

## **CHAPTER IX OF THE BOOK “THE FINANCIAL EXTENSION OF THE CREDIT AND SERVICES”:** *The European experience to promote access to credit for the micro, small and medium-sized enterprises (Micro-SMEs) through guarantee schemes*<sup>1</sup>

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“Rejected for lack of guarantees”. How many times have many entrepreneurs heard this phrase? Many of them have thought that their major guarantee was the project itself. How many projects have not seen the green light for lack of guarantees? How many opportunities have failed throughout the world not because the projects were not interesting enough in terms of profit and risk, but simply because they had no guarantees? We may ask how many talented and skilled entrepreneurs have felt frustrated because they have not been able to accomplish their own projects and somehow the whole of society has also been affected. This chapter will be about this issue and possible solutions.

### **1. About the obstacles the Micro-SMEs encounter for access to credit**

#### ***1.1. The guarantee and the financing***

Whenever the small medium-sized entrepreneurs are faced with a credit application form, independently of where they are, they are always obliged to specify in detail the guarantees they have and are able to afford. This is not merely a personal request but due to the fact that the finance system at global level is the most controlled and supervised sector. When we talk in general about deregulating sectors, the finance system is generally not included in this plan and its investing activity puts a special emphasis on the guarantees since the national legislation, influenced by the international rules as well as in the Basel Agreement, establishes their scheme of operation.

The financial institutions need to optimize the management of their assets and this requires the guarantees to be well qualified and valued. Since 1988 the recommendations expressed in the Basel Agreement emphasized the guarantee covers that endorse the investment assets in the financial sector. The guarantee covers are qualified and valued according to the different categories and affect the account

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<sup>1</sup> Chapter IX of the book “THE FINANCIAL EXTENSION OF THE CREDIT AND SERVICES”, <http://www.segib.org/upload/File/esxtension%20del%20credito.pdf> published by Iberoamerican General Secretary (SEGIB) in the occasion of XVI the Iberoamerican Summit of Chiefs of State and Government celebrated in Montevideo (Uruguay) the 3, 4 and 5 of november of 2006.

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<sup>3</sup> The authors thank professor Dr. Horacio Molina and professor Dr. Jesus N. Ramirez of Foundation ETEA [www.etea.org](http://www.etea.org) for the Development and the for Cooperation to their comments on this document [www.fundacionetea.org](http://www.fundacionetea.org)

operation of the financial institutions, in the request for capital (own resources) and the required volume of provisions. It is definite that for the finance institutions the guarantee has an unquestionable strategic “value” for its business and expansion plans. Consequently, the guarantees are a rare asset, especially the better qualified and valued and this is a very difficult issue Micro-SMEs face in order to have access to credit. As a result of the shortage of guarantees throughout the world, there has been some indication of dissatisfaction in the demand for credit and rejection of projects by lack of “sufficient” guarantees and this restrains the growth of the economy. Also the absence of a guarantee scheme as well as of guarantees causes deficiencies in the financing of enterprises and this makes it difficult for the Micro- SMEs to have access to credit in optimal conditions regarding interest and term.

Every company, even the smallest one, wants to grow and expand. In the world of the Micro-SMEs the short term financing absorbs the few guarantees it owns and consequently its growth is restricted. It would be possible to say that the business growth in the Micro-SMEs is threatened by this negative combination of the scarce guarantees available and its application in the short term credits. This problem will increase if a support system is introduced for the new enterprises and Start-ups, without the technical conditions to obtain credit in risk capital mechanisms, but even so considered important to revive the business world and the creation of new jobs.

As a result of the shortage of guarantees in relation to the demand, the financial organizations tend to select the candidates neither according to the quality of their projects nor the effort and capacity of the entrepreneurs to compete in the market, but according to the past success or the chance of being located in privileged surroundings. The guarantee is definitely an instrument aimed at covering and mitigating the moral risk and therefore becomes the selection criterion.

### ***1.2. Binomial diagnosis- public policy***

An accurate diagnosis of the problem of the little access to the financing for the Micro-SMEs is determining for all public policy, since options, analyses and proposals are made according to this. In particular the guarantee systems that appeared after the world wars were not a result of the diagnosis of the problems. However, the 1917 French legislation on the mutual guarantee societies, supposes a clear recognition that a guarantee system is an instrument that facilitates access to financing for the micro enterprise. Above all it was made to promulgate a law directed to the micro entrepreneurs of the time. In this legislation the diagnosis and the execution were correlated and that is possibly the reason for the guarantee system existing for 80 years.

It is to be emphasized that the state policy to facilitate the access to credit for Micro-SMEs does not only have to solve a socioeconomic justice or fairness problem. In fact, one is to solve a deficient operation of the credit market hindered by guarantee cover international rules on the investment assets that make difficult the access to the financing of the SMEs and generate situations of competitive inequality. One is to restore the equality of opportunities in the financial market of the various entrepreneurial projects, so that the allocation of resources follows the rentability parameters and risks of the projects and these are not excluded because of the differences in wealth.

The incorporated international rules in the Basel Agreement do not benefit Micro-SMEs to a great extent, since they do not usually have the required guarantees. If the financial organizations give credit to the Micro-SMEs without good quality guarantees, they are required to have more capital and provisions. The guarantee requirements which are requested by the moneylenders exclude from the market those entrepreneurs with profitable projects that do not have the appropriate guarantee. This means a distortion of the market that in the absence of informative asymmetries should have to assure that the best project, in terms of and rentability should obtain the financing at small cost. Thus we have reached a non desirable situation, in which the Micro-SMEs are recognized as essential for the development of the economic activity, the creation of new jobs, entrepreneurs, etc., and, on the other hand, they are competitively penalized by the international rules required by the financial sector. The existence of schemes that allow viable projects to have access to quality guarantees simply avoids such projects from being rejected by the credit system because the entrepreneurs who propose them do not have the guarantees that the financial system requires.

This deficiency in the financial market shows the need for governmental support in creating the guarantee system as a public policy<sup>4</sup> on the base of a previous diagnosis. This is the reality of the 20th century and beginning of the 21st. Through out the history of the guarantee systems, other reasons have justified its existence, although the credit risk cover has always been present. Therefore, the participation of the public sector has to be introduced as a result of this deficiency in the market. In this respect the European experience shows that the counterguarantee schemes are complementary for the efficiency of the guarantee systems/schemes to promote the financing of viable projects.

### ***1.3. The asymmetry of the information and the guarantee***

The guarantee is one of the solutions to reduce to the problems caused by the asymmetry of the information between the moneylender and borrower. On the one hand, it eliminates the negative economic consequences caused by the negative selection (to choose projects prepared to pay a higher interest rate but smaller probability of success) obtaining from the guarantee system better conditions than those the beneficiary would obtain himself. On the other hand, it eliminates the moral risk (attitudes that are not wished by the borrower which could affect the credit repayment) when jeopardizing economically the beneficiary and to answer as guarantor in the credit repayment, as well as establish analysis and follow-up procedures<sup>5</sup>.

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<sup>4</sup> Since liberal positions, of which one of the reference exponents is the Nobel of economy Hayek (1994), when referring to the subject of equality of opportunities in a very critical book with the intervention of the State in markets, as in *Camino de Servidumbre*, considers that the safeguarding of the equality of opportunities justifies this intervention "it is essential that the access to the different activities is open to all in such terms and that the Law should not tolerate any attempt against individuals or groups to restrict this access through open or disguised powers". Also it clearly expresses that the economic differences at the start, those that are inherited, do not help to create a state of competence.

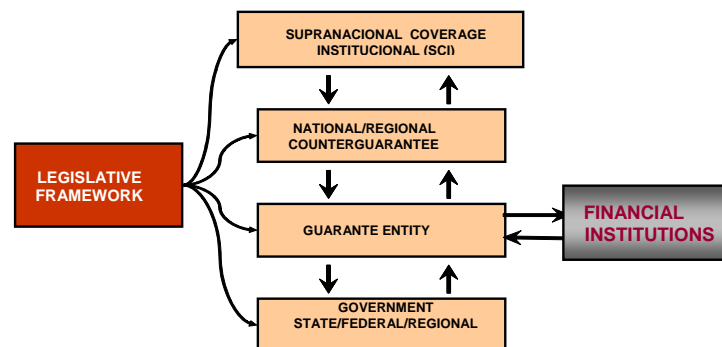
<sup>5</sup> As Reig and Ramirez (1998) indicate for the case of the Spanish guarantee societies, the guarantee systems imply the transfer of the credit risk of the financial organisation to the guarantee system, this is the reason why one will have to face such effects of informative asymmetry and requirements of capital and provisions which the financial organizations are faced with. This is also the reason why one will have to establish the suitable instruments to mitigate these situations and to strengthen its performance.

The evaluation of the viability is defined, to a great extent, by the economic sufficiency of the project to be financed to recover the investment made. Nevertheless, the future of the projects may not meet the expectations. One of the reasons being the information from the borrower and moneylender not agreeing and, on the other hand, it is necessary to believe that the resources should meet the ends. When faced with this situation it necessary to involve the borrower or his guarantors with their assets, through the presentation of additional guarantees. The guarantee not only tries to improve the solvency of the loan, but also prevent opportunistic behaviours and situations of uncertainty. With the guarantees the moral risk is avoided and this has been integrated in the regulation of the financial sector within the actual banking system. On the other hand, many guarantee systems usually work like a link between Micro-SMEs and the financial market and a formula to offer information to the market on the new agent. A guarantee requires knowledge of the guaranteed one by the person responsible for the loan and this helps to make up for the lack of information that the traditional financial system faces in its analysis.

#### *1.4. The integration of the guarantees in the financial system*

The problem of the lack of access to the financing of such an important socioeconomic agent as the Micro-SMEs is structural and is the result of the performance of several agents<sup>6</sup>. Therefore, the solutions must be long term and have to involve in a coordinated manner all the relevant agents: the public sector, financial sector and enterprise sector. An option to solve the problem of access to the financing is to make the guarantee systems available to the agents.

**Graph 1: “Alliance” of Public Administrations, Financial Organizations and SMEs in the Reciprocal Guarantee System**



Source: Own elaboration

<sup>6</sup> In a graphical form we would say that the guarantee is like a parking barrier so that if the micro-sme pays the parking fee the barrier will rise and the micro-smes will be able to “pass”, in this case to the financial resources. The problem is that once this first situation is solved the following ones require similar situations. In most of the cases when the micro-smes try to have access again it will come across the guarantee barrier. Therefore, later on, in another request, if it does not contribute it will “not pass” and the problem of access to financing for micro-smes continues.

The guarantee systems have to integrate themselves totally in the financial system because the guarantee systems have a final objective: to be an instrument to facilitate the access of the SMEs to the financing by means of an institutionalized channel of financing, that should be transparent and non-discriminatory, that integrates them in the formal financial circuit. The guarantee systems must be based on an authentic one and recognized *state policy* in favour of Micro-SMEs that, among other improvements, should try to facilitate the access to the financing of the enterprises. This is not about something temporary or whatever the government more or less decides, but that it has to be a question of State. This means that it is necessary to have a permanent guarantee system, not changing constantly because it has to be totally integrated in the financial system of the country or corresponding territory. This is the reason why its definition and configuration cannot be conditioned by the environment in which the activity takes place. There are consolidated systems in the world, fully integrated and more than 80 years of activity (among them, some European systems).

Complementarily an “**alliance**” should be established between the agents involved (public administrations, financial organizations and micro and SMEs and their organizations) in the legislative and subsequent operative development of the guarantee system, so that all the parties can satisfy their legitimate interests, within a legal frame of quality and security, so that the guarantee is granted in a quality guarantee system that has a “recognized value” within the financial system (qualified, analysed and integrated in the financial system).

Once the decision has been taken to implement the policy and its capacity has been determined, based on the diagnosis, various options will always appear. Nevertheless, not all have the same security, quality, relevance, effectiveness and impact. In general, the first step to choose the model of the guarantee is based on the origin of the resources. That is to say, the choice about the public, mixed or private nature of the resources determines the beginning of the commercial legal process and the development of the activity of the guarantee. It is in this commercial legal process that the differences between certain models are more clearly demonstrated and whether they are introduced in the financial system of the corresponding country. Another element of great importance in this phase is the period during which it is going to be applied in the guarantee system. Really what one is due to implement is a legal structure, mercantile and financial suitably perfected to fulfill the function that is had to develop. Evidently, the design legal-financier and technician of the guarantee system are going to condition the success of the future activity. It is not question to copy a scheme of a concrete country, immediately, or to apply to a scheme of “guarantee portfolio”, or “individual”, or the typical “Guarantee fund”, is one more a deeper question and of greater reach.

It must also be clear that the establishment of a guarantee organization is neither a necessary nor sufficient condition for a guarantee system to comply with its commitments. Therefore it is not a question of having “entities” of guarantee, but of having a secure, reliable and solid guarantee system. We should endeavour to have a guarantee system that is not questioned in the financial environment where it is located and is working. In this manner the management of a guarantee society could be questioned in particular, but the objective is to never question the “guarantee scheme”.

## **2. A panorama of the guarantee schemes**

### ***2.1. The evolution of the guarantee schemes***

The origin of the guarantee schemes is found in the *society of mutual guarantee* at the beginning of the 20<sup>th</sup> century in France. It is a very relevant fact that in the French society at the beginning of the century, the “craftsmen” (micro enterprises) had the social recognition that meant obtaining laws that endorsed their entrepreneurial and productive activity. Thus, a guarantee model appeared for the first time to facilitate access to credit for micro-smes supported in a commercial society. Therefore, the concept of mutual aid and cooperative movements at the beginning of the 20<sup>th</sup> century contributed to the origin of guarantee schemes.

In the middle of the 20<sup>th</sup> century, the need to reconstruct the deteriorated productive sector in great territorial spaces due to the world wars motivated the setting up of guarantee systems based on society schemes in coexistence with powerful public counterguarantee schemes and public guarantees based on development agencies or public banks. In a context of great destruction of assets, the States had to provide the financial systems with a solution for access to the financing of micro enterprises and SMEs. In this context the examples of the United States, Germany, Italy and Japan are significant.

Finally it is in the last decades of the 20th century, before the recognition of the importance of the micro and SME that the guarantee schemes appear with a more global perspective. Although today the terms micro and SME are fully recognized, if we went back to last decades and we went to the hemerotecas (database) we would realize that these terms were hardly ever used. Presently, we are in an absolutely different situation, that is to say, if we open newspapers and are aware of the media in general, the difficult thing is not to find everyday the terms micro and SME. It is in this global context of the two last decades of the 20<sup>th</sup> century and beginning of the 21st, when the guarantee schemes and their models spread all over the world and the concept of global economy became a reality assumed by all.

Except in very specific cases, such as some specific systems in Europe, the system in Japan and Small Business Administration (SBA) of the EE.UU., it can be affirmed that in most of the countries, the guarantee systems/schemes are an expression of the Nineties.

### ***2.2. The typology***

A typology and classification are necessary because it is usual to find in literature merely descriptive evaluations of guarantee schemes that have not been compared with others, and evaluations of heterogeneous systems as if they were homogenous, only because they have the activity of the guarantee in common. All this is aggravated by the problem of the generic use of certain denominations.

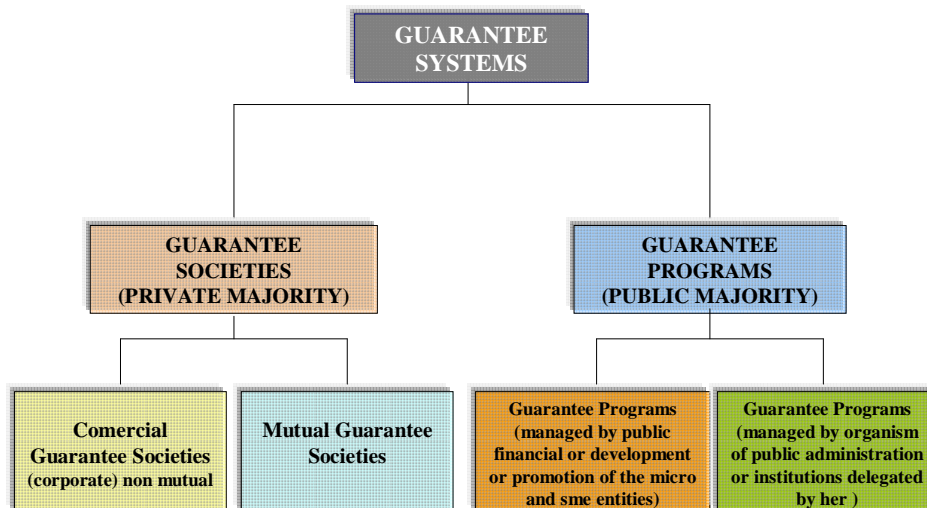
For the classification of the guarantee systems the following variables have an important role: The legal personality of the organization that manages the system (society schemes or public institutions), the origin of the resources (private or public

majority), the social object (exclusiveness or not of the activity of the guarantee), the length of time of the activity (indefinite/permanent or temporary) and the dimension of the beneficiaries (micro, small or medium enterprise).

Pombo (2006b)<sup>7</sup>, by means of a cluster hierarchic analysis, determines that the guarantee systems are classified based on the origin of the resources, with the existence of a conformation of public majority and another one of private majority. Among the public majority ones we find the guarantee programs and in the private majority ones we find the guarantee societies of a commercial nature and the societies of a mutualistic guarantee<sup>8</sup>. The aim of the societies of commercial or mutualistic guarantee is exclusively social, with a temporary horizon and indefinite permanence.

The execution of the guarantee program is usually decentralized towards an organism or specialized entity in the economic promotion or of support to the micro and SMEs (public or development banks, development agencies, societies/entities, fideicomisum, etc.) that provide technical management and other commercial activities.

**Graph 2: Classification scheme of the guarantee systems/schemes**



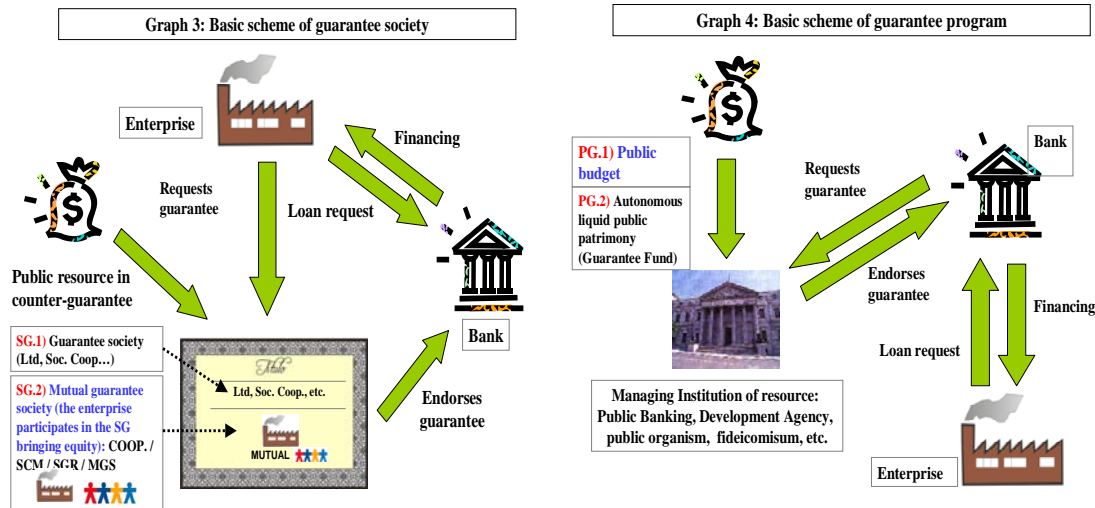
Source: own elaboration

<sup>7</sup> The work is based on a questionnaire about 50 European guarantee systems/schemes that include 1.661 guarantee entities of which 1.536 correspond to members of the AECM, practically the total of the population. On analysing several of their characteristics we can establish a classification, using the technique of the cluster analysis of hierarchic conglomerates. The results show that the origin of the resources, of private or public majority, is a key question to create this classification.

<sup>8</sup> “Societies of Mutual or Reciprocal Guarantee”, according to definition by Pombo and Douette (AECM, 2006), are the common initiatives of a group of independent micro and smes and or their representative organizations, directed to grant a collective guarantee on the credits (in some systems, in the social object of the SCM/SGR/SGM, it is contemplated to the concession of technical guarantees and the financial advising) granted to their members, participating in the conformation, sustainability, decision making and management of the scheme of guarantees, along with other partners, in their case, public and financiers. The philosophy is based on the mutuality of the responsibility, the decision making of the parts, the fulfillment of the rules of the competition and the market economy. However, they can obtain and receive public support.

The financial responsibility of the activity of the guarantee is separate from the resources of the institution but is based, in the last instance, on the public budget prerequisite that created the program. That is to say, the public sector places the activity of the guarantee in the context of legal structures of the public administration. In many situations, the activity of the guarantee is shared with the social object of the entity that applies it and, therefore, does not expect “exclusiveness”.

The next two graphs show and define the basic operation scheme of the guarantee societies and the guarantee programs.



Source: Own elaboration

### 3. THE GUARANTEE SYSTEMS/SCHEMES IN EUROPE

The European model of guarantees, according to Pombo and Douette (AECM, 2006) could be identified by the following concepts and characteristics:

- The European activity of the guarantee is based on an ample national consensus between the public sector, the financial sector, and micro<sup>9</sup> and small medium-sized enterprise users or beneficiaries. It is practised by specialized institutions. The guarantee systems are a part of the financial sector, according to the legal

<sup>9</sup> The European Commission adopted on 6 May 2003 a new Recommendation on the definition of the SME that modifies the 1996 Recommendation. The new text defines the types of enterprise (autonomous, associated and committed) and made a transparent method to calculate the financial limits and the number of employees.

Enterprise category	Employees	1996 Recommendation		2003 Recommendation	
		Turnover	General Balance	Turnover	General Balance
Medium	<250	<= 40m€	<= 27m€	<= 50m€	<= 43m€
Small	<50	<= 7m€	<= 5m€	<= 10m€	<= 10m€
Micro	<10			<= 2m€	<= 2m€

The large enterprise is the one that exceeds these limits. To allow for an easy transaction, both at EU level and national level, the new definition shall be used as from the 1 January 2005.



regulation and the financial supervision that creates the conditions for its sustainability and mutual trust.

- Their activity is developed within the framework of the global economy, respecting the rules of the competition and the market, proposing a better access to credit for the sustainable and viable projects of micros, small and medium entrepreneurs of the private sector.
- The guarantee schemes are consist of a mixture of private initiatives and/or public and tend to involve the entrepreneurs directly or indirectly in the action, decision and management mechanisms. The public aid provides balance, solidarity and support to reach a standard and more effectiveness.
- A special characteristic of the European structure is the existence of national counterguarantee in some regional cases, and of a supranational counterguarantee platform organized and financed by the EU Commission and managed by the European Investment Fund (EIF).

The European guarantee systems/schemes on 31.12.04 had their own resources of about 4,350 million euros, real guarantees of 41,000 million euros. 12,700 million became official in the last year and some micro and SMEs that were beneficiaries of about 3.400.000. The real impact of the amounts of the loans granted to the micro and SMEs sector can amount to an additional 35% above the amount of the guarantees referred, since the latter do not cover, in average, the total amount (100%) of the granted loans.

To follow there is a comparison between the systems of “public majority” versus “private majority” in Europe. There is also a comparison between the “mutualistic” systems versus the “non mutualistic” ones”<sup>10</sup>.

### ***3. 1. The Counterguarantee in the European model and the European Investment Fund (EIF)***

Counterguarantee is a risk cover scheme that provides guarantee cover for guarantee systems/schemes that operate at first level - or first stage- granting guarantees to micro-SMEs. Generally, a public initiative is set up to support the development of the guarantee system/scheme, absorbing and guaranteeing a part of the risk and therefore, increasing their activity. They can be legal entities responding through their equity capital or they can constitute independent liquid companies, administered by specialized organizations.

Counterguarantee, besides backing solvency, also contributes to obtain a more suitable dimension, independently of the existence of financially self-sufficient guarantee entities. Conceptually, in an area where the laws of competition rule, the intervention of the State is preferable if it is of a universal nature and in an indirect manner so that it avoids interference in the normal operation of the guarantee systems/schemes. This mission in Europe has the supranational support of the European Commission, through programmes administered by the European Investment Funds (EIF).

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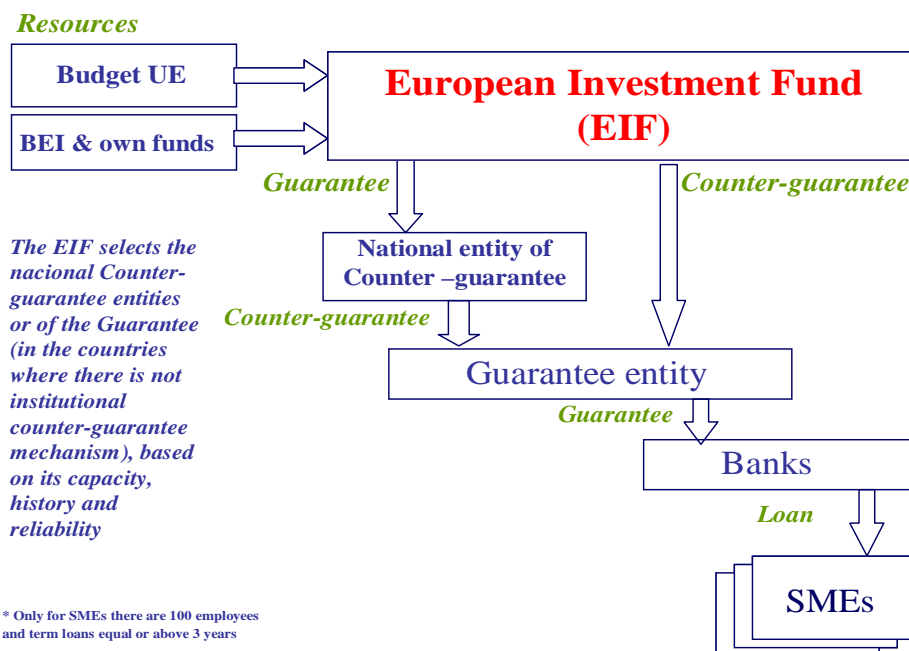
<sup>10</sup> This synthesis is based on the works made by Pombo, Molina and Ramirez (2006d) on a sample practically of the population of the European guarantee systems/schemes.

The EIF gives guarantee cover to the national counterguarantee mechanisms<sup>11</sup> and it can also guarantee directly the guarantee organizations in countries where this institutional mechanism does not exist, as can be observed in graph 5.

The importance of the micro-SMES in the European economic context and recognition of the importance of the guarantee as a mechanism that facilitates the access to credit for these enterprises improves the capacity of long term investment, especially in the smaller ones. As a result of this the European Commission launched specific programmes that allow counterguarantee organizations (or counter-guarantee) of the member countries of the European Union and future candidates (these subject to certain restrictions) to look for a partial cover for the taken risks, thus helping the capacity of intervention. These programmes manage the European Investment Fund (EIF), supranational financial organization, administered by the European Investment Bank (EIB) participated mainly by the European Commission.

This public intervention of the European Union in supporting the access to financing for the micro-SMEs, transversal to all the members, began in 1998 with the “ Guarantee Programme for Loans to SMEs” and was expanded within the framework of the “MultiAnnual Programme 2001-2006”.

**Graph 5: Mechanism of European support for access to financing for SMEs\***



Fuente: DG Empresas UE & FEI

In 2005, the EIF had a portfolio of 11,600 million euros in real guarantees, which lead to loans from about 20,000 million euros to 277,000 Micro SMEs, with an induced investment of 33,000 million euros and creation or maintenance of more than 1.100.000

<sup>11</sup> The Spanish counterguarantee company CERSA, SA, the Portuguese SPGM, Sociedade de Investimento, SA; that administers the Counter guarantee Fund are examples of these national schemes of counterguarantee.

jobs. The analysis of the results is very positive and it is expected that the programme will continue during the period 2007-2013. The new programme, in its final phase of approval, will allow the EIF to celebrate/enter risk cover agreements in guarantee operations in long term loans or leasing, guarantees for micro-credits, guarantees for risk capital organizations in initial projects and guarantee credit title operations.

The philosophy of support to the micro-SMEs through guarantee schemes could thus be considered a solid *state policy* of the European public powers that consider this instrument a strong means for the development of the activities of a class of economic agents who are of great importance to the European Union and each one of their member states.

### ***3.2. The systems of public majority versus those of the private majority***

The private majority systems in Europe are characterized by having society schemes, social object of exclusive guarantee, indefinite or permanent nature of the activity and a special attention to the micro enterprise<sup>12</sup>. Other significant characteristics or differences are the following:

- The private majority systems usually have a more specific legislation than the public majority systems.
- The proportion of guarantee schemes/entities classified as financial organizations is greater between the guarantee schemes/entities with public majority funds than between the guarantee schemes/entities of private majority guarantee. It is thus because many public guarantee programmes exist in public banks.
- The private majority systems operate in more regional and local areas, they use a greater number of entities, reach beneficiaries of smaller dimension, the volumes of the operations are more reduced and have a greater capitalization in relation to the public majority systems.
- In the private majority systems, there is a greater participation in the resources of the beneficiaries. The participation of the private initiative in the systems of greater mutualistic tradition is not in vain.
- From an operative point of view, the private majority systems provide a greater percentage of guarantee cover<sup>13</sup> and apply greater costs for the guarantee service. There are some differences in the term and average costs in favour of public majority<sup>14</sup>, which indicates that the latter can be considering the companies of greater dimension.

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<sup>12</sup> Pombo, Molina and Ramirez (2006d) prove that the systems/schemes of private majority are characterized by having society schemes, social object of the exclusive guarantee and indefinite or permanent character of the activity and a special attention to the micro enterprise.

<sup>13</sup> Pombo, Molina and Ramirez (2006d) prove that a greater percentage of average cover of the guarantee characterizes the group of private majority.

<sup>14</sup> Pombo, Molina and Ramirez (2006d) prove that a higher average cost characterizes the group of public majority.

- When the micro-SMEs have access to credit, through the guarantee systems of the private majority, they manage to obtain greater savings of financial costs (types of interest in the lowest loans) than when they do it through public majority systems. That is to say, the greater costs indicated in the previous paragraph would be compensated. This comes to confirm that not only is it possible to have access to credit but also to do it in the best conditions, being the guarantee system/scheme an instrument that “makes perfect” the relation between the moneylender and the enterprise.

**Table 1: Data of the activity of the European guarantee schemes/systems<sup>15</sup>**

GENERAL DATA ON SYSTEMS AND SCHEMES	Public Majority	Private Majority
Age (average of years)	11	45
No. of entities of the system/écheme (average entities)	4	77
No. of micros and smes beneficiaries (average micro-smes)	19.278	153.873
Own funds of the system in/or capital –equity- (average in thousands of €)	84.702	112.422
Portfolio of guarantees - outstanding guarantee - (average in thousands of €)	680.815	1.299.659
Guarantees granted in the last year (average in thousands €)	267.089	572.768

Source: Own elaboration

The guarantee schemes/entities of the private majority present a better performance because they have a greater number of entities that provide a greater activity in the number of micro-SME beneficiaries, permanent resources and portfolio of guarantees. The average age is greater for the private majority systems which support the idea that a policy of access to financing through guarantee systems offers results in the long term. Pombo, Molina and Ramirez (2006d) prove that a greater the number of years is related to a greater number of beneficiaries and a greater portfolio of guarantees. This result reinforces and makes the statistics of the performance of the private majority schemes/systems of private majority more reliable mainly because it is one of the oldest in Europe.

It is to be highlighted that the European experience shows that the counterguarantee schemes are basic in the activity of the guarantee. In Europe, one relies on the cover of the supranational support of the European Commission by means of programmes administered by the European Investment Fund. (EIF).

### ***3.3. The mutualistic systems versus the non mutualistic***

The first guarantee systems to appear in Europe had mutualistic<sup>16</sup> characteristics, therefore we should not be surprised with the strong influence that the model has had in the development of the guarantee system in other countries, specially in those that have developed in a similar socioeconomic framework.

The mutualistic systems are permanent or stable initiatives, with a strong presence of private capital in the enterprise sector and, to a lesser extent, in the public and financial

<sup>15</sup> Pombo, Molina and Ramírez (2006d) the sample of the implies and includes a 1,661 guarantee entities of 50 European guarantee systems/schemes of which 1,536 correspond to AECM members.

<sup>16</sup> Presently it would be more appropriate to denominate the projects as “associated enterprises” or “entrepreneur associations”.

sector. The mutualistic model requires a well structured enterprise and it is the instrument through which the entrepreneur, together with other institutions, tries to solve the problems of access to guarantee. The developed mutualistic models in Europe have been strongly institutionalized<sup>17</sup>, with specific regulations and its gradual tendency is to have the characteristics of a financial organization and to be submitted to the financial regulations. The main differences between the mutualistic and non mutualistic sector are the following:

- The mutualistic schemes are dedicated exclusively to the guarantee activity, unlike the non mutualistic systems in which the proportion of schemes that are not dedicated exclusively to this activity is very high.
- The mutualistic systems, unlike the non mutualistic ones, are closer to the micro entrepreneurs since they take care of the guarantee requirements of those in the nearby geographic areas.
- The entrepreneurs participate in the resources, the government control systems and the decisions in a manner that is more important in the mutualistic systems than in the non mutualistic ones.
- The activity of the guarantee in the mutualistic schemes is generally supported by counterguarantee through resources of a public nature, whereas such support is inferior in the non mutualistic systems<sup>18</sup>.
- The cost of the endorsement operations is somewhat lower in the mutualistic systems than in the non mutualistic ones. Nevertheless, in the mutualistic systems the transitory contribution to the resources of the guarantee organizations appears as additional financial support. The evidence in the mutualistic schemes to have a policy of fixed prices reinforces the concept of mutualism and cooperation so that this traditional mutualistic spirit is maintained and transferred in the guarantee operations.
- In the guarantee operations a greater percentage of cover is granted to the mutualists<sup>19</sup>, although the guaranteed amounts are inferior, which shows a greater dedication of the smaller entrepreneurs.
- The non mutualistic schemes facilitate access to higher average costs whereas the access to the term is very similar in both.

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<sup>17</sup> Pombo, Molina and Ramirez (2006d) prove that the mutualistic systems/schemes just as the private majority ones are characterized by having partnership schemes, social object of the exclusive guarantee and indefinite or permanent character of the activity and a special attention to the micro enterprise.

<sup>18</sup> In the non mutualistic the most numerous group is that of the public majority which logically do not benefit from public counterguarantee because of the origin of their resources.

<sup>19</sup> Pombo, Molina and Ramirez (2006d) prove that a greater percentage of cover, a greater saving of costs of the guaranteed financial operations and the fixed price of the service of the guarantee characterize the mutualistic systems/schemes. The financial sector especially values the percentage of cover to be raised because this measure allows a better qualification of its assets, reducing its capital requirements and provisions and definitively the mitigation of the risk (Basel Agreement). This among other issues makes it possible to clarify the best negotiation capacity of the loan conditions of the “mutualists”.

- The Micro-SMEs in the access to credit when they do it through mutualistic systems, obtain greater savings of financial costs that in the non mutualistic ones.

**Table 2: Data of the activity of the European guarantee systems/schemes<sup>20</sup>**

GENERAL DATA ON SYSTEMS AND SCHEMES	Non Mutualist	Mutualist
Age (average of years)	11	46
Nº of entities of the system/scheme (average entities)	3	86
Nº of micros and smes beneficiaries (average micro-smes)	17.930	182.621
Own funds of the system in/or capital –equity- (average in thousands of €)	78.586	130.490
Portfolio of guarantees - outstanding guarantee - (average in thousands of €)	631.976	1.537.605
Guarantees granted in the last year (average in thousands €)	251.215	674.340

Source: Own elaboration

- Regarding the average dimension of the activity of the mutualistic entities when compared with the non mutualistic ones, the former have more resources, reaching a higher number of entrepreneurs and, therefore, have a larger portfolio of guarantees.
- The average age<sup>21</sup> of the mutualistic systems is superior to the one of the “non mutualistic ones”. This result reinforces the statistics of the performance of the mutualistic schemes for being the oldest in Europe.

The development of a more operative and effective guarantee system/scheme is characterized, according to Pombo, Molina and Ramirez (2006d) by the involvement of the enterprise’s private resources in the guarantee system, to grant a high level of coverage to the financial system and to establish mechanisms (legal, technological - integrated in the handling of information and management - and integral systems of quality management) that reduce the moral risk problem and they do not produce rationing of the guarantee. All these characteristics are better identified in the profile of the mutualistic systems than in the non mutualistic ones<sup>22</sup>.

#### 4. CONCLUSIONS

First, the international rules on capital (equity) requirements and provisions in relation to the credit investments that are based on the qualification and valued of the guarantees associated to the credits, reinforces the competitive inequality in the access to the financial markets of the enterprises. In this manner, the Micro-SMEs that are an important source of employment and wealth but lack well-qualified guarantees have difficulties to have access to credit and to finance their expansion.

<sup>20</sup> Pombo, Molina and Ramirez (200d) the sample of the study implies and includes up to 1.661 guarantee entities of 50 European guarantee systems/schemes interviewed of which 1.536 correspond to AECM members.

<sup>21</sup> Pombo, Molina and Ramirez prove that the older the scheme the more beneficiaries it has as well as a larger guarantee portfolio. This result reinforces the statistics of the performance of the mutualistic schemes precisely for being the oldest in Europe.

<sup>22</sup> The concept of “alliance” referred to in this document reaches its maximum expression in the “mutualistic” guarantee systems.

Second, there is a way to solve the problems in the guarantee systems. Once it is decided to establish a guarantee system in a territory or to modify the existing one, the question is to establish a model suitable for the guarantee system based on a state policy entrepreneurial sector. The guarantee systems are not homogenous and, therefore, they do not have the same security, quality, effectiveness, relevance and impact<sup>23</sup>.

Third, the guarantee systems can be structured in two basic groups: the guarantee societies of which the funds are of private majority and the guarantee programs of which the funds of public majority. The former have two options: the mutualistic societies and the commercial societies (corporate). The latter include the institutional guarantee programs and programs of public entities funds of risk cover. In Europe, guarantee society model welcomes the greater number of entities as well as of Micro-SMEs beneficiaries SMES and activity at global level. In the beginning of the 20<sup>th</sup> century, the activity to grant guarantees to Micro-SMEs was developed on a mutualistic commercial society. The differences between the models have been analyzed in the document, but the contest of the public sector is important in the models of private majority through counterguarantee of the operations.

Fourth, the participation of the enterprise sector in the guarantee organizations has been made through mutualistic schemes, in which the beneficiary of the guarantee participates in the capital of the society. The mutualistic system is found in countries such as France, Belgium, Luxembourg, Germany, Switzerland, Italy, Spain, Portugal, Sweden, Hungary and Turkey. The continental nucleus seems obvious while in the Eastern European countries that joined recently this scheme is hardly observed or practically null.

Fifth, the development of a mutualistic system involves a structured and organized entrepreneurial set up, so that cooperation networks can be established. For that reason, the oldest European systems used as an organizational model the mutualism or the involvement of the entrepreneur in the activity, directly or indirectly. These two circumstances are determining to be able to understand the development of this European model.

Finally it is necessary to emphasize the important role of the European Investment Fund (EIF) as an institution of supranational cover towards the European guarantee.

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<sup>23</sup> The AECM (2004) has affirmed that the "Spanish guarantee system is the best formed and conceived in Europe". The Portuguese system of SGM has been assisted and tutored since 1994 by the Spanish guarantee system and, presently presents important levels of development.

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