

# Credit Guarantee Fund for Georgia

Ketevan LAPACHI, Revaz ORMOTSADZE

## Abstract

The paper addresses to the most acute problems (results of the world wide crisis and August conflict) of the Georgian economy - mobilizing savings and enhancing access to credit for the micro and small companies in Georgia and facilitating FDI growth by improving a foreign small business confidence to invest in Georgia. The paper analysis the international practice in design and management of the credit guarantee schemes (CGS) to develop some proposals and recommendations how to expand access to credit to the thousands of micro and small companies in Georgia and enabling them to grow at more accelerated rates.

**Keywords:** coverage limit, loans, guarantee scheme, collateral, lending institutions, small enterprises.

**JEL:** URLH81

## 1. Introduction

Access to financing continues to be one of the most significant challenges for the creation, survival and growth of SMEs, especially innovative ones. The problem is being exacerbated by the most severe financial and economic crises in decades.

The anti-crisis packages and accompanying measures address, in many countries, the financing problems of SMEs. Among the proposals put in place by countries are: measures to enhance SME's access to finance, mainly to credit through bank recapitalisation and expansion of existing loan and credit guarantee schemes (OECD, 2009).

Credit finance is important to SMEs, as they: have no or little access to venture capital, mezzanine capital, bond issues, etc; have weak own funds positions (limited capability to auto finance investment or working capital needs; rely predominantly on loan finance and usually have relative lack of collateral. Due to the relative lack of collateral, loan finance is more difficult to obtain than for larger companies. At the same time, asymmetric information, high administrative costs of small scale lending, small firms' lack of collateral and the high risk perception attributed to small enterprises are the core reasons commercial banks are generally reluctant to provide loans to SMEs.

In order to lessen the constraints to access finance faced by SME, governments, NGO's and private sector have developed initiatives such as credit guarantee schemes (CGSs) facilitating access to finance by providing credit default guarantees for SME that are economically healthy, have an economically meaningful project but at the same time do not dispose of sufficient collateral to access bank credit. In case of default, the lender recovers the value of the guarantee.

More than half of all countries have some form of

credit guarantee scheme, usually targeted at some sector, region or category of firm or individual which is thought to be underserved by the private financial sector. In addition, all of the multilateral development banks have guarantee schemes as well as loans and other instruments. Such schemes seek to expand availability of credit to SMEs, sometimes focused on specific sectors, regions or ownership groups, or on young or new technology firms. Often there is a subsidiary employment, innovation or productivity growth objective (Honovan, 2008).

Growing number of research papers on credit guarantee schemes reflect increasing interest on these type of policy interventions. At present, CGSs are operated by a large number of countries and are considered one of the most market friendly types of interventions.

This paper intends to analyse best international practice in designing and implementing CGS-s and identify best model for Georgia.

## 2. International Experience and Key Lessons

### 2.1. Objectives and Typologies of CGSs

The main objective of a credit guarantee scheme is to assist SMEs that are otherwise creditworthy but don't have adequate collateral to obtain a loan at a reasonable interest rate to finance investment projects. A successful scheme needs to be able to help riskier SMEs obtain financing by reducing the risk of a loan extended to them, limiting transaction costs and guaranteeing payment in case of default. The question, however, is whether such requirements can be translated into a CGS that is not only sustainable (e.g. Italy's Confidi schemes or Canada's SBLA scheme) but also creates financial and economic additionality.

Credit guarantee schemes are designed to diminish

the risk associated with lending to SMEs. They can reduce information asymmetry, alleviate high collateral requirements and improve loan terms and facilitate access to formal credit for small firms. Additionally, by allowing loans to be made to borrowers that otherwise would have been excluded from the lending market, these firms are now able to establish a repayment reputation that itself can, in the future, act as a type of collateral. Finally, by extending more loans to smaller businesses, lending institutions gain experience in managing these types of loans, encouraging further development in this market segment. Nevertheless, the extent to which credit guarantee schemes actually provide these benefits is a major area of debate (OECD, 2010).

Many guarantee schemes have broader developmental objectives, such as supporting export capacity, fostering entrepreneurial spirit, improving the financial sector's skill base, facilitating investment in innovation, and supporting national industrialization programs, etc.

The literature sources evidence that properly designed and implemented CGS-s can create not only credit additionality (extra loans), but technology and knowledge spillover and economic additionality (increase in profit and /or employment, etc). Although general evidence on whether such schemes are beneficial is lacking, some individual cases indicate that these systems can be important contributors to increased new firm activity. Chilean partial credit guarantee fund - FOGAPE, Korean Technology Credit Guarantee Fund - KOTEG, and Canadian Small Business Financing Program – CSBF serve as good examples.

Two dimensions that theory suggests are critical to performance of guarantee funds are: a) ownership and governance structure as well as respective roles of governments and private sector and b) pricing and risk management mechanisms applied by funds.

Four major types of guarantee funds are (Green, 2003) the following:

- Public Guarantee Schemes: public guarantee schemes are established by public policy. They usually involve state subsidies, especially initially. Typically, they are managed by a private organization or an administrative. In case of loan default, the guarantee is paid out directly from the government budget. This gives such a scheme higher credibility within the banking sector.

- Corporate Guarantee Schemes: corporate guarantee schemes are generally funded and operated by the private sector, e.g. banks and chambers of commerce. Being managed by experienced corporate leaders, they generally benefit from the direct involvement of the banking sector.

- International Schemes: international schemes are typically bilateral or multilateral government or NGO initiatives, e.g. the ILO, UNIDO or the European Investment

Fund. Often, international schemes combine both a guarantee fund with technical assistance to firms.

- Mutual Guarantee Schemes: sometimes known as mutual guarantee associations, societies or funds are private and independent organizations formed and managed by borrowers with limited access to bank loans.

Figueiredo and Gasper (2010) identify three main models for guarantee schemes: mixed model of with private guarantee entities and public counter-guarantee (a sort of PPP) –very frequent in older EU member states and the more significant in volumes and number of SME supported; Public guarantee scheme or guarantee fund – also very frequent mainly in a new EU member states (e.g. Invega Ltd, Lithuania); Fully Private (Mutual) Guarantee Scheme - not very frequent (e.g. SOCAMA, French).

Beck, Klapper, and Mendoza (2008) consider three common types of corporate structure across the globe: mutual guarantee associations or societies publicly operated national schemes and corporate associations.

Although MGA organization varies from fund to fund, they typically share some common structural characteristics, for instance they generally have: a) a general assembly composed by all members. The general assembly determines the regulations for issuing guarantees and elects members to the executive and supervisory boards. It can approve or veto actions planned by the boards, b) an executive board that monitors and supervises the technical management of the fund and takes day to day decisions, c) the supervisory board that monitors the guarantee contracts and the fund's financial situation (Green, A, 2003).

An important characteristic of an MGA is that it relies on social capital, i.e. the fund creates social norms and positive peer pressure to encourage repayment amongst its members.

One of the main advantages of MGAs over the other types of guarantee funds is their expertise and knowledge of the business sectors covered by the fund, the region in which the MGS is based and the market trends and production techniques of the enterprises whose loans are guaranteed by the fund. MGSs can also give members a more powerful bargaining position. MGSs play the role of a quasi-borrower vis-à-vis banks and are a more influential negotiating partner than a single small firm. Members are thus able to obtain loans with better conditions and possibly lower costs (Green, 2003).

The mutual guarantee funds tend to operate in high-income countries while most middle and low-income countries have publicly operated funds. As to public schemes, they are, on average, younger than mutual funds and are more likely to operate in emerging markets.

## 2.2 Identifying good practices in designing and management of the CGS-s

The appropriate design of CGSs as one of the main challenges for guarantee schemes. According to the literature, designing CGS-s the following aspects need to be considered by the policy makers: eligibility criteria, coverage rate, fees, types of loans, default rate, risk management mechanisms, stakeholders, regulation etc.

**2.2.1 Eligibility Criteria** - Eligibility criteria differ significantly across countries and regions. Most guarantee schemes target SMEs in a broad sense and generally do not restrict sectors or types of loans. Some countries (Canada, Chile, France, Colombia, India, Hungary, Korea and Malaysia) allow start-ups to apply for guarantees. These schemes do not impose restrictions on sectors (except for a general restriction on agriculture in the case of Canada), or type of loan (again, except for Canada, which does not guarantee working capital loans). The main differences seem to lie in the limits imposed on firm and loan size. Korea does not impose any limits on firm size, while France and the Netherlands target SMEs following the EU's definition (maximum turnover of 50 million Euros and 250 employees).

Eligibility criteria differ significantly across MENA region guarantee schemes. All schemes cover start-ups except for the Palestine, but there are significant differences regarding firm size, size of loans, sectors, etc. Morocco and Tunisia do not set any ceilings, while Jordan and Syria set their ceilings at the high EU level (250 employees). By contrast, Egypt, Lebanon and the Palestine restrict the use of guarantees to smaller firms (respectively 50, 40 and 20 employees). The guarantee schemes in Morocco and Tunisia cover loans up to US\$ 2 million, or the equivalent of 600 times GDP per capita. The ratios in Egypt, Jordan and Syria are lower (150 times GDP per capita). By contrast, eligible loans in Lebanon, the Palestine, and Saudi Arabia are smaller and more comparable to other PCGs outside MENA (50-60 times GDP per capita). Morocco, Egypt, Jordan, Palestine, and Syria allow the use of the guarantee for all sectors. However, there is some uniformity regarding maximum loan maturity. It is also noticeable that some schemes do not guarantee working capital loans (Saadany, Arvay and Rocha, 2010)

**2.2.2. Risk sharing:** The loan risk needs to be shared amongst the lender, the borrower and the guarantors. The guarantor should accept enough risk to be able to persuade banks to participate in the scheme. Coverage rates need to be high enough to encourage lender participation and yet low enough to limit moral hazard. Experiences suggest that coverage rates should generally be between 60 and 80 percent. From the 76 schemes, the median coverage rate is 80 percent. The 100 percent coverage exists in 40 percent of 46 developed and developing countries including Canada, Japan, and Luxembourg (World Bank, 2008). In some countries (for example, Italy and Mexico) coverage rates levels depend on the risk assessment and the type of loan.

In another interesting example, the Chilean fund FOGAPE determines coverage rates based on an auction. This fund allocates portfolio guarantees to participating banks that bid for a lower coverage ratio obtaining a large volume of guarantees.

**2.2.3 Fees** – Fees must be high enough to cover administrative costs, but low enough to ensure adequate lender and borrower participation. The percentage and the way fees are applied vary among different schemes. There are schemes where a registration fee for processing the application is required. In developing countries, the fee is typically about 1 percent of the loan amount. Other schemes usually impose an annual or a per-loan fee that ranges from 1 to 2 percent. A risk-based pricing structure is only available in some countries, e.g. Colombia – the Fondo Nacional de Garantía (FNG) charges different fees according to risk. Low risk applications with guarantees up to 40 percent are charged a 3 percent fee. Higher risk applications with a 70 percent coverage rate are offered a 4 percent fee (Levistky, 1997).

Among the 76 countries, 56 percent of fees were paid by borrowers and 21 percent were paid by the financial institution receiving the guarantee. Only 15 percent of schemes impose a membership fee, while 30 percent impose an annual fee and 48 percent of the 76 schemes charge a per-loan fee. 57 percent of the schemes base the fee on the amount of the guarantee; 26 percent of them base it on the loan amount (World Bank, 2008).

**2.2.4. Types of loans:** International experience has shown 72 percent of the 76 schemes use individual loans, 14 percent use the portfolio loans and 9 percent of schemes use a combination of the above mentioned approaches. (World Bank, 2008)

According to studies, first scenario: allows for a more careful risk management, reduces the probability of moral hazard, probably results in a higher quality loan portfolio. However, this method can also be more costly for the fund to manage. In the second case, the guarantor negotiates the criteria of the portfolio. For example, loans size, SMEs sector, a particular location etc. However, in this case default rates tend to be higher. Moreover, since the portfolio is based on specific lending objectives, there is less risk diversification. Managers are thus confronted with a trade-off between lending volume and portfolio quality (OECD, 2010)

**2.2.5 Defaults** - The default rate is an important indication of a scheme's sustainability. Levistky considers that a sustainable scheme should aim to have a default rate between 2 and 3 percent. Newly established schemes in developing countries might consider a higher default rate (i.e. over 5 percent) in their early years of operation. Another question is how defaults are handled. Guarantee payouts should only be used as a last resort. Before it comes to this, guarantors (or lenders) should negotiate rescheduled

payments. This, however, requires experienced staff to re-negotiate loan terms.

### **2.2.6 Risk management and regulation**

To reduce or diversify risks funds might use risk management mechanisms such as reinsurance, loan sales or portfolio securitizations, provided that local financial markets are relatively well developed. 76 percent of the schemes studied use risk management tools. 20 percent purchase some form of loan insurance, 10 percent securitize the loans portfolio and 5 percent use risk management strategies (World Bank, 2008).

An example of a reinsurance mechanism is a counter-or co-guarantee, provided by the government or an international financial entity. Counter-guarantee systems are mostly located in developed countries. They are common in Europe both at the supranational (e.g. European Investment Fund) and national levels. For example, in Hungary's Garantiqa has been able to achieve a high equity multiplier due to the high share of guarantees counter-guaranteed by the government. However, the use of counter-guarantees needs careful consideration and should be accompanied by adequate regulation and supervision of the scheme (World Bank 2011).

Governments are required to construct the conditions to enable the creation and the growth credit guarantee schemes. A 2005 study by the London International Development Department identified a number of micro and macro factors that can contribute to the success of guarantee schemes. Among them is the need for an open, competitive environment with independent banks and a framework that will support SME creation and growth. Additionally, guarantees need to be regulated – however this is a slow process. For instance, Latin American countries only began regulating guarantees in the early 2000s (OECD, 2010). For this reason, the proper regulatory mechanisms including minimum capital requirements, the appropriate solvency ratio and transparency criteria need to be established.

### **2.2.7 Donors, the public sector and the private sector participation**

The role of the government should be limited to setting-up the appropriate legal environment and contributing to technical assistance. The primary role of the public sector in facilitating credit guarantee schemes is to create the appropriate regulatory environment. Initial public funding could also be considered (e.g. as in Colombia or Chile). "However, it is It is advisable that state subsidies interfere as little as possible with market mechanisms determining the supply and demand, and therefore the price and quantity of credit. In many cases, governments have provided guarantee schemes with subsidies to target guarantees at

SMEs or to help a guarantee fund expand operations. Subsidies should only be given over a short-term period, and the eventual aim of a guarantee scheme should be independence and self-sufficiency. What is very important, any government measures taken to ease SME financing should not impair fair competition and should avoid contributing to a rise in protectionism?

Donors' participation brings creditability to the scheme. However, donors should carefully examine guarantee schemes, clearly define the responsibility of each actor and determine payment conditions to encourage adequate risk allocation.

Private sector participation is important to ensure a fund's sustainability. Banks and other private institutions can have a direct stake in a fund's capitalization. Other options include private funding through equity. Private funds reduce the guarantee fund's dependency on public funds, which can sometimes be unstable.

## **3. Modeling Guarantee Fund for Georgia**

Micro and small companies had traditionally been underserved (e.g. Georgia Microfinance Demand Survey conducted in 2004 uncovered more than \$200 million gap between effective demand and supply of micro loans both from bank and non-bank financial institutions) by the lending community in Georgia. Due to improving business environment (Georgia's rank on overall World Bank Ease of Doing Business Survey 2012 is 16 out of 183), a large number of new micro and small companies have emerged and, together with the existing ones, they are in need of funding from the lending institutions for the growth and development. Micro and small companies encounter many difficulties in accessing credit through the formal financial sector, in part due to their informality, poor financial planning, and lack of collateral to guarantee loans.

World wide crisis and August (2008) conflict have substantially worsened access to credit for micro and small companies. This issue remains problematic till now.

The developed economies in their stimulus packages (responses to the world-wide economic crisis) among the most important proposals were considering measures aimed at ensuring continued credit flows to small and medium-sized companies, interesting examples are provided in articles: "Germany's Feeble Stimulus Package" (The Economist, November 10, 2008); "We Have a Plan"(The Economist, October 9, 2008) and "Japan Economy: A Tunnel, no Light" (The Economist, November 13, 2008) according which the Japan government was planning to provide loan guarantees for small and medium-sized businesses; "Britain's Credit-Guarantee Plan" (The Economist, January 15, 2009), according which in Britain the state decided to guarantee up to \$29 billion of loans to small and medium-sized enterprises; etc.

As to Georgia, it is unable to provide similar support to micro and small companies to sustain their growth prospects without external assistance;

### 3.1 *Guarantee Fund*

The lack of access to credit hinders the expansion and development of micro and small companies whose access to credit will deteriorate the most as a result of the financial crisis and August conflict. In our opinion a properly designed Guarantee Fund

a) Can improve comfort level of credit institutions to facilitate lending to micro and small companies;

b) Will mitigate the existing concerns of investors to mobilize savings through investing in a commercial bank (and other well known Georgian companies) fixed income securities for on-lending to micro and small companies;

c) Will foster development of fixed-income securities market; and

d) Will improve a foreign small business confidence to invest in Georgia by protecting it from political uncertainties, by providing insurance against loss or damage resulting from political violence, expropriation, or the inability to convert local currency (similarly as OPIC does for a US small business).

A Guarantee Fund by sharing credit risk with bank and non-bank credit institutions (similarly as the Small Business Administration (SBA) does in the USA recognizing that small business is critical to country's economic recovery and strength, to building America's future, and to helping the United States compete in today's global marketplace) will allow them to enter the large market of micro and small companies securely and profitably and develop appropriate banking technology to efficiently serve this segment, can play a very important role for Georgia's development.

This concept complies with donor organizations strategy of expanding access to credit to the thousands of micro and small companies in Georgia and enabling them to grow at more accelerated rates. It addresses to the goal of USAID Financial Sector Strategy (USAID, December 16, 2003) "to increase the efficiency of financial intermediation – the allocation of savings to the most productive private sector activities – and deepen financial markets by expanding access and the range of financial products and services available, leading to economic growth, job creation, and poverty reduction". According to the USAID Strategy for Economic Growth (USAID, April, 2008) developing well-functioning markets in developing countries is the central challenge and the main area of opportunity for USAID. As to specifically to the financial sector reform "Priority should be given to systemic reforms and capacity building to help mobilize savings and channel domestic and international private capital to support productivity growth, rather

than financing development directly".

### 3.2. *Operations*

1. Through a contract with a credit institution (or a well known non-bank company) and trustee, the Fund will undertake obligation to pay a portion of the unpaid balance of between 30 and 80 percent to holders of fixed income securities issued by the credit institution;

We believe that many Georgian individuals and legal entities, who currently do not trust their savings to the Georgian banks, will invest some of their savings in dollar denominated bonds issued by a Georgian commercial bank if 50% of these investments are guaranteed by a Western institution, such guarantees can mobilize savings much more effectively than deposit insurance schemes in such countries as Georgia; but we should note that even such scheme does not exist in Georgia). Such guarantees will also foster development of corporate debt market in Georgia (e.g. mortgage securities market). Corporate fixed-income securities markets have become an increasingly important source of financing for the private sector in recent years, especially for some emerging market countries. Previously, corporate borrowing had centered around the banking sector in many countries. However, the advent of several banking crises (e.g. the Asian financial crisis) in some of these countries has led to the realization that the sources of corporate borrowing need to be diversified. Unfortunately, to date, corporate fixed-income securities market in Georgia remains largely underdeveloped, with a limited supply of quality issues and inadequate market infrastructure (in the history of Georgia there were only few cases of bonds issuance by Procredit Bank, Bank of Georgia, Arsi (guaranteed by Bank of Georgia) - a construction company, Georgian Credit - an MFI, and Elit Electronics in 2006-2007 for the total amount of about 12 million Lari).

2. Through a contract with a credit institution, the Fund will agree to share credit risk with it. If the entrepreneur does not honor its commitments, the Fund will pay a portion of the unpaid balance of between 30 and 80 percent of the total loan to the credit institution. It may or may not include a part proportional to interest as well. Once the guarantee is paid out, the Fund replaces the credit institution, assuming legal rights for the amount of the guarantee outstanding.

The first two type of operations are similar to Development Credit Authority (DCA) bond guarantee and loan portfolio guarantee, respectively, but they offer higher leverage and flexibility. Regarding flexibility, we would like to note that it is similar to the US Securities and Exchange Commission Rule 415 allowing issuing company to register all of the securities it expects to offer over a two-year period and then take all or part of them „off of the shelf“ by filling a short form statement (Shelf offering). As to the

need for loan portfolio guarantee, we would like to note that during credit crunch micro and small companies will suffer the most from not having access to credit and guarantee provided to credit institutions for lending to them will ease this problem. In addition it should be noted that DCA assessment (Chemonics, November, 2008) anticipates that in the medium term demand for Loan Portfolio Guarantees for on-lending down-market to agriculture, health and MSMEs will be increased. Besides, such guarantees can be used for the creation of the trade finance facility that will focus on: a) providing working capital to the Georgian exporters in the form of bridge financing against contract payments by guaranteeing such loans made by a credit institution and b) support to a Georgian importer in supplying a confirmed letter of credit to a foreign seller.

3. The Fund's political risk insurance products will be available to foreign small businesses (similar to a political risk insurance provided by OPIC to small US businesses). Insurance will be available for investments in new ventures, expansions of existing enterprises, privatizations and acquisitions with positive developmental benefits. The goal of this instrument is to improve a foreign small business confidence to invest in Georgia and as a result to contribute to the revival of FDI flow in Georgia and to ensure stability of the Georgian economy.

Social objective: Mobilize savings and facilitate access to credit for all micro and small enterprises that have a good business model for investment but which do not have the collateral normally required by formal financial intermediaries. In other words, the Fund will effectively serve as collateral to reduce the risk of the financial intermediary.

Constitution (Management of fund): For the first several years the Fund must be managed by donor(s) in order to generate credibility and be established as a trustworthy institution. After these first years of activities the Fund should be turned into an indigenous institution by taking into account that, typically, Guarantee Funds are developed by the public sector, but it is also possible to create them through a private initiative. Moral hazard diminishes if the Fund is administered under a mixed scheme in which the private sector has significant participation in the Board of Directors coupled with the endorsement of the government. In many countries, especially Asian countries, the banks are shareholders as well.

Capital: The Fund should begin with enough capital to generate confidence from the credit institutions and investors in debt securities that it has the capacity to honor payments and cover administrative costs with earnings. Initial capital should be calculated as a proportion of the amount the Fund expects to mobilize and its expected default rate. In those markets with greater fund experience, the projected default rate tends to be around two percent of the guaranteed portfolio, but at the beginning it is advisable to calculate expected defaults at around five percent.

### 3.3 Basic Principles of Activity

The Guarantee Fund should conduct its activities on the basis of the following principles:

- Cost sharing. The Fund should require that a counterpart (e.g. a financial institution) assumes part of the risk. In no case should the fund assume 100 percent of the risk. The famous "Payout Risk Curve" (the higher the level of coverage, the higher the probability of loss for the Fund) demonstrates this.

- Timely payments. The rules for processing payments on guarantees demanded by credit institutions, bondholders and other investors should be very clear and should result in payment less than 30 days after they present their request to the Fund. This generates credibility, which is critical to increased utilization of the Fund.

- Clear rules for refusing guarantees. The risk of financial institutions presenting existing past due loans as new loans must be eliminated from the beginning. The same goes for restructured loans. It is very common for financial institutions to try to pass their problem loans over to the Fund.

- Clear processes for recuperation of paid guarantees. Once the guarantee is paid, the Fund should make collection by legal means part of the process if possible. Failure to take these steps could result in large losses for the Fund.

- Commissions. The Fund should establish a commission based on coverage, keeping in mind the Payout Risk Curve and current interest rates in the market. It should not exceed two percent of the amount of the loan, unless the rate of default in the market is much higher than this figure.

- Fund revenues. The Fund has two types of revenues: interest earned on invested capital and commissions. These should be sufficient to achieve financial equilibrium, but at the beginning the majority of revenues will come from invested liquid capital. In time, commissions should absorb the total of guarantees paid out as well as administrative costs. Only in this way is the Fund sure to grow, with the reinvestment of income on invested capital, a large part of which should be liquid.

- Costs. These include paid out guarantees and administrative costs. At the beginning (perhaps in the first year), the Fund will only have administrative costs. Afterwards, it will begin to receive requests from the financial institutions for payouts for loans in default.

Following these principles, it is possible to construct an instrument that can leverage its capital in such a way as to generate up to 100 times its equivalent in credit loaned to micro and small companies. A Guarantee Fund is much more efficient than a direct credit program because it leverages financial intermediary's funds without tying up its own capital in loans that require complex administration. It is the most effective mechanism for expanding and "mas-

sifying” micro and small credit.

#### 4. Conclusions and suggestions

The above considerations demonstrate that it is the right time for Georgia to put into place a new instrument that can mobilize savings by developing corporate debt market, be the catalyst for much greater engagement by local credit institutions in the micro and small companies’ financial services market and improve foreign small business confidence to invest in Georgia. This instrument would enable the sharing of micro and small companies’ credit risk with the credit institutions in a way that would allow them to develop their own risk management technology to serve the segment securely and profitably.

Consequently, it is proposed that a Georgian Guarantee Fund be created that would have the following characteristics: Initial capital: up to \$10 million; Legal status: For the first several (three) years donor managed fund. After that turned into an indigenous for-profit company; Leverage: In order to avoid any additional risks from the donor(s) side the Fund can be restricted to provide guarantees with the total value of only \$20 million (i.e the worst case scenario, when it is assumed that guaranteed loan portfolio’s default rate is 100%). The deposit placed at the Georgian commercial bank can generate loans worth of additional \$10 million; Costs: If \$10 million initial capital is placed at the one year deposit in a commercial bank (at about 8-10% interest rate) with the right to withdraw monthly interest rates, then the interest paid on this deposit can easily cover the Fund’s administrative costs; Moreover, interest earned on the deposit, together with commissions received from the Fund’s activities, can cover the total of guarantees paid out. At the end of the project donor(s) can use the substantial amount of \$10 million for their other activities without affecting the total volume of guarantees provided by the Fund. For example, when the Fund continues its activities as an indigenous institution and assumes that the maximum default rate is 10% than \$2 million can guarantee the same \$20 million and donors can use \$8 million for their other activities). Beneficiaries: Micro and small companies; Organization of fund: Can initiate operations with about 10 people.

#### References

- Beck T. Klapper L, Mendoza J.(2008) The Typology of PCG funds around the World, The World Bank Research Group, November 2008. Retrieved from <http://siteresources.worldbank.org/>
- Bennett. F., Doran. A. and Billington. H., (2005); Do Credit Guarantees Lead to Improved Access to Financial Services? Recent Evidence from Chile, Egypt, India and Poland, Commission Financial Sector Team, Policy Division Department for International Development LONDON, February 2005.
- Facilitating access to finance. OECD Discussion paper on credit guarantee schemes (2010) Retrieved from <http://www.oecd.org/dataoecd/52/5/45324327.pdf>
- Fixing Finance: A Slice of Danish, the Economist (December 30, 2008) Retrieved from <http://www.economist.com>
- Japan Economy: A Tunnel, no Light, The Economist (November 13, 2008) Retrieved from <http://www.economist.com>
- Georgia Microfinance Survey, 2004
- Germany’s Feeble Stimulus Package, The Economist (November 10, 2009). Retrieved from: <http://www.economist.com>
- Green. A.,(2003); Credit Guarantee Schemes for Small Enterprises: An Effective Instrument to Promote Private Sector-Led Growth?, the United Nations Industrial Development Organization (UNIDO) Working Paper No. 10, August 2003.
- Guarantee Schemes and how they can help SME getting better access to financing, José Fernando Figueiredo António Gaspar President AECM Member of the Board of SPGM Portugal Retrieved from <http://www.oecd.org/dataoecd/23/36/45463393.pdf>
- IMF Country Report No. 08/328, October, 2008, p.11
- Levitsky. J., (1997); SME Guarantee Schemes: A Summary; The Financier, vol. 4, NO. 1 & 2, February/May 1997, <http://www.the-financier.com>
- Levitsky. J.,(1997); Credit guarantee schemes for SMEs an international review, Small Enterprise Development, No 2 June 1997.
- Roper. S., (2009) Credit Guarantee Schemes: a tool to promote SME growth and innovation in the MENA Region, Warwick Business School, UK for the 3rd MENA-OECD Working Group on SME Policy. Retrieved from <http://www.oecd.org/dataoecd/6/53/43982478.pdf>
- Saadani Y., Arvai Z., Rocha R. (October 2010) A Review of Credit Guarantee Schemes in the Middle East and North Africa Region The World Policy Research Working Paper 5612, Retrieved from <http://siteresources.worldbank.org>
- Summary of Joint Needs Assessment, The World Bank, October, 2008
- The Impact of the Global Crisis on SME and Entrepreneurship Financing and Policy Responses, (2009) Retrieved from <http://www.oecd.org/dataoecd/40/34/43183090.pdf> -
- USA Securities and Exchange Commission Rule 415, Retrieved from [www.sec.gov](http://www.sec.gov)

USAID Financial Sector Strategy, December 16, 2003, p.9

USAID Strategy for Economic Growth , April, 2008, p.25

We Have a Plan, The Economist, October 9, 2008, Retrieved from <http://www.economist.com>

Honohan, Patrick.,(2008) Partial Credit Guarantees Principles and Practice, Prepared for the Conference on Partial Credit Guarantees, Washington DC, March 13-14, 2008,Retrieved from [http://siteresources.worldbank.org/INTFR/Resources/Honohan\\_PCG-](http://siteresources.worldbank.org/INTFR/Resources/Honohan_PCG-)