Agriculture CS Hon. Mithika Linturi (right) with Commodities Fund Chairman, Mr. Duke Mainga Ondiba Echate (left) during the signing of Commodities Fund's 2023/2024 Performance Contract (PC) at the KEPHIS Nairobi Offices. Photo Credit: MoALD

Resurgence of credit guarantee schemes

By Zablon Oyugi

S**INCE** their first introduction in Japan in 1937, credit guarantee systems (CGS) have had their use spread throughout the world starting in Europe and the Americas in the 1950s and then to Africa in 1960s.

This trend has persisted despite ongoing failures and imperfections in credit markets for small and medium-sized enterprises (SMEs).

According to the World Bank publication on Principles for Public Credit Guarantee Schemes (CGSs) for SMEs, up to 68 percent of formal SMEs in emerging markets are either unserved or underserved by financial institutions, with a resulting credit gap estimated to be close to $1 trillion.

However, CGSs are still a common form of government intervention to unlock finance for SMEs, especially in the agriculture sector.

In fact, today more than half of all countries in the world have a CGS for SMEs and the number is growing. A recent count found 2,250 CGSs in almost 100 countries, as per the Food and Agriculture Organization of the United Nations (FAO) Credit Guarantee Systems for Agriculture and Rural Enterprise Development study.

Meant to diminish the risk incurred by lenders and mainly a reaction to small firms' lack of collateral, the guarantee schemes usually target a sector, a group of firms, a region or a group of individuals who ordinarily find it hard to access capital.

Credit guarantee schemes in Africa

In Africa, this initiative has been employed in a number of countries, however, there are large differences between schemes operating in North African and sub-Saharan countries.

According to Credit Guarantee Schemes for Small Enterprises report by Anke Green for United Nations Industrial Development Organization (UNIDO), whereas the schemes in the North Africa are fairly successful, their counterparts in sub-Saharan countries, with the exception of South Africa, experience setbacks similar to those in Latin America.

Commodities Fund is one of the credit schemes by the government of Kenya to boost agriculture financing for smallholders in the country. Photo Credit: MoALD

The report further indicates that the best-developed African schemes are encountered in Morocco, Egypt and South Africa.

Due to the poor performance, the schemes experienced serious declined in 1980s but there has been a resurgence since mid-1990s with newly established ones mostly based on government or multilateral initiatives.

The major types of guarantee systems identified in most parts of the continent are mutual guarantee associations, publicly operated national schemes, corporate associations, schemes arising from bilateral or multilateral cooperation, and schemes operated by NGOs.

Nigeria established its Agricultural Credit Guarantee Scheme Fund (ACGSF) in 1977. Today, the Federal Government holds 60 percent and the Central Bank of Nigeria, 40 percent of the shares of the fund which guarantees credit facilities extended to farmers by banks up to 75 percent of the amount in default net of any security realised.

In Kenya, the establishment of CGS to enhance access to credit by micro, small and medium enterprises (MSMEs) is a longstanding policy objective of the Government.

In fact, Kenya Vision 2030, in the Third Medium Term (2018-2022) Plan for the Financial Services Sector, identifies credit guarantee as a key programme to enhance performance of MSMEs in the country.

In November 2020, Kenya introduced a new Public Credit Guarantee Scheme (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 per cent 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 sub-Saharan Africa that has a specific proportion earmarked for marginalised groups (at least 30 percent for women, youth and persons with disabilities).

In December 2020, the Kenyan government, through the National Treasury, again rolled out CGS to respond to lack of sufficient collateral, high collateralisation requirements, short repayment periods and high interest rates challenges, in order to enhance access by MSMEs to quality and affordable credit.

Access to credit in Tanzania, especially in the agricultural sector and for small and medium Enterprises (SMEs) remained a challenge.

In an effort to address these challenges, the Bank of Tanzania established two credit guarantee schemes, namely export Credit Guarantee Scheme (ECGS) and Small and Medium Enterprises Credit Guarantee Scheme (SME-CGS) in July 2002 and September 2005 respectively.

These have been there to promote and support small businesses by creating an enabling environment for expanding and facilitating access to financial resources, to stimulate employment and export; thereby contributing to economic growth.

The Credit Guarantee Company in Egypt (CGC-Egypt) regulated by the Central Bank of Egypt is the sole guarantee scheme in Egypt in operation since 1991 as a risk mitigation tool responsible for supporting the small business of the country and improving their access to finance, as well as to needed advisory services.

According to a 2022 study on Credit Guarantee Schemes: Facilitating MSME Financing in Africa During the Covid-19 Pandemic by Alliance for Financial Inclusion's SME Finance Working Group (SMEFWG), in South Africa, the Bankers Association, alongside other government parastatals, have been very much committed to the success of CGS.

During Covid-19 Pandemic alone, South Africa is among some few African countries with the highest allocations of about USD6.2 billion for CGSs. Senegal allocated USD350 million while countries like Zimbabwe and Burkina Faso earmarked about USD8.3 million and USD20 million, respectively.

Interventions by the African Development Bank

Since its established policy on guarantees, the African Development Bank Group (AfDB) has been intervening in offering partial credit guarantees to enable countries source finances to support their small businesses and boost performances.

In 2022, for instance, AfDB approved a partial credit guarantee to support Benin's mobilisation of financing to meet United Nations Sustainable Development Goals (SDGs) targets.

This initiative was meant to enable the West African nation to raise funds in foreign currency from international investors for expenditures related to meeting SDG targets on agriculture and agro-industry, and water among other sectors by offering monetary support to farmer groups, cooperatives and agro-related SMEs.

Côte d'Ivoire and Egypt last year also got €400 million and $345 million from AfDB in partial credit guarantee to support projects across a range of sectors, including sustainable agriculture and agro-industry.

Implementing public credit guarantee schemes

Since the international community lacked a common set of principles or standards that can help governments establish, operate and evaluate CGSs for SMEs, World Bank Group and the FIRST Initiative in December 14, 2015 launched a new tool to help governments implement public credit guarantee schemes.

The tool was intended to become the standard for effectively and efficiently establishing and running public CGSs for SMEs around the world.

It has 16 principles covering four key areas including legal and regulatory framework, corporate governance and risk management, operational framework, and monitoring and evaluation that are critical for the success of CGSs.

Generally, it is recommended that CGS be managed independently of government involvement and funding donors.

In this, CGS managers need to foster proactive policy dialogue with line ministries, monetary authorities and banking supervisors.
According to Agriculture investment sourcebook by World Bank, CGS should be designed to develop sustainable business relationships between providers and recipients through building trust and a good credit history.

Advantages and disadvantages of CGs

There has been some debate about the advantages and disadvantages of CGSs for agriculture specifically as well as for firms and SMEs in other sectors.

The positive effects of CGSs relate to the financial additionality on the extensive margin, in that these guarantees induce banks to expand the risk frontier by providing loans to firms and farmers without access to loans (as opposed to simply subsidising bank risk on borrowers who already have access to credit).

CGSs also have financial additionality, meaning that guarantees improve access to better finance conditions, such as lower interest rates, larger loan sizes, longer loan terms, and less burdensome collateral requirements.

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