Session 4. Improving lending infrastructure for SME financing

Korean Experience in Credit Guarantee Scheme

September 27, 2017
1. Rationale for Credit Guarantee Scheme
Why SMEs need Government Assistance?

- **Characteristics**
  1. Lack of collateral
  2. High risk of default
  3. High transaction cost

- **Consequence**
  1. Limited access to finance
  2. Credit allocation by banks
  3. High interest rate
  4. Lack of long-term financing

Underdeveloped SME Financing Market

"Government Intervention Required!!"
What Kind of Government Intervention?

Direct fund
- Direct lending
- Grant
- Interest subsidy
- Credit Guarantee
- Fund of funds
- SME loan ratio
- Credit information infrastructure

Equity investment

Others

Issues: source of fund, selection, risk-taker, sustainability, efficiency, market-friendly
What is Credit Guarantee Scheme?

CGS (Credit Guarantee Scheme) provides guarantees on SME loans to cover the default risk of the borrowers. It is known as the most effective and market-friendly government intervention in SME financing.
Why Credit Guarantee Scheme?

- Access to formal finance
- Low interest rate
- Long-term investment
- Reliable collateral
- Expanded SME market
- Capital adequacy ratio
- Economic development
- Job creation
- Social safety-net
- Access to formal finance
- Low interest rate
- Long-term investment
More than half of the countries has introduced CGS but many are not so successful.
2. Credit Guarantee System of KODIT
Credit Guarantee Providers in Korea

Korea Credit Guarantee Fund
- Establishment: 1976
- Market share: 51%
- Source of fund: Central Government, Banks

Korea Technology Finance Corporation
- Establishment: 1989
- Market share: 24%
- Source of fund: Central Government, Banks

16 Regional Credit Guarantee Foundation
- Establishment: 1999
- Market share: 25%
- Source of fund: Local Government, Central Government, Banks
Overview of KODIT

- KODIT is the largest credit guarantee institution in the world as a single entity

- **Status**: Non-profit, Non-capital Special Legal Entity
- **Establishment**: 1976
- **Capital Fund**: USD 4.7 billion
- **Outstanding Guarantee**: USD 42 billion
  * New supply (in 2016): USD 12.1 billion
- **Number of guaranteed companies**: 205,361
- **Number of Employees**: 2,300
- **Business network**: 1 Head office, 9 Regional HQs, 107 Branches
How the Scheme Works?

1. Ordinary Procedure
   - KODIT (Guarantor)
     - Credit Assessment (one by one)
     - Apply
     - Issue Guarantee
     - Loan
     - Repay
   - SMEs (Debtor)
   - Banks (Creditor)

2. SMEs Defaulted
   - KODIT (Guarantor)
     - Payment Claim
     - Repayment
     - Subrogation Pay
     - Default
   - SMEs (Debtor)
   - Banks (Creditor)
Key Operational Principles

Eligibility
- All for-profit entities are eligible with some exceptions

Ceiling per company
- Maximum USD 9 million
- Firm specific: by sales and equity (working capital)

Coverage Ratio
- 70 ~ 85% (Start-ups: up to 100%)

Guarantee Fee Rate
- 0.5% ~ 3.0% per annum (risk based pricing)

Other key facts
- Pure credit (no collateral), direct screening & internal rating model, bank funding
Sources of Fund

• Contributions

- Government (irregular)
  - Subject to yearly budget of the government

- Banks (regular)
  - Mandatory donation in proportion to outstanding corporate loans (APR 0.225%)

- Others (irregular)
  - Occasional contributions from banks or large enterprises

• Cumulative contributions (~ 2016)

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<thead>
<tr>
<th>Government</th>
<th>Banks</th>
<th>Others</th>
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<tr>
<td>44%</td>
<td>51%</td>
<td>5%</td>
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</table>

Government | Banks | Others
Performance and outcomes

- Outreach
  - In Korea 1/3 of MSMEs are credit guarantee customers (MSMEs: 3.5 million)

- Financial additonality
  - CGS generated 63% of additional credit and 3.1% lower interest rate (2012)

- Economic additonality
  - Improved performance, more job creation of guaranteed SMEs
  - Increased tax revenue for government

- Financial sustainability
  - KODIT is financially sustainable by bank funding w/o government budget
### SME Loan Market Development

**SME loan market grew up to 80% of total corporate loan market**

<table>
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<tr>
<th>Category</th>
<th>1975</th>
<th>2016</th>
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<tr>
<td>LEs</td>
<td>1.1</td>
<td>128</td>
</tr>
<tr>
<td>Amount</td>
<td>1.1</td>
<td>128</td>
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<tr>
<td>%</td>
<td>64.3%</td>
<td>19.4%</td>
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<tr>
<td>SMEs</td>
<td>0.7</td>
<td>490</td>
</tr>
<tr>
<td>Amount</td>
<td>0.7</td>
<td>490</td>
</tr>
<tr>
<td>%</td>
<td>35.7%</td>
<td>80.6%</td>
</tr>
<tr>
<td>Total</td>
<td>1.8</td>
<td>618</td>
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**Guaranteed loans take 13.0% of total SME loans of Banks**

- Guaranteed loans take 13.0% of total SME loans of Banks.
Macroeconomic Tools

- Counter-cyclical roles during the economic crises

Source: Bank of Korea, KODIT

(1 USD = 1,150KRW)
3. Implications
① Financial Sustainability

- Who pays the fund for guarantee?
- Seed capital may not be enough for the sustainability
- How to share fund among three parties (Government, Bank, SMEs)

② Operational Efficiency

- How to design optimal operational framework?
  - Direct (CGS) vs. indirect (banks), Individual vs. portfolio

  * Consideration: development of banking sector, credit information infrastructure such as CB and PCR
③ Risk management

- Credit risk of SMEs → credit assessment tools (Direct method)
- Moral hazard of banks → maximum payment ceiling (Portfolio method)

④ Regulator and Performance Evaluation

- Who will regulate CGS? Financial regulators or relevant ministries
- What we measure? Outreach, additionality, financial sustainability
Thank you!