GUARANTEE SCHEMES AND MSMES' ACCESS TO FINANCE

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INTRODUCTION

Enhancing access to finance for Micro, Small and Medium Enterprises (MSMEs) is high on policy makers' agenda around the world, due to their role in the overall development and inclusive growth of nations. MSMEs are an important sector in the MENA region and have contributed immensely to the region's socio-economic development. As the largest employer in the region, MSMEs play a significant role in reducing unemployment rates and stimulating economic development and innovation. However, their viability and growth can be restricted by lack of access to credit and equity, which results in a less vibrant private sector (Ayadi et al., 2021). In particular, MSMEs in emerging economies identify access to finance as a key barrier to their growth. According to the SME Finance Forum, the MENA region has the highest proportion of MSME finance gap compared to potential demand, measured at 85%. Access to credit for MSMEs is limited by a number of factors, including information asymmetries, as these enterprises are more opaque than large firms, and lack of collateral (Ayadi & Shaban, 2021; Barajas et al., 2020).

One of the key tools used by regulators and policy makers to enhance MSMEs' access to finance is guarantee schemes. These schemes act as mechanisms of risk transfer, under which a guarantor (the guarantee scheme) ensures the lender (financial institutions; mainly banks) against a proportion of the possible losses incurred when extending a loan. This helps banks overcome collateral and information asymmetry constraints. The role of Credit Guarantee Schemes (CGSs) became clear during the COVID-19 crisis, as governments in the region provided financial support to credit guarantee schemes, to channel them to sectors in need (Ayadi & Sha'ban, 2021).

Hence, the development of CGSs in the region can have a clear impact on MSME access to finance. In recent years, CGSs witnessed significant growth, not only in terms of volume but also in product innovations, operations and digitalisation.

This policy paper provides an analysis of the role of CGSs in promoting access to finance for MSMEs and the impact of digital strategies. First, this paper provides an overview of MSME financial inclusion in the region and the challenges faced by these firms in accessing formal banking services. Second, it reviews the design and performance of guarantee schemes operating in Egypt, Tunisia, Lebanon, Jordan, Morocco and Algeria (EMGN members from the Southern Mediterranean). The analysis is based on a comprehensive literature review, desk research, a survey and meetings conducted with guarantee schemes operating in these countries. The paper clarifies the role of guarantee schemes in enhancing access to finance for MSMEs and how digital solutions have the potential to enhance their outreach. Finally, it provides policy recommendations on how to strengthen their role.

1 THE CHALLENGE: OVERVIEW OF MSME FINANCIAL INCLUSION IN THE MENA REGION

MSMEs in the region, as in other regions in the world, provide many benefits to the economy, including generating a majority of new jobs, promoting innovation, diversifying the economic base, in addition to integrating women and young people into the economic development (McConaghy, 2013). Despite these benefits, MSMEs remain significantly underserved by financial institutions in the region. In particular, the percentage of firms with an account or a bank loan in the region is significantly lower than the world average, whilst the percentage of firms that are credit unconstrained is higher, particularly in Jordan and Egypt (Table 1). The percentage of firms with a bank loan or line of credit is significantly low for small and medium enterprises in Egypt, Jordan and Morocco. A high proportion of loans require collateral (the highest numbers are in Tunisia and Egypt) and the value of collateral is also higher than the world average.

Table 1:SME Financial Inclusion in the target countries

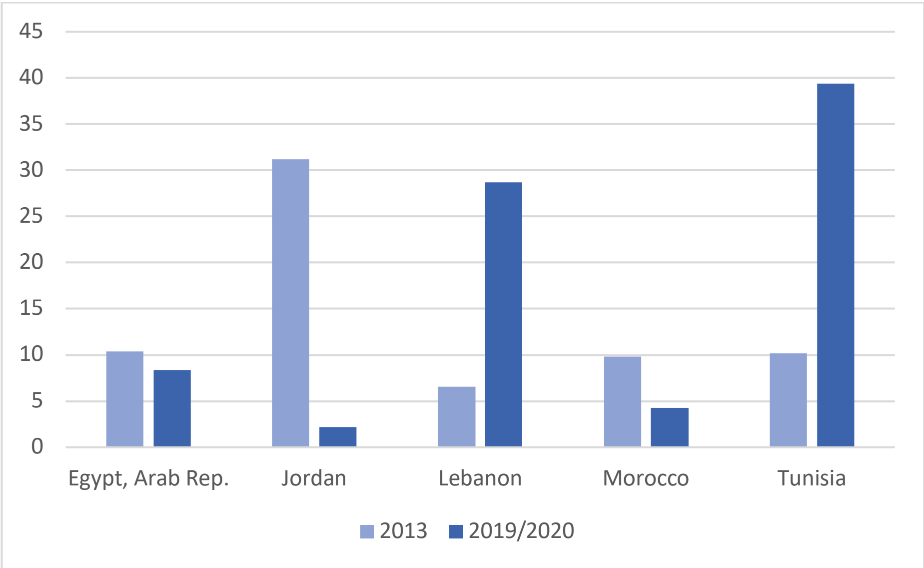
Economy	Subgroup Level	Percent of firms with a checking or savings account	Percent of firms that are credit unconstrained	Percent of firms with a bank loan/line of credit	Proportion of loans requiring collateral (%)	Value of collateral needed for a loan (% of the loan amount)	Percent of firms using banks to finance investments	Proportion of investment financed by banks (%)
All		88.4	70.2	32.8	73.1	189.7	25.6	14.3
MENA		78.2	71.7	24.4	79.6	194.9	23.9	12.1
Egypt (2020)	Small	79.5	73.4	3.6	97.3	228.6	11.8	7.3
	Medium	93.5	78.7	6.8	91.7	168.9	9.2	7.1
Jordan (2019)	Small	69.3	84.4	13.3	89.3	294.5	30.7	6.2
	Medium	93.8	76.8	16	83.4	258.8	46.2	22.1
Lebanon (2019)	Small	91.8	65.8	32	90.2	197.4	27.4	17.4
	Medium	98.6	71.7	52.3	86.9	138.2	48.2	28.3
Morocco (2019)	Small	57.9	51.4	18.6	70.7	47	53.3	11.3
	Medium	65.6	52.9	22.5	68.7	n.a.	26.8	3.2
Tunisia (2020)	Medium	97.4	59.1	54.1	97.2	354.4	57.1	25.8
	Small	97.6	49.9	33.4	95.5	275.7	19	12.9

Note: Small enterprises are enterprises employing 5-19 people and medium enterprises are enterprises employing 20-99 people.
Source: Enterprise Survey

According to the SME Finance Forum (2018), the MSME finance gap to potential demand stands at 94% in Egypt, 74% in Jordan, 39% in Lebanon, 72% in Morocco and 53% in Tunisia. The Financial Access Survey (FAS) also reports that the outstanding SME loans from commercial banks (% of GDP) in 2021 was only 6% in Jordan and Lebanon and 16% & 18% in Morocco and Tunisia, respectively. The large finance gap and low outstanding loans to SMEs in these countries highlight the need for policies and frameworks to support their access to finance.

Countries in the region adopted a number of strategies to address this challenge. For instance, in Egypt, the central bank has set a lending target to MSMEs at 25% of banks' total loan portfolios, in addition to relaxing their credit assessment through the use of alternative (digital) data. The Central Bank of Jordan has also been mobilising funds at competitive interest rates and appropriate maturities to this sector for the last decade. In Morocco, the set-up of credit bureaus, credit scores and the National Electronic registry of moveable assets made it easier for MSMEs to access credit. These efforts resulted in an improvement in access to finance for MSMEs. On the other hand, Tunisian and Lebanese SMEs' access to finance remains insufficient. According to the World Bank's Enterprise Surveys (2020) in Tunisia and Lebanon, SMEs' access to financing seems to have deteriorated over the period 2013-2020 (Figure 1).

Figure 1: Percentage of firms choosing access to finance as their biggest obstacle.



Source: Enterprise Surveys

The challenges of MSMEs being able to access finance include supply-side obstacles, such as capacity and incentives of financial institutions to provide funding, demand side constraints including financial literacy, transparency, formality, technical capacity and collateral availability, in addition to eco-system obstacles, such as the availability of an appropriate support system and credit registries (Abraham & Schmukler, 2017). Entrepreneurs in certain sectors, such as green, blue and the Cultural and Creative Industries (CCI), face significant challenges in accessing finance, despite the key role they play in achieving the sustainable development goals (SDGs) and creating job opportunities (Challita, 2023). In a recent survey addressed to entrepreneurs in these sectors, 75% of respondents state that financial support is crucial for their growth, 73% state that access to finance is a high impact barrier to company development, whilst only 29% receive good support from banks and financial intermediaries.

2 ASSESSMENT: OVERVIEW OF CGSS IN THE REGION

2.1 General Description

Guarantee schemes in the region have been operational for more than two decades, with the main objective of facilitating access to finance for SMEs. Table 1 provides a general description of the main characteristics of CGSs in the Southern Mediterranean countries (that are members of EMGN).

Table 2: General descriptions of CGSs

Guarantee Scheme	Country	Purpose	Inception year	Type of credit guarantee scheme (CGS):	CGS approach:	The main objectives of the CGS:
Credit Guarantee Company (CGC)	Egypt	Profit	1989	Private	Hybrid - combination of portfolio and individual guarantees	Create the needed ecosystem favouring entrepreneurship & facilitating their access to finance through: 1) Apply innovative & dynamic guarantee products 2) Provide capacity building & technical assistance services 3) Function across an advanced platform
SOTUGAR	Tunisia	Non-profit	2003	Public	Hybrid - combination of portfolio and individual guarantees	Facilitate SME's access to financing - Share risk with the lender
Kafalat SAL	Lebanon	Profit	1999	Private	Individual - guarantees extended on a loan-by-loan basis	To assist small and medium sized enterprises (SMEs) in accessing commercial bank funding

Jordan Loan Guarantee Corporation (JLGC)	Jordan	Profit	1994	Mutual	Hybrid - combination of portfolio and individual guarantees	Enhancing the opportunities for MSMEs to obtain appropriate credit Enhancing Jordanian exports by providing insurance for export credit at a sustainable basis
Tamwilcom	Morocco	Non-profit	1949	Public	Hybrid - combination of portfolio and individual guarantees	-
Caisse de Garantie des Crédits d'Investissements PME – CGCI	Algeria	Non-profit	2004	Public	Hybrid - combination of portfolio and individual guarantees	Extend access to finance to SMEs/ improve banks' lending /support productive businesses and economic development

Source: Authors' Survey

CGSs in these countries mainly deal with banks and extend guarantees, either on a loan-by-loan basis or as a portfolio that complies with certain pre-approved criteria. CGC Egypt offers programmes dedicated to micro enterprises and other programmes for small and medium enterprises. The majority of their portfolio is dedicated to industrial, agricultural and commercial sectors. Similarly, Kafalat in Lebanon offers a number of programmes for small and medium enterprises, with a special focus on innovation (startups), farming and energy. However, due to the current economic hardship faced by the country and the decreasing trust in the financial sector, many of these programmes have been suspended (from 2020). In an effort to preserve the private sector and reduce business closures and layoffs after the Port of Beirut explosion of August 4, 2020, Kafalat - with the support of the World Bank - introduced "The Building Beirut Businesses Back and Better Fund (B5) Fund", to support the recovery of MSEs damaged by the explosion and to sustain the operations of eligible Microfinance Institutions (MFIs) in the form of grants. SOTUGAR Tunisia also serves MSMEs and their top three sectors include agriculture & fishing, manufacturing and technology, media & telecommunications. JLGC offers programmes dedicated to SMEs, micro enterprises, housing loan guarantees and Kafala guarantees for Islamic finance. Their top three sectors in terms of outstanding guarantees are manufacturing, wholesale and retail trade, and hotels and restaurants. Similarly, Tamwilcom Morocco offers guarantee programmes including investment and working capital loans and their top three sectors are manufacturing, construction, wholesale and retail trade. CGCI Algeria mainly offer products to SMEs and very small enterprises and have a programme dedicated to agriculture.

All these CGSs support business startups (innovation) and provide special support to projects that contribute to achieving certain development goals or energy efficiency and cleaner production. Currently, only Tamwilcom Morocco have introduced product innovations related to the green goals. However, most CGSs in the region state that one of their main areas of focus in the coming years is green finance. Tamwilcom and JLGC provide higher coverage for projects owned / managed by women.

2.2 The role of CGSs in enhancing access to finance for MSMEs

Credit guarantee schemes have emerged as a key tool, utilised by governments and development institutions to overcome challenges faced by MSMEs in accessing credit. These include: high cost, limited supply, complicated application procedures and collateral requirements. CGSs mainly aim to reduce the credit risk of MSMEs, making their financing more available and affordable (by reducing risk premiums). These CGSs list the following as the benefits of the guarantees: lower collateral needs, bypass lenders' risk aversion, increase loan size, lower financing cost, increase SME lending, provide loans to otherwise non-eligible SMEs, and lengthen maturity.

These schemes state that the estimated percentage of borrowers that would not have been able to receive a loan without a guarantee is not less than 70-90%, demonstrating their role as a risk transfer tool in facilitating SME access to finance. Although all CGSs (except Kafalat) do not set a cap for the collateral required by lenders, having a guarantee helps reduce collateral requirements. Their rejection rates are very low, less than 5%. The reasons these CGSs list for rejecting an application include bad credit history, poor risk scoring and excessive leverage, lack of financial figures, failure to comply with eligibility rules and non-tolerable legal risk.

In addition to collateral requirements, small companies also face the challenge of lack of transparency (which includes reporting financial figures) and understanding the application procedure. CGSs can also overcome these obstacles by offering training, technical assistance, or support activities targeting small companies. Currently, only CGC and JLGC offer such support.

Moreover, CGSs play a key counter-cyclical role in times of crisis, for example, in the COVID-19 pandemic these schemes were essential in implementing government strategies in response to the crisis. Considerable public funds were allocated to these schemes, to ensure continuity of finance for MSMEs and to stimulate economic recovery. CGSs in the region adopted a number of measures to enhance their role in the pandemic, including introducing special programmes with relaxed conditions, lowering their fees, increasing their coverage rate and accelerating their procedures.

These efforts and the subsequent enhanced strategies resulted in a significant growth in the CGSs' portfolios in the region. Figure 2 shows that there was an increase in the number of guarantees per million people for all countries (except Lebanon) from 2016 to 2021. However, it is also important to analyse the structure of their portfolios, in terms of the proportion by size of firm. For example, SOTUGAR Tunisia has the highest number of guarantees per million people, however, looking at the distribution by size of firm, more than 99% of their portfolio is directed to micro enterprises. Similarly, about 71% of Tamwilcom's number of guarantees in 2021 was provided for micro enterprises. CGC Egypt has grown significantly over the years. Despite the fact that CGC is providing guarantees to all sizes of firm, the majority are directed to small companies. JLGC Jordan also tripled their portfolio, mainly focusing on medium enterprises. On the other hand, the number of Kafalat Lebanon guarantees has deteriorated over the past decade, due to the economic situation. In terms of volume (Figure 4), the outstanding guarantee portfolio for CGC, JLGC and Tamwilcom increased significantly from 2019 to 2021. The reasons for the CGSs' positive growth are mainly due to market demand, government policies, especially after COVID-19, in response to curbing the impact of the shock on the economy, in addition to internal changes.

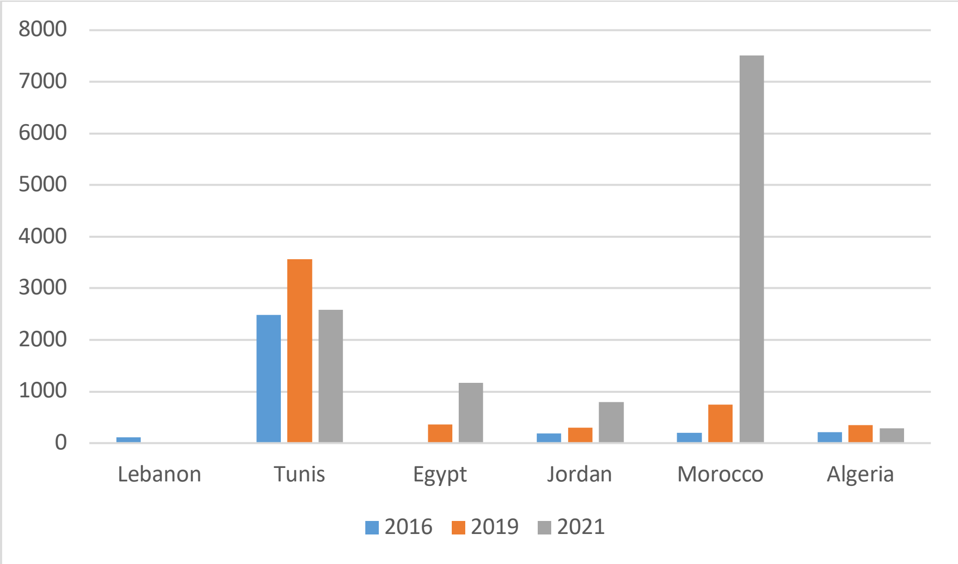


Figure 2: number of guarantees per million people - EMGN survey

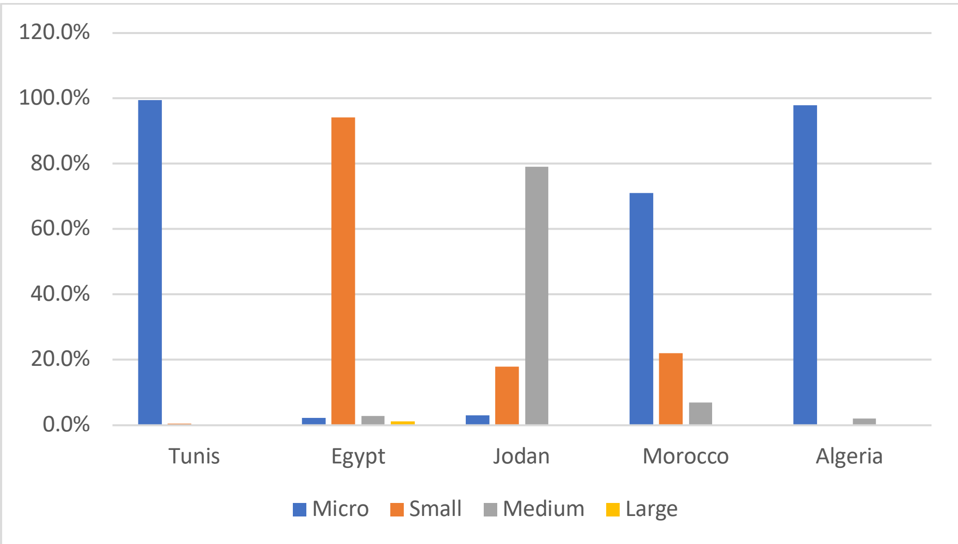


Figure 3: percentage of % of total guarantees by type of enterprise (2021) - EMGN survey

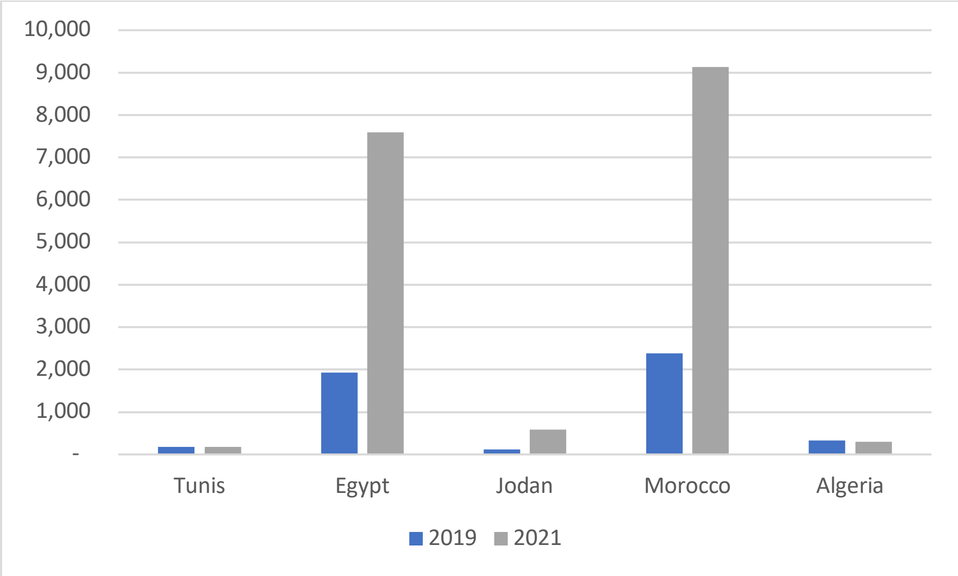


Figure 4: Outstanding guarantee portfolio (2019/2021) Million USD - EMGN survey

Interestingly, CGSs in the region seem to be outperforming the banking sectors in their countries, in terms of asset quality. For example, on average, the non-performing loans ratio (NPLs) and the net losses ratio (measured as outstanding claims to outstanding guarantees) of Algeria, Egypt, Jordan, Morocco and Egypt are lower than banks' non-performing loans (Figure 5). In terms of profitability, the return on assets of CGSs in Egypt and Tunisia is higher than the banking system average (Figure 6).

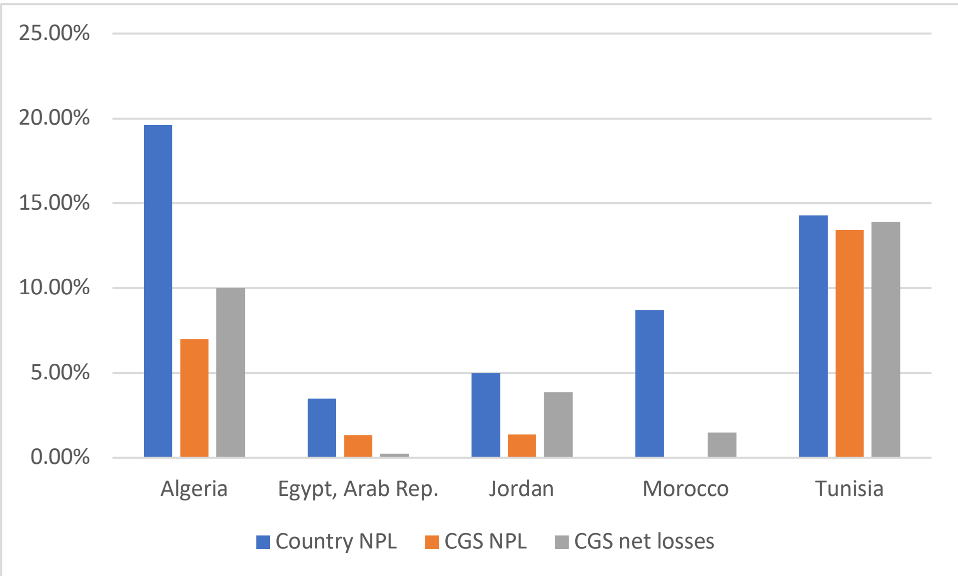


Figure 5: Comparison between selected countries' banking system NPLs and CGSS' NPLs & Net losses% (2021) - EMGN survey / CEIC Data

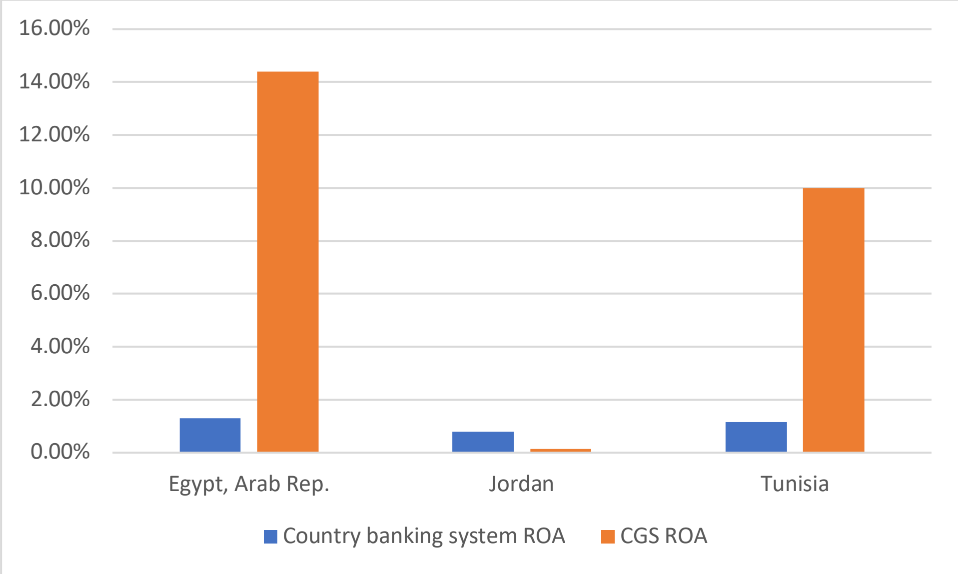


Figure 6: Comparison between selected countries' banking system ROA and CGSS' ROA% (2021) - EMGN survey /Global Financial Development Database

However, the CGSs state that there are a number of constraints to their development. In Lebanon, the economic conditions are complex and the banking sector has collapsed, turning the country into a cash-based economy. This, in turn, has suspended Kafalat operations - except for grants from multinational institutions. In other member countries, the CGSs state that they face challenges related to low quality of loan applications and risk aversion or lack of interest from lending institutions. Additionally, the region suffers from a lack of awareness about the existence of credit guarantee schemes and how they operate, which combined with the banks' risk aversion, can be a significant obstacle to their growth and achieving their ultimate goal of enhancing access to finance for MSMEs, empowering and enabling them to create new jobs.

2.3 CGSs and digital solutions

The trend of implementing digital transformation strategies in the financial system including banks, guarantee schemes and other types of financial institutions, has implications on their business models and outreach. Feyen et al. (2021) show that digital innovation has brought major benefits in connectivity of systems, cost and newly created usable data. Digital solutions have the potential to enhance CGS visibility, productivity and efficiency, which would ultimately enhance financial inclusion of MSMEs. Additionally, direct digital products can be more accessible for SMEs[1]. As for awareness

[1] Direct digital products are provided by guarantee institutions in Europe, for example, the French guarantee https://www.socama.com/.

issues, digital media can be adopted to promote the products and services provided by CGSs amongst financial institutions, MSMEs and industry associations. Moreover, digitalisation can help CGSs in impact evaluation, product development, and training, capacitation and better communication.

Currently, all CGSs in the region have a digitalisation strategy. CGC Egypt started implementing its "Digital Transformation Strategy" in December 2021, with the main objectives of creating a digital-based business model, increasing the scalability of CGC platforms & marketplace, the application of data driven new products and providing a nationwide SME data provider, in order to enhance access to finance for SMEs. CGC introduced a new direct product, called "Engz", with a fully-fledged digital base and direct MSME outreach. Currently, in the guarantee processes whether individual or hybrid, there is reliance on manual communication, involving bank officers sending emails to CGC for inquiries or case submissions. However, the scheme is in the process of developing a digital portal, which can empower bank officers to seamlessly submit cases, streamlining the process. This would eventually expand their market presence and foster growth.

Kafalat Lebanon is more focused on digitising their business process management, in order to optimise process and procedure flows, reducing response time and increasing revenues. SOTUGAR Tunisia is also implementing digital methods aiming at: process acceleration, lowering paper use and reduction of treatment costs. The scheme is currently looking into digitising their analytical modelling, in order to better manage credit risk measures and align with regulations. CGCI Algeria aims to automate the guarantee process, implement an online guarantee subscription portal and implement an electronic document management system. Tamwilcom Morocco's main objective is to become a fully digital CGS by 2025. All their small credit operations are already handled using an IT system and a delegation approach. Lastly, JLGC Jordan list the following objectives in their digital transformation strategy: raising the efficiency of internal work procedures, developing internal control systems and increasing their efficiency, developing the level of protection and data preservation, preparing periodic reports for the various administrative goals and levels, and achieving full linkage with the company's main partners, whether financing agencies or exporters.

However, CGSs as with other financial institutions, face a number of challenges in their digital transformation, including managing their security and privacy risks, complexity of integration of legacy systems and new technology, lack of qualified personnel to manage the transformation and the increased costs for equipment and services.

3 SUMMARY AND KEY RECOMMENDATIONS

CGS has been a key policy intervention tool in facilitating access to finance for SMEs, by sharing the risks associated with their lending and, in a way, providing substitute collateral. Hence, steadily improving the infrastructure for such tools and supporting their growth can contribute significantly to the financial inclusion of SMEs and, ultimately, to economic growth and job creation.

Utilising these tools can be limited by a number of factors, including lack of awareness amongst entrepreneurs and SMEs, lack of interest from financial institutions (mainly banks combined with risk aversion), in addition to limited products and services.

Based on the analysis provided in this policy paper, the following recommendations can be made:

i. Direct digital products

Currently CGSs in in the region do not have a direct link with potential borrowers. i.e., MSMEs and entrepreneurs and they deal mainly with financial institutions (mostly banks). However, financial institutions may lack interest in using credit guarantee schemes, which may be related to risk aversion on their part, excessive administrative requirements, or unclear definitions of eligible clients. Direct products have the potential to solve this challenge, where the client applies to the CGS through a digital platform, the scheme studies and prepares a file for qualified and eligible borrowers to obtain bank loans and then, upon bank approval, the applicant is granted a loan with a guarantee. Such products have the potential to increase the outreach of guarantee schemes, with the ability to apply online - regardless of physical location - and to help overcome the issue of banks' lack of interest.

ii. Utilising digital technologies

Utilising digital solutions can increase CGSs' revenues, as automated procedures help them serve more beneficiaries and applicants with the same number of human resources, increasing their productivity by analysis and reducing their cost by operation, which can result in more attractive pricing for the beneficiary. Digital solutions can also help CGSs build credit risk scoring models, enhance the quality of data and minimise operational risk by reducing errors. In addition, this can ease and accelerate the procedure of issuing guarantees.

iii. ***Scheme awareness programmes***

A stronger awareness of credit guarantee schemes by different stakeholders, including regulators, financial institutions, MSMEs and industry associations, is crucial for achieving their development goals. Our research shows that the knowledge of MSMEs and entrepreneurs about the existence and operations of such schemes is rather limited. Hence, adopting a multi-channel approach for creating awareness about guarantee schemes amongst stakeholders - mainly MSMEs - is key to increasing their outreach. This can be done through electronic media, in particular social media advertising, which can increase their visibility amongst younger generations, conducting workshops and seminars, and approaching business incubators.

iv. ***New products with specific development focus***

In order for CGSs to achieve their development goals, they need to be innovative and inclusive in their products and services. CGSs in Egypt, Tunisia and Lebanon do not currently have special products dedicated to green, blue and CCI sectors, which are considered key sectors for accelerating the green transition. Given the current challenges facing these countries, in terms of climate change, resource depletion, pollution and overexploitation of marine resources, supporting green and blue sectors is of utmost importance (Ayadi & Forouheshfar, 2023). CCI is also considered a high potential strategic sector that can boost creativity, innovation and social development (Challita, 2023). However, access to finance is a major challenge for these sectors that can play a significant role in achieving sustainable development goals and job creation. Additionally, currently only Tamwilcom and JLGC offer eased conditions for women-led MSMEs. Women-led MSMEs make significant contributions to the economies they operate in and are key engines of growth, development and job creation. However, women face greater challenges than men in accessing finance, due to discriminating legal environments, social and cultural norms, economic and capacity building opportunities, amongst others.

Hence, CGSs can introduce special products to target these sectors with favourable conditions, including higher coverage, lower fees and accelerated procedures.

v. ***Capacity building***

From the demand side, MSMEs face a number of obstacles to accessing finance, including lack of transparency, unclear financial projection and lack of skills, which can lead to the rejection of their loan or guarantee application. CGSs can engage in advisory, training, technical assistance or other support activities targeting smaller companies. This can be done in partnership with SME support organisations aimed at strengthening, for example, their accounting, management and marketing skills, so that they can be better positioned to successfully apply for a guarantee or a loan.

vi. Introduction of a targeted counter guarantee scheme

Counter guarantees are a form of reinsurance or a risk management tool, in which the guarantor provides protection to CGSs against the losses incurred from extending guarantees to lenders. This risk mitigation tool can foster the credibility and outreach of CGSs, providing them with a leveraging effect, which allows further extending of guarantees. Southern Mediterranean countries have not yet established such schemes. Hence, it is recommended to consider the setting up of a regional counter guarantee scheme, with a dedicated and focused sustainable development mandate, to create a meaningful economic impact and enhance access to finance for sustainable MSMEs.

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The **Euro-Mediterranean Guarantee Network (EMGN**) seeks to alleviate the region's structural constraints for MSMEs to access to finance by gathering guarantee schemes active in the countries of the Euro-Mediterranean. EMGN is promoted by the Euro-Mediterranean Economists Association – EMEA, the European Institute of the Mediterranean (IEMed) and the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH.

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