

How to Provide Solutions for Innovative and Creative Start- Ups in Uncertain Times

How Can Guarantee Schemes
Help with the Solutions

Robert John LEIGH

Historically

- The first Guarantee Funds in Europe were created as long ago as 1848
- In the 1990s, interest in credit guarantee funds was strong. In particular many guarantee funds were created in the transitional economies of Eastern Europe and the former Soviet Union. Many of these have been quite successful.
- The failure of some guarantee funds during that time however meant that they became less popular with donors but in troubled times such as now they seem to be having a revival.

The role of guarantee funds

- A Credit Guarantee is a Financial product that a small entrepreneur can buy as a partial substitute for collateral. It is a promise by the Guarantor to pay all or part of the loan if the borrower defaults.
- The main target group for guarantee funds are small and micro entrepreneurs who have the capacity to repay but cannot obtain conventional banking finance due to insufficient collateral

Typical Mission Statements for Guarantee Funds

- Will act as a catalyst for growth aimed at improving the private business sectors ability to access finance, and to realise the potential benefits of bringing both the private business and financial sectors closer together by:
 - 1 Improving access to finance for viable businesses that are unable to provide adequate collateral.
 - 2 Sharing the risk associated with individual business credit exposures, with the financial institutions.

The Loan Guarantees are normally provided following a joint due diligence procedure with the client banks for each business case.

The shared collateral guarantee would be controlled and managed in accordance with strict legal agreements, policies and procedures implemented to international standards.

2 Main Types of Guarantee Funds

- Individual Guarantee Scheme: Each and every applicant is individually screened by the Guarantor.
- Portfolio Guarantee Schemes: The Guarantor simply gives the Bank permission to attach a Guarantee to any applicant that fulfils certain eligibility criteria.
- Both Schemes are in common use.

Advantages and Disadvantages

- Individual Model Advantages:
Completes control of Appraisal Process.
Better information for Monitoring purposes
- Portfolio Model Advantages:
Lower operational costs
Fast

Preferences

- My personal preference in these difficult times would be for an Individual Scheme:
- As a lending banker I would have the comfort of a second professional screening.
- As a Guarantor I would have the comfort of my team assessing the project.
- As an applicant I would have the comfort of 2 professional assessments and advice.

Uncertain Times

- SME Guarantee Schemes are ideally placed to help fight the impact of the current crisis on SME Finance.
- They are natural intermediaries between Banks, SME customers & bring added value to all parties.

Added Value

- They encourage banks to maintain their credit business by sharing in the bank's risk sometimes up to 80%.
- Due to the presence of a Guarantee banks can issue a greater volume of credit given because of the improved regulatory capital ratio.
- Provide comfort of additional professional screening.

Part of the Solution

- From what we have seen Guarantee Funds can be part of the solution for Innovative and Creative start-ups in uncertain times.
- However they must be part of a full financial infrastructure package especially in Developing countries: Greater Administrative Simplification, Quality Business planning, proper financial statements, marketing information, transparency etc

Contribution

- Their contribution to SME's Access to finance cannot be denied:
- Contribution in terms of: risk sharing, risk assessment, monitoring and mitigation are invaluable to the prime lenders and therefore the SMEs.

Not the total Solution

- Experience has shown that guarantee funds are *not* tools to solve the problems of weak entrepreneurship or poorly performing banks. As a rule of thumb,
- guarantee schemes are only likely to be successful when the four Ps are all present: well-**p**repared entrepreneurs
- who present good **p**rojects to good
- **p**erforming banks that have
- **p**rofessional staff to carry out an evaluation and come to the conclusion that the borrower cannot present sufficient collateral

No Secret

- There is no secret to lending: whatever the Fund is called: Seed Capital, Equity, Venture Capital, Revolving Credit, Guarantee etc they are all subject to the basic canons of lending:
- Training of Bank Staff, Guarantee fund staff etc

Training

The following is typical of the sort of training needed by lending staff:

- Project assessment and analysis
- People Assessment
- Modern Cash-flow analysis techniques
- Ratio Analysis
- Problem Identification and remedial management
- Project monitoring
- Relationship management
- Analysis of financial statements, balance sheet, profit & loss etc and their relations to cash-flow forecasts.
- Cash and working capital.
- CAMPARI:
 - .CHARACTER – The Person Involved?
 - .ABILITY – Can they achieve what is promised?
 - .MARGIN – Is the return reasonable for the risk?
 - .PURPOSE – What is the money needed for?
 - .AMOUNT – How much is needed? Too little is as dangerous as too much!
 - .REPAYMENT – How and when will we get our money back?
 - .INSURANCE – What happens if the plans don't work out?
- From these basic canons of lending they will realise there are further questions and they will also need to realise that they must first: Gain a first class understanding of the customers business and what he actually does. If you don't understand the business don't lend.

Listening – A Lost Art

- The final jigsaw in the lending puzzle especially within Innovative and creative projects is the ability for lending staff to listen!

The entrepreneur should know much more than the lender about his business. Listen & learn and use your financial and business experience to help & support his project.