Inter-American Development Bank Document

**Barbados**

**Lessons learned for the Barbados SME Guarantee Fund**

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1. **Background**
   1. The proposed program will provide a guarantee mechanism to promote productive investment projects, with particular emphasis on SMEs. The project will be in the form of a lending operation to the government to create a partial credit Guarantee Fund to compensate for the existing lack of collateral from SMEs for loans from commercial banks. It is expected that in the long term, the guarantees undertaken under the project will have a demonstrative effect that will stimulate a higher risk appetite in commercial banks for the SMEs segment and lead to increased financing in this market segment.
   2. The objective of the proposed project is to contribute to increased productivity of SMEs by facilitating access to medium- and long-term credit for productive investment projects. In particular, the program will assist SMEs in accessing credit, through the provision of partial credit guarantees to IFIs, for medium and long term capital investments that allow the SMEs to modernize and remodel their businesses.
2. **Lessons Learned in Barbados.**
   1. **Government initiatives.** Barbados has made a longstanding concerted effort to develop its public policy to support the smaller firms in the country. In 2002, the government enacted the [Small Business Development Act](http://www.commerce.gov.bb/Legislation/Documents/Small%20Business%20Development%20Act,%20Cap%20318C.pdf), which provided a framework of activities aimed at supporting micro and small enterprises through incentives (fiscal and others) and technical support.
   2. The government has more recently developed a dedicated institutional framework to spur SMEs entrepreneurship through the Ministry of Industry, International Business, Commerce and Small Business Development. The “[Barbados Growth and Development Strategy Document for 2013-2020](http://www.economicaffairs.gov.bb/news-detail.php?id=138)” has a section dedicated to Micro, Small and Medium Sized Enterprise (MSME) Development (Section 4.3.5), in which it highlights the government’s commitment to provide for greater access to capital for MSMEs and to further promote their growth, productivity and revenue generation. The policy also highlights the importance of the private sector in the country’s economic growth, the government’s commitment to promote business facilitation, and the role that financial institutions play in promoting investments.
   3. As part of this public policy framework, over the last 10 years the government has been developing a number of dedicated funding initiatives amounting to about US$80 million comprising: the Enterprise Growth Fund Limited (created in January 1998), the Caribbean Financial Services Corporation and the Youth Entrepreneurship Scheme, each with a specific sector allocation such as tourism and small hotels investment, agricultural development, industrial investment and employment.[[1]](#footnote-1) The government, through the Central Bank of Barbados (CBB), also offers financing and guarantee schemes to support credit and export promotion. There are different types of schemes provided by the CBB,[[2]](#footnote-2) with the most important mechanism being the Enhanced Credit Guarantee Scheme (ECGS) and the Trade Receivables Liquidity Facility (TRLF).
   4. These schemes have had limited effectiveness to address financing needs for SMEs: (i) their eligibility criteria has been sector or niche based, too narrow to support the comprehensive needs of SME financing, (ii) their terms and conditions have not been sufficiently attractive for the financial institutions, (iii) their non-standardized requirements from one scheme to another have created a perception with financial institutions that applying for a guarantee is cumbersome, (iv) there has been limited outreach with financial institutions and potential beneficiaries to developed a sustained pipeline, and (v) the practice when filing claims has created a perception with financial institutions that these can only be submitted once the company has been liquidated and that it can be particularly of contentious justification.
   5. Taking into consideration these lessons learned, the SME Guarantee Fund proposes to set up a fully differentiated and dedicated scheme for SMEs in Barbados, with sufficiently broad eligibility criteria to comprehensively support SME needs, clear and swift operating regulations to address concerns from the financial institutions, and managed separately to cater to IDB requirements to segregate funds and provide specific reporting).[[3]](#footnote-3) This SME Guarantee Fund has been developed in conjunction with the CBB, representatives of the financial institutions and with representatives of SME to provide an effective public policy instrument to encourage the participation of the banking system in the downscaling efforts of financing to SMEs in Barbados.
   6. The objective of the proposed project is to contribute to increased productivity of SMEs by facilitating access to medium- and long-term credit for productive investment projects. In particular, the program will assist SMEs in accessing credit, through the provision of partial credit guarantees to IFIs, for medium and long term capital investments that allow the SMEs to modernize and remodel their businesses.
3. **Lessons Learned in Latin America and the Caribbean.**
   1. There are several successful SME guarantee fund experiences in the region (Chile, Peru and Colombia) on which the program can draw for positive demonstration effect experience and lessons learned. Through these schemes, SMEs were able to obtain suitable financing amounts, terms and conditions relative to their needs, while the intervention showed generally positive trends in investment, productivity, employment, and revenues.
      1. For example, in Chile[[4]](#footnote-4) beneficiaries of the guarantee fund are 14% more likely to obtain credit than non-beneficiaries (SMEs that did not apply for guarantee), contributing to an increase of 40% in volume of credit, in sales of 32% and in profits of 24%.
      2. In the case of Colombia[[5]](#footnote-5), firms supported increased 6% in terms of sales and 3.7% in terms of employment more than firms that did not benefit from the program (limited because use of a part of the funds was directed towards working capital).
   2. Several lessons have been drawn from these experiences to improve the design and implementation of the SME Guarantee Fund in Barbados: (i) the guarantee mechanism has been designed to support medium- to long-term investment loans to maximize the project’s effect on productivity, thus avoiding the pitfall of broad use of proceeds in guarantee schemes that ended up supporting a large proportion of short-term transactions (therefore having a reduced impact on productivity); (ii) the guarantee mechanism is managing a conservative scenario in which the default rate may be higher than the current banking system’s outstanding portfolio (given that the scheme is supporting loans that are currently not being supported), however proper risk mechanisms have been put in place in order to assure proper origination, approval, and monitoring by the IFIs (such as providing a partial credit guarantee so that IFIs commit their own capital to the loans).[[6]](#footnote-6)
   3. Finally, the need to expand the supply of medium and longer term credit to SMEs for productive investment is justified also by diagnoses and resulting lessons learned from the work undertaken by the Multilateral Investment Fund (MIF) in Barbados in support of small businesses, as well as from the work of Compete Caribbean via the Private Sector Assessment Report.

1. For a more detailed analysis see Lindsay Holder and Clyde Mascoll, “A Policy Framework To Incentivize The Micro Business Sector In Barbados, The Barbados Private Sector Association, July 2013. [↑](#footnote-ref-1)
2. Products managed by the CBB include: Enhanced Credit Guarantee Scheme (ECGS), the Trade Receivables Liquidity Facility (TRLF), Tourism Loan Guarantee Scheme, Barbados Investment Fund, Export Credit Insurance Scheme, Export Finance Guarantee Scheme, Export Rediscount Facility, Industrial Credit Fund. [CBB, 2014](http://www.centralbank.org.bb/WEBCBB.nsf/0/3da4317e82b2ce59042572ec000d0141?OpenDocument). These schemes will continue to operate independently and are not expected to be affected by the project. [↑](#footnote-ref-2)
3. See [Analysis of SME’s Demand for Investment Credit](http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=38995189). [↑](#footnote-ref-3)
4. OECD, “Facilitating access to finance: discussion paper on credit guarantee schemes”; Juan José Llisteri et al, IDB, “Sistema de garantías de crédito en América Latina: orientaciones operativas”, 2006 [↑](#footnote-ref-4)
5. Irani Arraíz, Marcela Meléndez and Rodolfo Stucchi, Office of the Evaluation and Oversight, IDB, “Partial credit guarantee and firm performance: evidence from the Colombian National Guarantee Fund”, September 2012 [↑](#footnote-ref-5)
6. OECD, “Facilitating access to finance: discussion paper on credit guarantee schemes”; Juan José Llisteri et al, IDB, “Sistema de garantías de crédito en América Latina: orientaciones operativas”, 2006; Cristian Larraín and Jorge Quiroz, Banco del Estado de Chile, “Estudio para el fondo de garantía de pequeños empresarios”, March 2006; Kevin Cowan, Alejandro Drexler and Alvaro Yañez, Central Bank of Chile Working Papers Nº254, “The effect of credit insurance on liquidity constraints and default rates: evidence from a governmental intervention”, August 2009; Irani Arraíz, Marcela Meléndez and Rodolfo Stucchi, Office of the Evaluation and Oversight, IDB, “Partial credit guarantee and firm performance: evidence from the Colombian National Guarantee Fund”, September 2012; Javier Alvarado and Francisco Galarza, Centro Peruano de Estudios Sociales, “Los fondos de garantía para el acceso al crédito en Perú: alcances y limitaciones”, October 2002. [↑](#footnote-ref-6)