

CREDIT GUARANTEE SCHEMES: FACILITATING MSME FINANCING IN AFRICA DURING THE COVID-19 PANDEMIC



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EXECUTIVE SUMMARY

Unlike in other regions where credit guarantee schemes (CGSs) were one of the most favored initiatives to alleviate financing constraints faced by small businesses during the COVID-19 pandemic, only a small fraction of countries in Sub-Saharan Africa (SSA) adopted CGSs as a response strategy.

In this regard, using a combination of desk research, country case studies and surveys with experts from AFI member institutions in SSA, the following compilation of case studies investigates the role of CGSs to improve MSME financing during the COVID-19 pandemic. The objective is to extract lessons learned for other AFI network members and inform relevant crisis responses that can be considered in the future.

1. RATIONALE AND BENEFITS OF THE PUBLIC CREDIT GUARANTEE SCHEMES (PCGS)



CGSs are an important form of government policy response. They act as guarantors and share potential credit risks to incentivize lending institutions to address financing challenges faced by micro, small

and medium enterprises (MSMEs) during the COVID-19 crisis. In addition to safeguarding business' survival, such schemes can help MSMEs build credit reputation and creditworthiness over time, create market opportunities for financial service providers to serve underserved segments of the population and leverage private capital from banks to stimulate capital flows into the economy. This may result in a ripple effect where MSMEs can grow and expand operations, create more jobs and contribute to national development.

2. POSITIVE LESSONS FROM CGS INITIATIVES IN SSA COUNTRIES

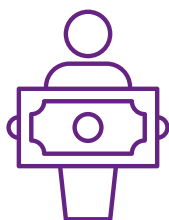


Having a CGS in place as a long-term development plan can enhance flexibility and adaptation to crises. Sample countries with existing CGS, like Lesotho and Côte d'Ivoire, appear to have responded faster during COVID-19 in making necessary adjustments to suit beneficiaries. Moreover, CGS can be a tool to reach excluded groups. For example, Kenya stipulated that a substantial proportion of the CGS funds target women, youth and people with disabilities. These segments of the population tend to be disproportionately affected during crises. Finally, CGSs with more active multi-stakeholder collaboration can improve transparency and performance monitoring, as in South Africa.

The key findings and implications can be summarized as follows:

1

Rationale and benefits of the Public Credit Guarantee Schemes (PCGS)



2

Positive lessons from CGS initiatives in SSA countries



3

Observed shortcomings of CGS initiatives in SSA countries



4

Opportunities for strengthening CGSs



3. OBSERVED SHORTCOMINGS OF CGS INITIATIVES IN SSA COUNTRIES



The impact and reach of reviewed CGS were relatively low because MSMEs scarcely benefitted from the public CGSs during COVID-19. Some identified reasons for the low uptake include:

- > inadequate ancillary support for MSMEs to improve the chances of approval, such as free training on filling out guarantee applications and presenting standardized supporting documents
- > delay in roll out of schemes because, although intended for mitigation purposes, most CGS only began operations after the peak of the COVID-19 crisis
- > insufficient public sensitization and limited bank distribution network for accessing loans covered by the CGS
- > bureaucratic processes and lack of transparency, among others

4. OPPORTUNITIES FOR STRENGTHENING CGSs



To maximize the potential of CGS as a policy tool to improve MSME financial resilience and crisis response management, it is advised to:

- > provide complementary support services to MSMEs to improve their capability to apply for the CGS, garner

more confidence to apply and gain better chances at application approval, especially for those involved in informal activities

- > increase public awareness and knowledge of the CGS procedures and benefits, including relaxed measures introduced in a crisis setting to enable participation of a wide range of lending institutions and intended beneficiaries/borrowers
- > seek extensive opportunities to collaborate with organizations that have grassroots links (cooperatives or mutual guarantee associations) to expand the CGS distribution network to reach the most affected or distressed MSMEs. FinTechs should also be given the opportunity to participate as lenders, especially because they have very agile loan evaluation models
- > concurrently pursue national initiatives to strengthen the enabling credit infrastructure (credit rating databases and collateral registries) to improve efficiency and transparency in evaluating loan applications backed by the CGS
- > set up a dedicated specialized entity with a defined mandate to administer the country's CGS and commit to reducing administrative bottlenecks, support the timely roll-out of CGS-related interventions, simplify the application process and monitor the overall progress and sustainability of the CGS goals.



Female chef preparing food, Lesotho. (Ariadne Van Zandbergen/Alamy Stock Photo)

1: INTRODUCTION

BACKGROUND AND OBJECTIVES

Globally, there is evidence that MSMEs play an important role in national economic development. This is particularly the case in emerging economies in Africa, where most MSMEs operate at a micro-level and account for the bulk of the private-sector output and total available jobs.

Nevertheless, MSMEs operating in Africa face ubiquitous survival and growth challenges due to funding constraints, making them highly vulnerable to sudden economic shocks, such as the one created by the COVID-19 pandemic.



The financing gap for MSMEs with high growth potential is of particular concern because it represents a critical lost opportunity for developing economies.

While the impact of the global economic contraction caused by the COVID-19 pandemic has affected all businesses, MSMEs face even stiffer uncertainties and risks in terms of losing their means of livelihood. Bearing in mind that most MSMEs in Africa engage in informal activities (AFI, 2021a) which, are predominantly conducted in-person and on-site, MSME revenues and business activities dipped significantly due to lockdowns imposed as a prevention measure (IFC, 2021). As such, SSA MSMEs have faced pressing funding constraints to finance working capital and investment to help them adapt to the new business environment. Policymakers worldwide put in place a wide range of measures to enable the flow of credit to businesses, including MSMEs, to contain the fallout (AFI, 2021b).

While some measures were introduced to strengthen banks' lending capacity by preserving their capital, encouraging flexibility in loan restructuring or even direct public sector grants and lending to households and businesses, others were aimed at incentivizing financial institutions to use their available capacity to provide capital flows into the private sector, while simultaneously encouraging MSMEs in affected sectors to access loans to sustain operations.

Bank loans, although grossly insufficient, are still a common source of external finance for MSMEs. However, MSMEs are typically considered high-risk customers. Due to a lack of track record of creditworthiness or reliable information on past performance and growth prospects, banks tend to demand excessive collateral from MSMEs and charge higher interest rates to cover potential losses in the event of default on loan.



Since MSMEs rarely have sufficient collateral to meet such requirements, especially start-ups or those owned by marginalized groups, they are left with uneven opportunities to access business finance.

This prevails during unexpected events as severe as the current pandemic. Further, given the heightened uncertainty during the period, banks predictably become extremely risk-averse. To curb the risk of excess credit rationing, support banks to accommodate the surge in loan demand and support MSMEs from going out of business, many governments implemented CGS to provide public-backed guarantees for bank loans (Ayadi & Shaban, 2021).

The CGS transfer some credit risk and potential credit losses from banks to the governments, thereby mitigating the costs and exposure for banks. Well-designed CGSs are also considered less market distortionary than other interventions, such as interest rate subsidies and targeted credit lines.

The following compilation of case studies conducted in the SSA investigates CGS-related key initiatives launched by financial sector regulators and policymakers in SSA and their role in providing liquidity and mitigating the impact of COVID-19 on MSMEs. The objective is to extract lessons for other AFI network members and inform the crisis response that can be considered in the future. The report is primarily based on a combination of desk research on open source country-specific COVID-19 economic response policy documents. It is supplemented by a survey conducted with key AFI member institutions from SSA. The purpose of the survey was to delve deeper into the practical aspects of CGS policies in mitigating the impact of COVID-19.



The Policy catalogue of MSME
financing in Africa

[> View Catalogue](#)

A review of the **Policy catalogue of MSME financing in Africa** revealed that, whereas credit guarantees were relatively popular in North African countries, the rollout of CGSs was limited in the rest of the African continent. This report focuses on four countries (Kenya, Côte d'Ivoire, Lesotho and South Africa).

It is complemented by experiences from the broader SSA region provided to inform the analysis. In addition, the authors compiled an [Excel database](#) on identified CGS-related interventions in SSA, which should be read alongside the case studies presented in the report. Finally, the report analyses the strengths, shortcomings and opportunities to improve existing CGSs in the SSA.

It proposes a range of policy considerations in designing and implementing CGSs in the African context, especially from a crisis response perspective.

2: UNDERSTANDING HOW CGSs WORK

2.1 DESCRIPTION

CGSs were considered an important policy tool of government response to incentivize banks to accommodate funding challenges faced by MSMEs during the COVID-19 crisis.

Additional instruments are often required to address MSMEs' perceived high-risk classification by financial institutions to enable adequate credit supply to these businesses. This is where CGS can play an important role. They are a form of risk-sharing mechanism where a third-party acts as a guarantor to provide partial or full credit risk cover to lenders enabling them to extend loans to customers who may not have sufficient bank worthy collateral (OECD, 2018). This arrangement involves the third-party guarantor providing risk mitigation services, usually at a fee, with pre-defined conditions as to how much will be covered in case of default, under what circumstances the cover will be provided and a description of the responsibilities of all contracting parties.



Scoping and assessment report on MSME access to the finance ecosystem in Africa made by AFI found that financial institutions identify CGSs as an important mechanism to mitigate some risks they face when lending to MSMEs (AFI, 2020a).

Rather than providing capital to MSMEs directly, the CGS guarantee contracts are such that development actors and/or the public sector commits to taking up part responsibility for potential future liabilities or losses that would have been borne by commercial lenders in case of default otherwise.

RATIONALE FOR STATE INTERVENTION

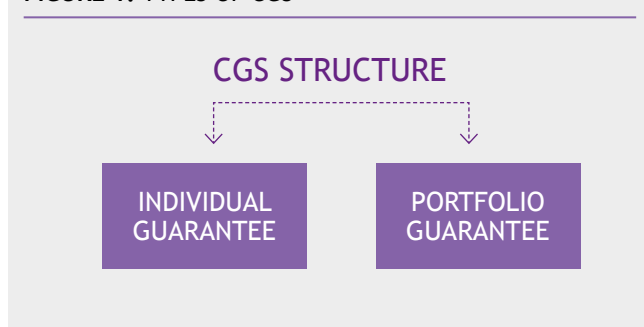
State intervention is often required to establish a CGS and ensure that it is adequately capitalized to meet its commitments. However, this does not preclude co-investment or co-ownership by other interested stakeholder groups, such as development finance institutions and the private sector. PCGSs present an essential component of the credit infrastructure to overcome market failures deficiencies in the financial

ecosystem. Some deficiencies include the lack of effective credit information sharing mechanisms between financial institutions, weak enforcement of creditor rights and inappropriate collateral regimes in SSA. All these may exacerbate MSMEs difficulties in MSMEs ability to access finance (AFI, 2020a). As a risk mitigation tool, CGSs could be structured to reduce the probability of default and increase the recovery rate, should a default occur.

STRUCTURE

PCGS may be structured in different ways (Chatzouz, Gereben, Lang, & Torfs, 2017). Figure 1 shows two common structures.

FIGURE 1: TYPES OF CGS



For individual guarantees, the guarantee facility is offered directly to MSMEs and can be presented as collateral to lenders. This may entail the PCGS assessing and deciding on guarantee applications on a case-by-case basis. For portfolio guarantees, the guarantee is provided to lenders to serve as collateral for their portfolio of qualifying MSME loans. Here, MSMEs' guarantee applications are often routed through the lender. To fund PGCS, resources usually take the form of periodic budgetary appropriation. However, funding can come from international development partners, the private sector and/or a combination of all.

ADMINISTRATION

There are two common approaches to administer PCGSs (Pombo, Molina, & Ramírez, 2020):

- > a specialized organization with a separate legal entity observed in Angola, Cote d'Ivoire and Mali. Such entities administer/operate the CGS and usually assume the risk of coverage on their equity capital and
- > CGS Fund managed by a unit of an existing organization/agency with a multi-purpose set-up, engaged in other activities. These operators merely act as fund administrators and do not assume risk on their equity, such as in Eswatini, Kenya, Lesotho, Namibia and South Africa.

2.2 POLICY STRENGTHS/BENEFITS OF CGS

CGSs have been used extensively for many decades, in different country contexts and with varying measures of success.

Some studies by various bodies, including the International Finance Corporation, Organisation for Economic Co-operation and Development, African Development Bank and European Investment Fund, indicate the potential positive influence of well-designed CGSs on MSME financing. There is a number of potential gains associated with PCGSs from an economic policy perspective:

- > **Fewer market distortions:** PCGSs generate fewer market distortions than other policy interventions, such as direct lending programs or state-owned banks (Saadani, Arvai, & Rocha, 2011). This is because they often entail less interference in credit allocation and use commercial banks as the main vehicle for loan origination;
- > **Encourages financial inclusion of MSMEs and market opportunities for service providers:** Guarantee facilities can unlock access to finance at scale for excluded MSMEs that lack sufficient collateral but are otherwise creditworthy by lowering or diversifying the risks faced by formal financial institutions serving this group and fostering competition among financial service providers. This can encourage financial institutions to extend services to hitherto untapped markets where such groups access external funds due to reduced collateral requirements;

In some countries, MSMEs would ordinarily need to provide collateral as high as double the loan value. By extending more loans to smaller businesses, lending institutions gain experience managing these types of loans, encouraging further development in this market segment. While gaining experience with small firm lending, banks can then develop ways to reduce transaction costs to make the provision of credit to small firms more profitable. MSMEs can also build their creditworthiness based on repayment reputation;

- > **Unlocking private capital to optimize scarce public resources:** Since the loan financing and disbursement are usually the responsibility of commercial banks under PCGSs, these interventions have much lower initial cash flow obligations from the state. Thus, they are useful where there are fiscal constraints or contest immediate needs for scarce government resources, as in the case of the pandemic;

> **Overcoming market deficiencies caused by information asymmetry and adverse selection:**

MSMEs often struggle to provide adequate information on their creditworthiness. This creates uncertainty in gauging the project's expected rates of return and borrower integrity. Gathering such information on MSMEs can be challenging and costly, especially when the volume/value of the transaction is small. As a result, financial institutions can resort to suboptimal credit allocation because they become rigid and inclined to maintain the existing or more familiar borrower pool, thereby excluding possible safer borrowers. Providing technical assistance to banks to aid more accurate evaluation of lending risks, CGSs can improve banks' ability to make appropriate lending decisions. Providing ancillary support services to MSMEs and training entrepreneurs, CGSs can assist in bridging the information gap and reduce these deficiencies;

- > **Credit and economic additionality:** Although not easy to measure and separate from broader concurrent development initiatives strictly due to beneficiaries taking advantage of CGS, CGS can influence increments in total volume and value of credit flow from banks to credible MSMEs. The spillover effect or outcomes can improve MSME resilience, income and quality of life of the borrowers' households, increased economic activity in terms of sales, employment or product development or efficiency and contribution to economic growth.

2.3 SHORTCOMINGS OF CGSs

The extent to which the implementation of CGS actually translates into the highlighted benefits is debatable. While studies suggest practical cases of such benefits, empirical evidence on the exact nature and magnitude of CGSs impact is inconclusive. There are arguments that CGSs do not attack key underlying access barriers (Asian Development Bank, 2016). Barriers, such as financial product mismatch for MSMEs or low bank penetration in remote areas, remain unresolved by just having a CGS in place.

CGSs have been known to record sub-optimal default rates and recoveries. This is why a number of CGS were discontinued or became inactive (Hansen, et al., 2012). There is a risk that CGSs may increase the moral hazard of both borrowers and lenders (Green, 2003). Borrowers may feel less obligated to repay guaranteed loans. On the other hand, banks might be laxer in their risk assessment screening or customer monitoring functions due to reducing overall risk provided under a CGS.

Other criticisms include the design complexities, increased administrative cost, and encouraging MSMEs dependence on bank loans, which might be counterproductive in diversifying their finance sources. Therefore, understanding the challenges and associated cost is helpful for countries when they decide on the right structure for any CGS initiative.

FIGURE 2: SUMMARY OF POTENTIAL GAINS FROM PCGS

INPUT	OUTPUT	INTERMEDIATE OUTCOME	DESIRED OUTCOME	IMPACT
Implement CGS and related activities.	<ul style="list-style-type: none"> > Financial institutions are provided with a risk sharing mechanism. > MSMEs receive CGS support. 	<ul style="list-style-type: none"> > Increased lending to creditworthy but excluded MSMEs. > Financial institutions extend range of services to underserved MSMEs and new markets. 	<ul style="list-style-type: none"> > MSMEs scale up and grow. > Improved MSME resilience. > MSMEs build credit reputation 	<ul style="list-style-type: none"> > Improved productivity and economic output. > Multiplier effect e.g. job creation and contribution to national growth. > Enhanced wellbeing leading to reduced vulnerability, reduction in poverty rate, etc.

Source: Elaboration of The real effects of EU loan guarantee schemes for SMEs: a pan European assessment.

3: KEY FINDINGS

3.1 LEVEL OF UPTAKE OF CGSs IN SSA DURING AND POST COVID-19 PANDEMIC

A review of policy responses in AFI member countries indicates that the use of CGSs was a relatively less popular COVID-19 economic response strategy in SSA than in other regions.

55%

According to the International Monetary Fund's policy tracker, about 50 percent of 131 countries adopted a CGS initiative targeting MSMEs (IFC, SME Finance Forum & G20's GPFI, 2021).

Adoption rate was particularly more common in high-income and upper middle-income countries. More than two-thirds of the G20 countries had CGSs as a COVID-19 policy response initiative for small businesses. While the objectives and operational models were quite similar across SSA countries, fund size and specific target beneficiaries varied slightly, with some SSA countries focusing on priority sectors.

In terms of an explicit focus on MSMEs owned by women or youth, this was widely lacking for the following reasons:

NUMBER OF COUNTRIES WITH A CGS INITIATIVE AS PART OF COVID-19 RESPONSE

The study has shown that approximately 18 of 45 SSA countries represented in the AFI member network (40 percent) applied a CGS as a COVID-19 mitigation strategy for small business support. Identified CGSs were primarily driven by governments' mission to provide emergency support to distressed businesses and help stabilize the economy from the shock caused by the pandemic.

REASONS FOR NOT USING CGSs

The study established that the top two reasons given by countries who did not use CGSs as COVID-19 economic response tools were: preference for alternative support initiatives based on local realities and reluctance of the guarantor, in this case, the government agency, to accumulate contingent liabilities in their books.

SIZE OF FUNDING

During the period, public sector budgetary allocations for CGSs varied. The differences can be explained by the priority given to the CGS as part of the broader economic response strategy, the objectives of the guarantee fund and the kind of financing needs being addressed (working capital or investment) and, expectedly, the size of the economy. For example,



Shop owner wearing a face mask, Cape Town, South Africa. (REUTERS/Alamy Stock Photo)

South Africa and Senegal had the highest allocations of about USD6.2 billion and USD350 million, respectively, while countries like Zimbabwe and Burkina Faso earmarked about USD8.3 million and USD20 million, respectively.

TARGET BENEFICIARIES

Reviewed CGS target beneficiaries were primarily MSMEs. However, it must be observed that only 16 percent of CGS policies from 18 identified countries specifically mention women- and youth-owned businesses as intended recipients.

COVERAGE RATIO

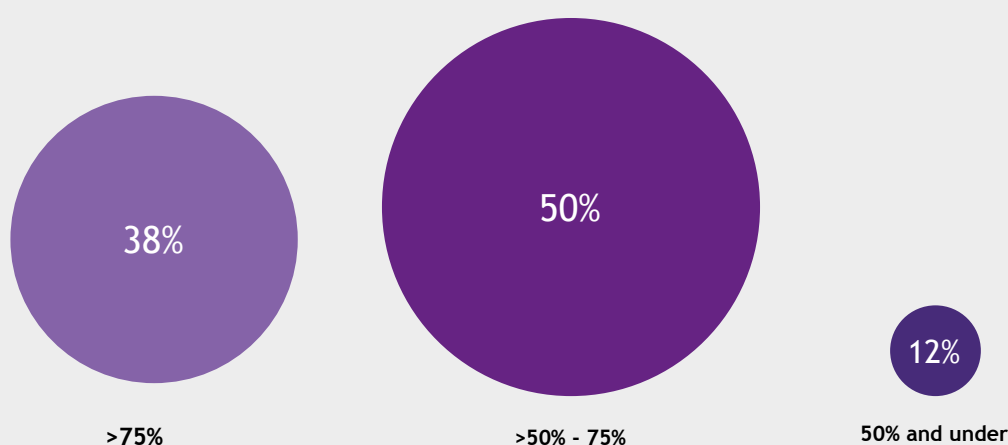
Except in very few countries, the government's share of risk is relatively high and adequate to attract participation.

TOP CHALLENGES

Figure 4 highlights the major challenges faced in implementing the CGSs, as mentioned by AFI member network country representatives.

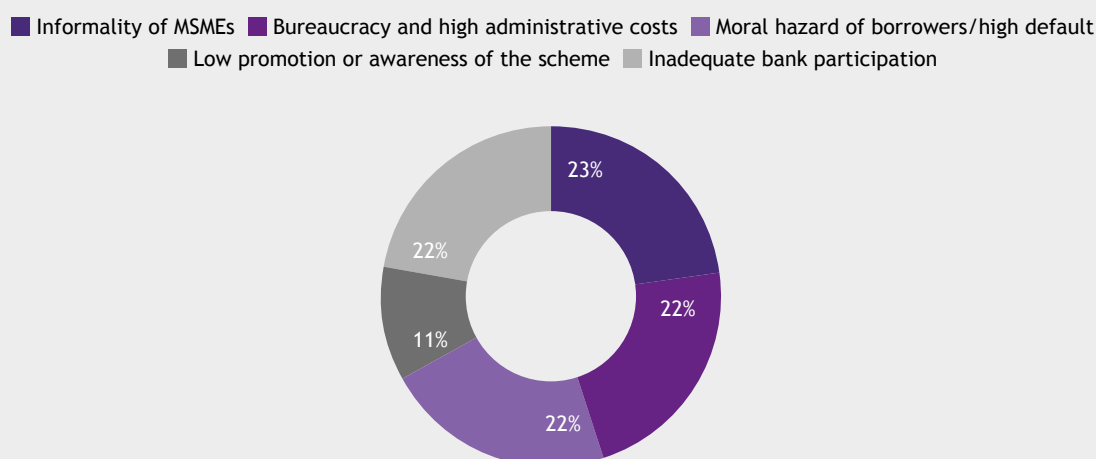
MSMEs are predominantly informal and do not have relevant financial history or capacity to put together supporting information, and incomplete documentation from MSME applicants (and potential applicants) in countries like Eswatini and Angola present a major concern. In Malawi, as in other countries, there have been experiences of CGS beneficiary borrowers treating the funds received as a grant, resulting in defaults in repayment. Other prevalent challenges across the board include too many bureaucratic processes that reduce efficiency and deter participating financial institutions and low outreach.

FIGURE 3: CGS COVERAGE RATIO



Source: Survey responses from AFI network members

FIGURE 4: FACTORS IMPEDING THE SUCCESS OF CGS IN SSA



Source: Survey responses from AFI network members

3.2 COUNTRY CASE STUDIES

This section highlights the structure and operational modalities surrounding the publicly supported CGSs in four SSA countries, namely Kenya, Côte d'Ivoire, Lesotho and South Africa, as part of their broader COVID-19 response strategy to support MSMEs.

KENYA

In November 2020, Kenya introduced a new PCGS initiative for MSMEs via a public finance regulation. Given that the World Bank's enterprise survey for 2018 shows that, on average, Kenyan banks request 240 percent of MSME loan amounts for collateral worth, the purpose of the PCGS was to induce more bank lending to MSMEs. This PCGS is one of the few in SSA that has a specific proportion earmarked for marginalized groups (at least 30 percent for women, youth and persons with disabilities).

The coverage ratio of the PGCS was one of the lowest reviewed (25 percent). Such coverage could have both pros and cons. While it can ensure that regulations that apply to PGCS applicants are more committed since they would have to devote more assets/collateral to secure the balance, it could deter smaller firms who may have been struggling during the period but with genuine prospects for repayment over time. To further dissuade the occurrence of moral hazard on the part of borrowers, regulations provide that any claims paid by the PCGS due to default, would still be recoverable from the borrower as a debt due to the government.

There are seven participating banks in Kenya, but not all have a presence in all the regions/provinces of the country. This can impair the level of awareness and reach. Meanwhile, participating financial intermediaries are obligated to submit frequent performance reports to the PCGS administrator as a risk management approach. However, given that a specialized agency does not administer the fund, there is a risk of inadequate staff capacity to review such reports in detail. Table 1 details the basic information governing this scheme.



Kenyan fashion designer inside her studio in downtown Nairobi. (REUTERS/Alamy Stock Photo)

TABLE 1: SUMMARY OF KENYA CREDIT GUARANTEE SCHEME

DETAILS	
TITLE	Credit Guarantee Scheme
LEGAL STATUS	Guarantee fund administered by the National Treasury of Kenya, not a separate legal entity.
PURPOSE	To improve and stimulate the national economy by encouraging additional lending to MSMEs by leveraging private sector resources.
TARGET BENEFICIARIES	MSMEs, women, youth and persons with disabilities.
OWNERSHIP	Administered by the National Treasury and Planning Cabinet Secretary in conjunction with a Steering Committee.
FUNDING	Appropriation from the Parliament of Kenya. An initial allocation of KSH3 billion to be increased to KSH10 billion. ¹
ELIGIBILITY CRITERIA	<ul style="list-style-type: none"> a) MSME registered with a local county government and hold a valid business permit or trade license b) Can verify compliance with relevant tax laws c) Be creditworthy and intend to use the credit advanced for business purposes, including working capital, acquisition of assets or rebuilding the businesses d) Satisfy any other condition that may be imposed by the Steering Committee.
DOCUMENTATION REQUIRED	To be advised by participating banks.
OPERATIONAL MODALITIES	<ul style="list-style-type: none"> a) Portfolio guarantee - participating financial intermediaries are responsible for evaluating individual applications for credit facilities under the scheme based on normal banking prudential guidelines, monitoring the borrower accounts and initiating recoveries in case of default b) At least 30 percent of the CGS is earmarked for marginalized groups (women, youth and persons with disabilities) c) Any money paid by the scheme on a guarantee shall be a debt due to the national government from the borrower whose loan was guaranteed.
COVERAGE	25 percent
INTEREST RATES	Preferential (participating financial institutions expected to offer low-interest rates).
FEES	Not specified, but there is an indication of a fee.
MAXIMUM LOAN AMOUNT	KSH5 million and a loan tenure of 36 months or less.
PARTICIPATING INSTITUTIONS	Seven: ABSA, Cooperative Bank, Credit Bank, Diamond Trust Bank, Kenya Commercial Bank, NCBA and Stanbic Bank.
RULES GUIDING CLAIMS	The guarantee can be invoked for the principal outstanding amount if the facility has been classified as non-performing during the specified period and recovery proceedings legally initiated. This is subject to the maximum level guaranteed, whichever is earlier.
RISK MANAGEMENT	<ul style="list-style-type: none"> a) No individual MSME loan disbursement can be more than one percent of the guarantee funds b) Periodic performance reports are to be submitted to the administrator.
SUPPORT SERVICES	Provided by participating financial institutions during regular business.
UPTAKE	Extremely low. According to the Parliamentary Budget Office of Kenya, as of June 2021, a total of 334 credit facilities amounting to KSH634.5 million have been disbursed under the scheme.

Source: Public Finance Management (Credit Guarantee Scheme) Regulations

1 KSH10 billion estimated at USD89.3 million.

CÔTE D'IVOIRE

In January 2020, the Ministry for the Promotion of SMEs of Cote d'Ivoire reactivated operations of the Le Fonds de Garantie des Crédits aux PME (Small and Medium-Sized Business Credit Guarantee Fund) (FGPME), a government-owned specialized entity. This coincided with the outbreak of the COVID-19 pandemic, although the restructuring was already in place before the pandemic. Since the FGPME was already in place, it was leveraged as a support strategy with additional funds of CFAF51 billion allocated to the FGPME during the COVID-19 period. Although the FGPME is normally available to MSMEs, the additional funds targeted medium-sized businesses with turnover between CFAF150 million and CFAF1 billion. The inference is that micro and small firms received support through alternative initiatives. Coverage ratio is high at 80 percent. Another incentive is that the FGPME refunds half of the guarantee fee initially paid by the borrower upon the full repayment of the loan. Table 2 details the basic information governing this scheme.

LESOTHO

The PCGS had been in existence in Lesotho National Development Corporation (LNDC) for about a decade. The Board of Directors approved the restructuring of the PCGS in April 2020 to respond to the effects

of COVID-19 on the economy. The revamped scheme targets all business sectors and expands guarantee cover from the previous 50 percent to 75 percent of the loan sum. Fees have been waived, and the maximum guarantee amount increased from M5 million to M8 million. Table 3 details the basic information governing this scheme.

SOUTH AFRICA

In May 2020, the loan guarantee scheme was launched as part of the government's economic stimulus package, with the South Africa Reserve Bank serving as the administrator. The objective is to support small businesses that experienced financial distress due to the pandemic. The guarantee focuses on immediate financing needs for operational business expenditure alone. It excludes loans for investment, asset acquisition or other forms of financial transaction. In terms of uptake, the reach recorded was low. According to the Banking Association of South Africa, as of June 2021, only R18,39 billion had been disbursed by banks to SMEs in loans under the scheme, much less than anticipated. Although 50,717 applications were received, less than a third were approved (13,324). Table 4 details the basic information governing this scheme.



Workers in the cotton mill, Côte D'Ivoire. (mauritius images GmbH/Alamy Stock Photo)

TABLE 2: SUMMARY OF LE FONDS DE GARANTIE DES CRÉDITS AUX PME

	DETAILS
TITLE	Le Fonds de Garantie des Crédits aux PME (Small and Medium-Sized Business Credit Guarantee Fund)
PURPOSE	Facilitate the access of medium enterprises to bank loans by sharing the financing risk.
OWNERSHIP	Government
FUNDING	Additional CFAF51 billion allocated for COVID-19. ²
ELIGIBILITY CRITERIA	Additional CFAF51 billion allocated for COVID-19. <ul style="list-style-type: none"> a) Ivorian natural or legal person with a turnover between CFAF150 million and CFAF1 billion b) Up to date with fiscal and social obligations c) Provide evidence of creating sustainable jobs.
DOCUMENTATION REQUIRED	<ul style="list-style-type: none"> a) Proof of legal and tax status b) SME status issued by the Ministry for the Promotion of SMEs of Cote d'Ivoire c) Proof of turnover (balance sheet) d) Certificate of social regularity from the social security authority e) Certificate from the Identification Committee of Support and Supervision Structures f) Business plan g) Certificate from the bank confirming approval of loan application subject to the provision of necessary guarantees h) Proof of a minimum contribution of 20 percent of the amount of the guarantee requested by the bank i) Bank account statements for the last six months.
PROCEDURE	<ul style="list-style-type: none"> a) The business submits a loan application to the FGPME approved bank b) The bank analyzes the file according to its usual credit procedures c) After notification of the lending bank's agreement in principle, the SME submits a CGS request to the FGPME online or by post d) Upon approval by the FGPME Management Committee, the lending bank sets up the loan and deducts the guarantee issuance fee from the SME, on behalf of the FGPME.
COVERAGE RATIO	Capped at 80 percent of the guarantee requested by the banks (guarantee requested by banks should not exceed half the loan amount).
INTEREST RATES	Capped by the FGPME.
FEES	10 percent of the amount of the guarantee given by the FGPME, half of which is refundable.
MAXIMUM LOAN AMOUNT	Up to CFAF200 million.
PARTICIPATING INSTITUTIONS	Three of 29 banks: Banque Populaire, BNI and Versus Bank.
AWARENESS	Monthly SME club meetings.

Source: FGPME

² CFAF51 billion estimated at USD88 million.

TABLE 3: SUMMARY OF LESOTHO COVID-19 RESPONSE PCGS

	DETAILS
TITLE	COVID-19 Response PCGS
LEGAL STATUS	Ministry of Trade and Industry, Cooperatives and Marketing, LNDC is a multi-purpose parastatal responsible for implementing the country's industrial development policies. The PCGS is just one of the various investment support functions it carries out.
TYPE OF LOANS SUPPORTED	Short, medium and long-term loans, working capital, leasing finance.
COVERAGE	Up to 75 percent cover.
TARGET BENEFICIARIES	All enterprises operating in all sectors of the economy.
ELIGIBILITY CRITERIA	Only registered companies that have existed for a minimum of 12 months.
MAXIMUM LOAN AMOUNT	Between M200,000 and M8 million.
LOAN MATURITY	60 months (five years).
REPAYMENT FREQUENCY	Monthly
FEES	Zero
COLLATERAL VALUE	Promoters must provide at least 7.5 percent collateral (or as may be required by the bank). The lender is free to accept any form of collateral, including assets to be purchased with the loan proceeds.
PROCEDURE	<p>a) Loan applications for PCGS are submitted directly to commercial banks</p> <p>b) The banks send the application to the LNDC on behalf of the customer.</p>
FUNDING	Government
PARTICIPATING INSTITUTIONS	Commercial banks: Standard Lesotho Bank, Post Bank, Nedbank and First National Bank.
AWARENESS	Visits to districts to raise awareness.

Source: LNDC



Female farmer, Lesotho. (robertharding/Alamy Stock Photo)

TABLE 4: SUMMARY OF SOUTH AFRICA COVID-19 LOAN GUARANTEE SCHEME

DETAILS	
TITLE	COVID-19 Loan Guarantee Scheme
OWNERSHIP	National Treasury, the South African Reserve Bank and the Banking Association South Africa.
TARGET	Small businesses and sole proprietors experiencing financial distress as a result of the COVID-19 pandemic.
PURPOSE OF LOAN	Strictly for operational expenditure (salaries, rent, utilities and ordinary course of vendor payments).
PERIOD	Application open for 14 months.
FUNDING	Government provided initial R100 billion through the National Treasury and possible extension up to R200 billion. ³
ELIGIBILITY CRITERIA	<ul style="list-style-type: none"> a) The business must be in good standing with its bank: up to date with other loan payments or no outstanding loans as at the end of February 2020 b) An existing relationship with the bank granting the loan c) Registered for tax purposes d) Be adversely impacted by the COVID-19 outbreak or lockdowns.
DOCUMENTATION REQUIRED	<ul style="list-style-type: none"> a) A calculation of the loan amount required to fund up to six months of qualifying expenses and supporting documents (utility bills, rental agreements) b) Detailed cash flow projection c) Management accounts for the year, noting the current financial position and financial performance d) Most recent financial statements e) Proof of tax registration and evidence of legal status.
OPERATIONAL MODEL	Application goes through banks that use their normal risk evaluation and credit application processes to approve or decline.
COVERAGE RATIO	Not specified.
INTEREST RATES	Fixed at the repo rate plus 3.5 percent.
FEES	Nil
MAXIMUM LOAN AMOUNT	R100 million. Moratorium period of one year is given, the loan can be paid off within five years.
PARTICIPATING INSTITUTIONS	All commercial banks are eligible.
RULES GUIDING CLAIMS	If a customer defaults on the loan, banks can claim on the guarantee from the Reserve Bank, which, in turn, claims the funds from the National Treasury, but only after banks have followed the stipulated procedures and standard recovery processes, subject to an independent audit to ensure that sound lending practices were applied.
RISK MANAGEMENT AND REGULATION	Commercial banks and the National Treasury share risks. Banks are required to check the qualifying criteria of applicants. They will use their existing processes and infrastructure to process loan applications. Banks will cede any loans under this scheme to the Reserve Bank as security and will regularly report to the Reserve Bank on the performance of the loan portfolios.
IMPACT/REACH	Low.

Source: National Treasury

3 R100 billion estimated at USD6.2 billion.

4: IMPLICATIONS AND LESSONS LEARNED FROM THE REPORT FINDINGS

HAVING A CGS IN PLACE CAN ENHANCE FLEXIBILITY AND ADAPTATION TO CRISIS

For countries like Côte d'Ivoire and Lesotho, having an existing PCGS structure even before the COVID-19 pandemic, appears to have been an advantage. It allowed for rapid response to crises and quick accommodation to the needs of targeted beneficiaries. For example, it has been observed that Lesotho quickly approved the expansion of guarantee coverage and fee waivers to encourage credit flow during COVID-19. Similarly, Côte d'Ivoire introduced an incentive for a partial refund of guarantee fees to compliant borrowers.

CGSs CAN BE A TOOL FOR REACHING EXCLUDED GROUPS

Historically, women, youth and other vulnerable groups who have experienced uneven opportunities to access finance are more affected by the crises, such as the one created by COVID-19 (IFC, 2021). The case of Kenya has shown that PCGSs can act as a policy tool to bridge the divide by allocating a substantial proportion of the PCGS funds for targeted support to disadvantaged and marginalized groups.

PUBLIC AND PRIVATE SECTOR COLLABORATION CAN IMPROVE EFFECTIVENESS, MONITORING AND TRANSPARENCY

Having a range of stakeholders involved in contributing to the success of any CGS is a plus. In South Africa, the Bankers Association, alongside other government parastatals, was very much committed to the process. This helped ensure that monthly progress reports were made available to the public and that some adjustments were made in response to public feedback. For example, the eligibility requirement based on MSME turnover was adjusted to make it less restrictive. To make the scheme fitter for purpose, input from the private sector also helps gather relevant information on implementation to know what is working.

VERY FEW MSMEs APPEAR TO HAVE BENEFITTED FROM THE PCGS DURING COVID-19

The results in the countries that have conducted performance evaluations show that the objective of supporting distressed businesses during the pandemic was not fully met. Huge variances were recorded. This implies that some necessary infrastructure and implementation measures were not in place to ensure adequate uptake and support. For example:

- a) **Poor timing of the rollout:** Many schemes in the CGS catalogue, although announced as part of the countries' broader COVID-19 mitigation strategies, eventually came into effect in late 2020 after the initial peak of the COVID-19 pandemic.
- b) **Insufficient public sensitization:** Even where these CGSs exist, the communication strategy to broadcast CGS was inadequate, leaving some potential beneficiaries unaware of the scheme. Even when information was provided, it was insufficient to fully understand what the scheme entails and how it can be benefitted from.
- c) **Lack of distribution and evaluation agility affected deployment:** The distribution networks used were limited. For example, the schemes could have been designed to attract more participating banks/lenders or involved cooperatives who can even take up part of the risks and reach broader segments of the population, especially those in more informal settings. Also, the PCGSs were delivered based on the regular risk modeling and lending structures, which failed to consider the fluid economic environment during the COVID-19 pandemic. Finally, MSMEs with outstanding loan payments were mostly restricted from accessing additional bank loans under the CGS.
- d) **Inadequate support for MSMEs:** Since many target MSMEs in the SSA are informal businesses and some do not even fall within the formal financial system, the CGSs should have ensured that a reasonable level of guidance was provided on how to compile and present guarantee applications.
- e) **Low guarantee coverage in a few instances:** Considering the uncertain climate, business owners and lenders would be reluctant to take on extra debt or risks, respectively, unless the guarantee provided under the CGS is significant enough to allay those fears and increase confidence in an enhanced risk environment.

5: NEXT STEPS

POLICY CONSIDERATIONS TO STRENGTHEN CGSs FOR CRISIS RESPONSE

The following considerations are based on the observations and conversations with industry players in AFI member institutions. They are important for optimizing the implementation of any CGS to improve access to finance of MSMEs, especially during a crisis.

5.1 STRATEGIES FOR INCREASED REACH AND IMPACT

a) Increased public awareness and enlightenment:

Generally, public awareness was rather low for the CGS initiatives studied. It is important to ensure widespread knowledge about such schemes to ensure the participation of the right lending institutions and intended beneficiaries. By persuading a wide range of financial institutions to participate, the scheme can reach many borrowers. With multiple lenders participating, the CGS can compare and assess how best to adapt or modify the scheme for better results. Target beneficiaries also need to be aware of existing CGS and their benefits. The CGS can partner with other government agencies in charge of entrepreneurship development or small business promotion to leverage their communication channels when reaching MSMEs. Participating banks also need to publicize the scheme and have help desks for interested customers/prospects.

b) Complementary support services for MSMEs to increase capability: Since informality is one of the major challenges identified as affecting the success of CGS as a crisis response tool in the SSA, AFI members may consider providing MSMEs applying to the CGS with robust support to enable such MSMEs access and benefit from these schemes, particularly those in informal rural settings. Ancillary support services can include free workshops or training on how best to fill out guarantee applications, present supporting information in more standardized or acceptable formats, and form partnerships with ongoing financial literacy programs.

c) Partnerships with local associations and digital finance service providers: It has been observed that the distribution network for implementing the COVID-19 response CGSs in SSA was limited. Only a

few banks participated, and not all had branches in all SSA countries. To enhance the deployment of such schemes and reach the most affected population, it is possible to partner with organizations that have in-built structures for connecting with MSMEs at the grassroots (cooperatives or mutual guarantee associations), which act as a form of solidarity group formed by small enterprises who are often individually unable to meet the stringent requirements for accessing bank loans.

By pooling resources from members, these associations can act as guarantors enabling members' access to bank loans or, in some cases, giving out small loans directly. There are different ways that a state-backed CGS can partner with these groups to support more local businesses: provision of counter-guarantees, training or capacity building for members, contributing to a joint risk fund, leveraging their network to assess/evaluate guarantee applications or monitoring members compliance with repayment of a CGS-backed loan. Allowing FinTechs to participate as lending institutions under the scheme can also increase agility because FinTechs can use less restrictive models in assessing loan applications.

d) Pursue a mature enabling credit infrastructure as a prerequisite for CGS success: Most CGSs under review opted for portfolio guarantees, meaning that participating banks were responsible for evaluating/reviewing borrower loan and guarantee applications. In such cases, the extent to which a country's credit infrastructure is developed plays a major role in making the CGS work effectively. In SSA, most countries have limited credible credit reporting, credit rating structures/database and collateral registries. It is inevitable that many potential MSME beneficiaries are disqualified and unable to access the CGSs, especially micro-firms that are not already in the formal financial system. A mature credit infrastructure is useful for guarantors/lenders to evaluate an MSME's performance or growth prospects and creditworthiness to avoid accumulating non-performing loans registered under the CGS.

It is also beneficial for speeding up the process of evaluating applications under the scheme and increasing transparency. This implies that AFI members may consider having CGS interventions embedded in a nation's broader financial inclusion and financial sector development framework.

5.2 STRATEGIES FOR REDUCED BUREAUCRACY, ADMINISTRATIVE EFFICIENCY AND SUSTAINABILITY

a) Set up a specialized entity to administer the scheme: In some SSA countries where bank participation was low, respondents noted that bureaucracy and lack of transparency contributed to dissuading banks from participating. To reduce some of these administrative bottlenecks and support the timely rollout of necessary CGS-related intervention, it is best to dedicate a separate entity with a clear long-term mandate rather than a multi-purpose government agency or a unit set up on an ad hoc basis. This also ensures transparency and staff competence, especially if the CGS is responsible for individual risk assessment.

Based on expertise garnered, such an entity can then check and monitor that eligibility criteria for lenders and borrowers are balanced, unambiguous, consistent and fair and that consideration is given to the informal nature of most MSMEs. The CGS can also leverage digitized operations for efficiency and branch network of participating financial institutions to decentralize operations.

b) Shared risks: Most CGSs reviewed had provision for the loan risk to be shared among all parties (borrower, lender and guarantors). This is a good practice to limit a moral hazard. The extent to which each party should share in the risk is an intricate element and should be constantly revisited based on existing realities. It is advised the guarantor accepts just enough risk to ensure sufficient protection against default risk and provide strong motivations for effective loan origination, monitoring and ownership. Risk sharing ratio can also be determined in line with the overall risk assessment and the type of loan.

c) Independent supervision and constant monitoring and evaluation: It is recommended to systematically and periodically evaluate the performance of CGS and make the findings available to the public. Only a handful CGSs studied in this report have conducted performance evaluations. Such assessment is important for transparency, learning and improving the entire process. The guarantor can be evaluated on cost-effectiveness, efficiency in processing applications and substantiveness of the complementary support given to borrowers. It is useful to evaluate borrowers, where possible, if beneficiaries have been able to build a credit history that allows for reduced collateral requirements or interest rates and access to longer-term loans and how the borrowers' living standards have changed. For lenders, assess the change in overall lending to MSMEs and the number of guaranteed borrowers who no longer need the guarantee to access loans.

d) Aim for self-sufficiency: During the COVID-19 pandemic, public budgets were generally strained due to unexpected expenditures. For SSA countries, particularly those with limited government revenues, considerations can be given to development finance organizations and private sector institutions to have a direct stake in a CGS fund's capitalization. More active participation from these stakeholders can reduce dependence on public funds and strengthen the cooperation between the public, private and non-for-profit actors' determination to see the scheme succeed. Revenues can also be raised through registration fees. The fees may be fixed to cover the CGS costs and remain affordable for targeted beneficiaries.



Fair trade pineapple processor, Côte D'Ivoire. (Jake Lyell/Alamy Stock Photo)

ABBREVIATIONS

SME	small and medium enterprise
MSME	micro, small and medium enterprise
CGS	credit guarantee schemes
SSA	Sub-Saharan Africa
PCGS	public credit guarantee schemes
FGPME	Le Fonds de Garantie des Crédits aux PME
LNDC	Lesotho National Development Corporation

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