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# ACCESS TO FINANCE FOR SMEs BY CREDIT GUARANTEE SCHEMES IN TURKEY

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**─Abstract ─**

Credit guarantee schemes assist banks in lending to SMEs by overcoming collateral problems. The guarantees are used to share the risk between the bank and the guarantee institution in an agreed ratio. Thus, the bank's risk and operation costs are lowered and its returns increased. This encourages banks to lend to SMEs who are unable to provide adequate collateral. In our study, we investigate the relationship between SMEs, banks and CGSs. We also aimed to explain the functioning of CGSs in Turkey and to evaluate their performance. In this respect, we determined some ratios of CGSs in Turkey and compared with some of the EU countries using data for a six year period from 2006 to 2011. The results show that CGSs in Turkey are increasing their performance of supporting SMEs, but they should increase their effort to reach the average level of AECM member countries.

**Key Words:** *Credit, Guarantee, SMEs*
**JEL Classification:** G23

## 1. INTRODUCTION

Small and Medium Sized Enterprises (SMEs) are the backbone of all economies and are a key source of economic growth, dynamism and flexibility in advanced industrialised countries, as well as in emerging and developing economies. SMEs constitute the dominant form of business organisation, accounting for over 95% and up to 99% of enterprises depending on the country(OECD, 2009). One of the most important constraints of SMEs is the lack of credit which hinder them from reaching their business potential. Banks are reluctant to provide loans to SMEs for some reasons such as asymmetric information, high administrative costs, lack of collateral and the high risk perception. The credit guarantee mechanism is a commonly used response to these factors. The guarantees are used to share the risk between the bank and the guarantee institution in an agreed ratio. Thus, the bank's risk and operation costs are lowered and its returns increased. This encourages banks to lend to SMEs who are unable to provide adequate collateral.

CGSs are operated by a large number of countries and two of them support SMEs in Turkey. In our study, we investigated the relationship between SMEs, banks and CGSs. We also aimed to explain the functioning of CGSs in Turkey and to evaluate their performance. In this respect we determined some ratios of CGSs in Turkey and compared with some of the EU countries. The study makes use of transactions data for a six year period from 2006 to 2011. The structure of the study is as follows. Chapter two provides a brief definition of SMEs, overview of the importance of them and presents the financial problems of SMEs. A brief overview of the Turkish SMEs is also given in chapter two. In section three, the description and typology of CGSs has been given and a brief overview of the Turkish CGSs is presented. Section three also evaluates some ratios of the CGSs in Turkey and compares them with some EU countries. The paper ends with some concluding remarks.

## 2. SMALL AND MEDIUM SIZED ENTERPRISES

It has hard to draw one single definition of SMEs valid across countries. In our study, we depend on the EU official definiton classifies SMEs as the companies with fewer than 250 employees and which are independent from larger companies. Furthermore, their annual turnover may not exceed €50 million, or their annual balance sheet not exceed €43 million. In addition to this definition, SMEs have some widely accepted qualifications. SMEs perform vital productivity and growth enhancing functions in any economy. They play an important role in developing and developed economies as they create new business, increase employment opportunities, develop innovative product ideas, and raise productivity (Nitani and Riding, 2005). SMEs are usually the source of new ideas and products and through such innovation they fuel a nation's economic engine. Through job creation SMEs contribute towards poverty alleviation, social stability and local and regional development. However, in most economies SMEs face constraints when accessing formal sector credit and this prevents them from achieving their full potential. The market failure in the credit market for SME's stems mainly from four factors. These are high administrative costs of small scale lending, asymmetric information, the high risk perception on small firms and lack of collateral(De Alwis and Baynayake, 2009). SMEs represent 99% of enterprises around the world and account for more than half of all private sector employment. Their role and need for support in funding has been recognized by governments globally who have introduced a variety of initiatives including credit guarantee schemes (OECD, 2009).

## 2.1. SMEs in Turkey

There was not an agreement on the definition of SME in Turkey until 2005 when the definition of SME in accordance with the EU criteria was accepted. According to this definition in Turkey, SME is an enterprise which has between 1 to 249 employees, has annual balance sheet value and receive sales revenues up to 25 million Turkish Lira and operate under "independency principle''.

Like in other developed or developing countries, SMEs are the backbone of Turkish economy. Because of their big proportion in Turkish enterprises, SMEs are a very important source of employment investments. They also contribute immensely to value creation in the country. According to Turkish Statistical Institute more than 99% of enterprises are SMEs and more than 78% of the work force is employed by SMEs in Turkey. SMEs' share in total turnover is nearly 65% and SMEs' share in total exports was 60% for the year 2010. The SMEs sector, including services, accounted for 78% of the total employment, 50% of capital investment, 55% of value added, roughly 55% of exports in 2008. While SMEs impact the economy in terms of employment, they also make a remarkable contribution to capital investment, value added and Turkish exports. In SMEs, while 78% of the wage earners are male, only 22% are female. Despite the economic improvement of SMEs in Turkey, still they have problems such as low level of productivity and technology, insufficient know-how and ineffective human resource management(KOSGEB, 2012). However, the most important problems seems to be financial such as difficult access to bank credit, insufficient access to capital market, insufficient equity capital and lack of financial management.

## 3. CREDIT GUARANTEE SCHEMES (CGSs)

In surveys of SMEs worldwide, access to finance emerged as one of the most urgently felt needs. This is why programmes of financial assistance are one of the principal ways in which governments, international development agencies and donors support this sector.

Within the financial sector, banks are reluctant to deal with SMEs for some reasons. Information asymmetry is a core reason of commercial banks' generally being reluctant to provide loans to SMEs. In most instances, SMEs are unable to provide information on their creditworthiness they tend to lack appropriate accounting records and collateral. This leads to uncertainty on the project's expected rates of return and the integrity of the borrower. Gathering such information on SMEs can be challenging and costly. Lending administrative costs tend to be higher for smaller firms. Obtaining information requires more resources as a percentage of the underlying loan. Visiting borrowers and monitoring their activities is expensive and not always economically rational when a loan size is small(Green, 2003). Such information asymmetries increase banks' reluctance to lend to SMEs because of the presence of adverse selection and moral hazard in the credit transaction (Hoff and Stiglitz, 1990). Adverse selection is another problem stemming from information asymmetry. In this context, adverse selection starts with the market phenomenon whereby the probability of default increases with the interest rate. As interest rates increase, safer borrowers are driven out of the lending pool while riskier borrowers remain. This leads to an increasingly riskier portfolio of loans. For this reason, banks are reluctant to raise the interest rate above a certain level. Instead, they prefer to maintain the quality of the borrower pool. However, banks' inflexibility in increasing interest rates prevents many SMEs, which are typically riskier investments, from obtaining loans even if they would be willing to pay the higher interest rate(OECD, 2009). Banks are hesitant to lend to SMEs not only because of the asymmetric information problem arising from difficulties on gathering historical financial information; but also for high transaction costs, weakness on registration of the collateral, execution of the contract, laws of bankruptcy, judicial process, unaudited financial results and their structure based on limited liability (Thornsten et al, 2010). In order to lessen the financing constraints faced by SMEs, governments, national guarantee organisations and the private sector have developed initiatives such as credit guarantee schemes where financial institutions are encouraged to make loans available to smaller enterprises, on the understanding that a government or quasi-government body will reimburse a percentage of the loan should the firm default. (OECD, 2009 - Boocock and Shariff, 2005)

Today the credit guarantee system of each country comes in different shapes, reflecting the history and the socioeconomic development stage of the country. Even countries in a similar stage of economic development or in geographical proximity may be operating different type of systems. Thus, it is hard to draw a definition of credit guarantee that exists in a wide variety of forms. Yet, it is widely accepted that credit guarantee system attempts to overcome the credit market imperfection which disadvantaged groups—notably the SMEs—are experiencing in getting formal loans, by allowing lenders to shift loan recovery risks to the guarantee program (Vogel and Adams,1997).

Green (2003) refers to four major types of guarantee schemes :

- *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.

### 3.1. Credit Guarantee Schemes in Turkey

There are two financial lend support bodies in the form of guarantees to SMEs in Turkey; (1) The Credit Guarantee Fund, Inc.(KGF) and (2) Union of Credit and Guarantee Cooperatives for Tradesmen and Craftsmen of Turkey (TESKOMB)

- *The Credit Guarantee Fund :* KGF was established in 1991. It is composed of TOBB (The Union of Chambers and Commodity Exchanges of Turkey); KOSGEB (Small and Medium Industry Development

Organization) as major shareholders and by 20 Turkish banks, as well as some minority shareholders, such as TESK (The Confederation of Tradesmen and Cratftsmen of Turkey); TOSYOV (Turkish Foundation for Small and Medium Business) and MEKSA (The Foundation of Vocational Training and Small Industries). The main objective of KGF is supporting the SMEs by providing a guarantee for their financing and consequently increasing the credit usage in general. KGF acts as an intermediary organization and makes it possible for the SMEs with the inadequate collaterals to apply for bank credits, also increase the number of customers for the banks and minimize their risks. This does not simply mean an increase of the number of firms who become eligible to obtain bank credits, but also means an increase in the number of medium or long term credits available for SMEs and an increase in the limits of credits provided for them. Main priorities of KGF are to support young and woman entrepreneurs, to promote innovative investments, to promote high-tech SMEs, to support export, to increase the rate of employment and to contribute regional development. KGF has protocol with 26 banks, 14 leasing institutions and have 33 branches in 29 cities in Turkey. They provide guarantee for the needs of loans which will be used for operational requirements for enterprises. There is no imposed restrictions of type of credit. It could be cash credit as investment credit or non-cash credit as credit for letter of guarantee but KGF covers up to 80 % of the loan. If credit request is considered appropriate and used by means of guarantee of the fund, KGF draws annually definite and certain amount of commission on balance of guarantee by cash. Commission rates are between 1% and 2% depend on the type of guarantee. Guarantee limit is TRL 1.000.000 per SME and TRL 1.500.000 for the risk group that SME is related.

- *Union of Credit and Guarantee Cooperatives for Tradesmen and Craftsmen of Turkey :* TESKOMB was established in 1970 as an umbrella organization bringing together all the cooperatives established throughout Turkey. TESKOMB and its suborganizations have been established in accordance with the Law on Cooperatives of Turkey. The main objective of cooperatives is to provide the required credit to member tradesmen and craftsmen for their professional activities or to provide collateral to these members to attain these credits or bank guarantees. In this context, the cooperatives; (1) determine the amount of credit to be provided to the members in line with their declarations or evaluation reports, (2) find new credit opportunities for members, (3) receive loans from related organizations in order to realise the objectives of the cooperatives. There are 32 Regional Unions and 910 cooperatives with 1.100.000 members under TESKOMB as of 2012. The only finance institution that provides credit with below market interest rate to tradesmen-craftsmen and SMEs in Turkey is Halk Bank. The credits provided by Halk Bank are classified under two headings, namely; "specialization credits" and "others". Under specialization credits, there are; industry credits, fund credits and cooperative credits. The others are "commercial" and "personal" credits. The cooperative credits are disbursed through Tradesmen-Craftsmen Credit and Guarantee Cooperatives. The difference between the interest rate of these types of credits and commercial credits is compensated by the State(TESKOMB, 2013).

### 3.2. Evaluation of Credit Guarantee Schemes in Turkey

To explain the place of gurantee schemes in Turkish economy, the share of the guarantees in GDP and in SME Loans are analysed and compared with some EU countries. In addition to these ratios, the average amount of the active guarantees are also calculated for comparison. The data is collected from the statistics and publications of European Central Bank(ECB), European Asssociation of Mutual Guarantee Societes(AECM[*]), Banking Regulation and Supervision of Turkey(BRSA), Worldbank, OECD, Halkbank and KGF.

The total volume and the number of active guarantees in portfolios of the credit guarantee schemes in Turkey by 31.12 from 2007 to 2012 are below in the Table 1.

- *The total volume of outstanding guarantees in portfolio* (VOLGU) is the total monetary outstanding amount of guarantee commitments in the off-balance records of the annual financial statements. Over the period from 2007 to 2012 the total volume of outstanding guarantees in portfolio increased by 125% and reached to € 3,58 billion from € 1,59 billion. The major increase of 36 % is noticed between 2010 and 2011.
- *The number of active guarantees in portfolio* (NUMGU) is the number of outstanding guarantee commitments, in the off-balance records of annual

[*] AECM represent 38 member organisations from 20 EU member states as well as from Turkey, Russia and Montenegro

financial statements of the guarantee by 31.12. Unlike the growth of the volumes of the outstanding guarantees in portfolio, the number of operations has not increased in this period.

Table 1 Volume and Number of Guarantees in Portfolio

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|
| Volume(€.000) | 1.593.705 | 1.494.585 | 1.980.000 | 2.121.511 | 2.878.097 | 3.578.607 |
| Number | 267.225 | 254.455 | 262.023 | 265.392 | 279.024 | 264.118 |

Source : AECM, Halkbank, KGF.

Table 2 monitors the growth of the ratios measured by the volume of guarantees to GDP(ROGDP), to the total volume of SME loans(ROSMEL) and to the number of guarantees(RONUM) in 2007-2012 period.
All of the ratios have increased in this period. But the increase in RONUM is significant. The average number of the active guarantees is almost doubled.

Table 2 : Volume of Guarantees to GDP, to SME Loans and to the Number of Guarantees Ratios

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|
| ROGPD | 0,0034 | 0,0030 | 0,0045 | 0,0039 | 0,0052 | 0,0058 |
| ROSMEL | 0,0263 | 0,0196 | 0,026 | 0,0229 | 0,0344 | 0,0329 |
| RONUM | 5.964 | 5.874 | 7.557 | 7.994 | 10.315 | 13.549 |

Source : Worldbank, AECM, Halkbank, KGF, BRSA and own calculations.

Table 3 indicates the ROGPD, ROSMEL and RONUM of some AECM member countries from 2009 to 2011.

- The results for Turkey in ROGP category are behind the mean. Turkey seems to be less supportive than the average, with 0,0046, 0,0039 and 0,0048 in comparison with 0,0072, 0,0070 and 0,0064 in 2009, 2010 and 2011.
- Turkey’s result for ROSMEL category is above the avarage of AECM countrie. The share of guranteed loans in the SME lendings of the commercial banks is relatively higher in Turkey compared with the avarage of AECM member countries reviewed (0,026 vs 0,0196 in 2009, 0,023 vs 0,018 in 2010 and 0,034 vs 0,018 in 2011).
- Turkey’s results for RONUM are quite below the avarage in comparison with 7.577 vs 71.872 in 2009, 7.994 vs 72.546 in 2010 and 10.315 vs 72.291. Turkey is the last among AECM member countries in this section.

Table 3 Volume of Guarantees to GDP, to SME Loans and to the Number of Guarantees Ratios of AECM Member Countries

| | ROGPD | | | ROSMEL | | | RONUM | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2009 | 2010 | 2011 | 2009 | 2010 | 2011 | 2009 | 2010 | 2011 |
| Austria | 0,0017 | 0,0016 | 0,0014 | 0,0031 | 0,0029 | 0,0025 | 83.108 | 68.439 | 65.876 |
| Belgium | 0,0014 | 0,0014 | 0,0019 | 0,0044 | 0,0044 | 0,0061 | 95.838 | 79.184 | 102.845 |
| Bulgaria | n.a | 0,0009 | 0,0016 | n.a. | 0,0019 | 0,0035 | n.a | 25.155 | 30.931 |
| Czech Rp. | 0,0049 | 0,0063 | 0,0053 | 0,0237 | 0,0302 | 0,0257 | 152.478 | 161.426 | 151.762 |
| Estonia | 0,0050 | 0,0069 | 0,0065 | 0,0098 | 0,0151 | 0,0172 | 75.386 | 91.910 | 82.598 |
| France | 0,0071 | 0,0083 | 0,0082 | 0,0161 | 0,0192 | 0,0187 | 22.205 | 26.563 | 33.549 |
| Germany | 0,0024 | 0,0020 | 0,0023 | 0,0062 | 0,0057 | 0,0065 | 122.464 | 115.092 | 121.964 |
| Greece | 0,0151 | 0,0114 | 0,0064 | 0,0377 | 0,0215 | 0,0116 | 64.505 | 43.411 | 23.443 |
| Hungary | 0,0187 | 0,0163 | 0,0136 | 0,0603 | 0,0577 | 0,0552 | 43.779 | 37.020 | 32.740 |
| Italy | 0,0217 | 0,0213 | 0,0208 | 0,0383 | 0,0377 | 0,0363 | 44.946 | 45.650 | 46.234 |
| Latvia | 0,0023 | 0,0047 | 0,0044 | 0,0044 | 0,0097 | 0,0109 | 115.090 | 159.108 | 212.527 |
| Lithuania | 0,0083 | 0,0079 | 0,0066 | 0,0235 | 0,0257 | 0,0262 | 72.283 | 63.747 | 54.549 |
| Luxembourg | n.a | n.a | 0,0001 | n.a. | n.a. | 0,0001 | n.a | n.a | 32.075 |
| Montenegro | n.a | n.a | n.a | n.a. | n.a. | n.a. | n.a | n.a | n.a |
| Netherlands | n.a | 0,0038 | 0,0043 | n.a. | 0,0064 | 0,0070 | n.a | 118.648 | 124.097 |
| Poland | 0,0014 | 0,0011 | 0,0013 | n.a. | 0,0071 | 0,0085 | n.a | 7.181 | 9.904 |
| Portugal | 0,0163 | 0,0218 | 0,0189 | 0,0225 | 0,0317 | 0,0277 | 54.642 | 44.345 | 35.164 |
| Romania | 0,0060 | 0,0074 | 0,0109 | 0,0313 | 0,0373 | 0,0536 | 23.012 | 58.412 | 51.912 |
| Russia | n.a | n.a | n.a | n.a. | n.a. | n.a. | n.a | n.a | n.a |
| Spain | 0,0062 | 0,0062 | 0,0058 | 0,0070 | 0,0071 | 0,0072 | 65.197 | 68.247 | 75.617 |
| Slovakia | 0,0033 | 0,0030 | 0,0030 | 0,0139 | 0,0130 | 0,0127 | 105.952 | 101.886 | 98.326 |
| Slovenia | 0,0028 | 0,0044 | 0,0063 | 0,0048 | 0,0075 | 0,0112 | 73.379 | 127.507 | 121.679 |
| Sweeden | n.a | n.a | n.a | n.a. | n.a. | n.a. | n.a | n.a | n.a |
| Turkey | 0,0045 | 0,0039 | 0,0052 | 0,0260 | 0,0229 | 0,0344 | 7.557 | 7.994 | 10.315 |
| *MEAN* | *0,0072* | *0,0070* | *0,0064* | *0,0196* | *0,0182* | *0,0182* | *71.872* | *72.546* | *72.291* |

Source : Worldbank, ECB, OECD, AECM, BRSA, Halkbank, KGF and own calculations.

## 4. CONCLUSION

In our study, we investigated the relationship between SMEs, banks and CGSs. We also aimed to explain the functioning of CGSs in Turkey and to evaluate their performance. In this respect, we determined some ratios of CGSs in Turkey and compared to some of the EU countries using data for a six year period from 2007 to 2012. The results show that the total volume of outstanding guarantees in portfolio increased by 125% and reached to € 3,58 billion from € 1,59 billion. The major increase of 36 % is noticed between 2010 and 2011. Unlike the growth of the volumes of the outstanding guarantees in portfolio, the number of operations has not increased in this period. The ratios measured by the volume of guarantees to GDP, to the total volume of SME loans and to the number of guarantees are increasing. The increase in RONUM is significant. The avarage amount of the active guarantees is almost doubled. When we compare the results for Turkey, we determine that Turkey seems to be less supportive to the SMEs than the AECM countries in the period from 2009 to 2011. Especially, Turkey’s results for

RONUM are quite below the avarage. Turkey is the last among AECM member countries in this section. As a result; CGSs in Turkey are increasing their performance on supporting SMEs, but they should increase their effort to reach the avarage level of AECM member countries.

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