Sida

Guarantees

- Portfolio Guarantee Example

Farmers and small businesses in Bosnia-Herzegovina had a hard time getting loans and credit until Sida together with USAID issued guarantees to two banks. The results so far show a positive impact on companies' ability to invest in their production.

The banking sector collapsed after the conflict on the Balkans in the 1990's and the international banks that started re-building the sector were conservative, often demanding real estate as collateral for loans. Companies with good business ideas and good cash-flow, were mostly unable to get financing.

In 2010, one of Sida's three focus areas for the development collaboration with Bosnia-Herzegovina is market development with a focus on economic growth through better competitiveness of small and midsized companies. As Sida had started providing technical assistance to manufacturing companies in the SME sector and to the agriculture sector in collaboration with USAID, this need became clear. Improving access to capital was necessary in order for companies to be able to expand and to employ more people. For some the situation was even more severe, as they faced the threat of bankruptcy. A combination of technical assistance and a financial instrument to support growth increased the potential of the development strategy in Bosnia-Herzegovina to help the country's economic growth and to prevent future conflicts.

Creating a portfolio guarantee

All banks that fulfilled a number of basic legal and financial criteria were approached to discuss the opportunity of improving lending to small and medium sized companies. The guarantee presented a solution that would compensate for the clients' lack of collateral and this would result in new and more business. Three banks were interested in participating and after negotiations two of the banks signed the agreement.

Structure of the guarantee

The guarantee covers 50% of the credit risk of the banks' respective portfolios of SME loans. The banks are responsible for the credit assessment, the conditions of the loan and the agreements with each client. Sida does not need to know the individual borrower, but receives the reporting on how the loans are performing on a portfolio level and carries out monitoring and evaluation jointly with USAID.

The banks pay two fees for the guarantee: 0.75% upon signature of the agreement, and 0.5% on the outstanding amount that is guaranteed.

These were the first two guarantee that Sida created in co-operation with USAID.
One of the banks has so far had a utilization rate of about 60% and the second bank 100%. The difference may to some extent be explained by the former having a somewhat more conservative management, and the latter the ambition to expand its market-share.

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When approving loans in combination with the Sida/USAID guarantees they have in certain cases been able to lower the interest rate of the loan, according to the bank, especially to old clients. However, only one of the banks has recognized the guarantee as first class collateral in accordance with guidance from the local financial supervisory authority.

Funding of SMEs enabled job creation
Monitoring and evalution is jointly carried out by USAID and Sida, with USAID closely monitoring the implementation of the project on site. During a monitoring visit by Sida, some of the companies presented what had been achieved through the loan; new production premises and new machines for new production lines.

"In all visits it was amazing to see the owners enthusiasm, their visions, their determined ways of managing their company, allowing their companies to grow and take on more employees, especially in a country which has suffered not only from one economic crisis over the past five years, but actually two", according to a Sida representative who visited some of the companies. All companies were family owned and had originally been financed by themselves, and eventually they had approached the banks for loans.

To date the two guarantees have resulted in more than 40 new loans, with a total value of USD 17 million creating 375 new jobs and sustaining some 1 200 jobs.

How Sida's key principles and conditions apply

Additionality: Limited medium and long term loans were previously available for SMEs (at least 3 years maturity), which had a severe effect on their possibilities to manage working capital needs and to invest.

Market Distortion: Since no other actor would offer the guarantee the operation is non-distortionary i.e. not interfering with market conditions.

Risk-Sharing Partnership: The guarantee covers 50% of the loan value, and is further split between Sida and USAID on a 50-50 basis.

Sustainability: The guarantee is helping banks to lend to a previously underserved segment and future guarantees should not be needed for those clients that participate in the programme, as they build their track record.

Eligibility: Sida contributions must be supported by a country and/or sector result strategy. In this case, improving banks' lending was in line with the then prevailing country strategy to stimulate economic growth in a country where 50% of the population is affected by poverty.

Summary

Country:	Bosnia-Herzegovina
Purpose:	Reduce collateral requirements and lengthen loan terms Increase lending to SMEs
Implementing Partner:	USAID administers the guarantee
Guarantee recipient:	Raiffeisen Bank and Sberbank (formerly Volksbank)
Direct Beneficiaries:	SME and agriculture sectors
Total project value	USD 20 million
Sida's value of guarantees:	USD 5.0 million (Sida's portion is 50% of the guarantees, to cover 50% of the banks' lending
Duration:	Ten years with 5 years to disburse loans from 2010

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