the guarantee.
- The processes in implementing the guarantee fund are cumbersome and make it difficult for banks to utilise the fund as it is slow in both approving guarantees and paying out claims due to onerous requirements.
- The fund is not implemented at scale and has no meaningful impact.

9. Risk mitigation

Lessons from other countries can be used effectively in the technology they use to improve information flow, turnaround times and simple application and payment processes.

Banks undertake internal marketing of the product to build familiarity and promote usage.

10. Additional comments

South Africa has experience in running Credit Guarantee Schemes. For many reasons the schemes have not achieved the impact or level of performance of other countries. Consequently it has not resulted in unlocking private sector financing particularly during the downturn when credit markets are constrained.

Drawing on past lessons and international experiences and using well-established DFIs would allow South Africa to rapidly implement a scheme that would serve the country not only during the current period of slow growth but also contribute to a broader transformation agenda and would be in place as a counter-cyclical measure for future downturns.