CASE – Centrum Analiz Społeczno-Ekonomicznych
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How Credit Guarantee Schemes Could Ease Access to Funding for Companies with Belarusian Capital in the EU

POLICY PAPER

Sierž Naúrodski
Aleś Alachnovič

Abstract

Responding to the current financial needs of companies with Belarusian founders or owners in the EU, the policy paper proposes credit support solutions coming from worldwide practices of credit guarantee schemes that may be relevant for implementation to ease access to funding for companies with Belarusian origin. It provides insight into how to spur investment by émigré Belarusian business without a credit history and collateral in EU countries after relocation from Belarus that could be beneficial for the hosting countries. We consider two possible options: the first is an international credit guarantee scheme, with an EC commitment to support Belarusian businesses abroad. The second is a mutual guarantee scheme that the Association of Belarusian Business Abroad (ABBA) could create and lead in order to support loan provision to Belarusian businesses in exile with their own funds.

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ABBA – Association of Belarusian Business Abroad is the biggest association of Belarusian business abroad bringing together more 90 members from 10 countries from Europe and the USA. ABBA’s goal is to integrate, protect the interests and develop the legal and ethical business of entrepreneurs with Belarusian roots for the development of New Belarus as an independent democratic country.

CASE – Center for Social and Economic Research is an independent, non-profit research institute founded on the idea that research-based policy-making is vital for the economic welfare of societies. Established in Warsaw in 1991, CASE today is recognized as the top think tank in Central and Eastern Europe and is one of the most highly regarded think tanks internationally. CASE carries out policy-oriented research and development assistance projects, specializing in the areas of: 1) Fiscal, monetary and financial policies 2) Sustainable development policies 3) Trade, innovation and productivity policies.

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Introduction

In response to the issues related to the European Union's (EU) support for Belarusian business (see Annex 1), in 2021 ABBA and CASE Belarus[1] economists proposed a solution that the European Commission (EC) alone or together with other international financial institutions initiate a credit guarantee scheme (CGS) to guarantee creditworthiness for Belarusian businesses and start-ups that decided to relocate to the EU. In January 2022, EC representatives confirmed that there was strong interest in the EC to contribute to a potential CGS. This proposal became even more relevant after the beginning of the Russian invasion of Ukraine on 24.02.2022, as the economic sanctions and boycotts of Belarus had negative economic effects and consequently led to massive emigration of Belarusian civilians and businesses from Belarus to the EU. According to 2022 estimates,[2] between August 2020 and June 2022, the cumulative number of Belarusian businesses relocated to the EU was at least 4,100 private businesses differing in scale and legal form, including self-employed.

In 2022, ABBA and the CASE Belarus team had several meetings with the Polish development bank BGK (Bank Gospodarstwa Krajowego[3]), which resulted in subsequent joint negotiations with the European Commission to provide funds for a guarantee mechanism to be managed by BGK and addressed to Belarusian businesses in Poland. This policy paper thus aims to support the negotiations and propose specific solutions of credit guarantee schemes that could potentially be implemented to ease access to funding for enterprises with Belarusian founders or owners in the EU. It provides an insight into how émigré businesses with no credit history or collateral could benefit from a guarantee mechanism for new business start-ups or enabling businesses to access external financing in the EU after relocation from Belarus.

The first part of the report discusses why financing is a problem for Belarusians willing to invest in the EU. It also gives estimates of the investment gap for Belarusian firms in the EU, calculated by the ABBA team. The second part presents the essence of credit guarantee schemes, why they are needed, how they function, their key benefits, and types. Finally, the third part provides specific solutions and a description of credit guarantee schemes, with recommendations that could be relevant for a guarantee scheme for businesses with Belarusian shareholders in the EU.

Problem statement and market gap analysis

The private sector was the key driver of protests following the unfair presidential election in Belarus in August 2020, and faced a harsh government response in the aftermath. The political crisis affected many Belarusian private companies in different sectors as well as the self-employed. According to a survey conducted by the Imaguru Startup Hub and the Coordination Council in October-

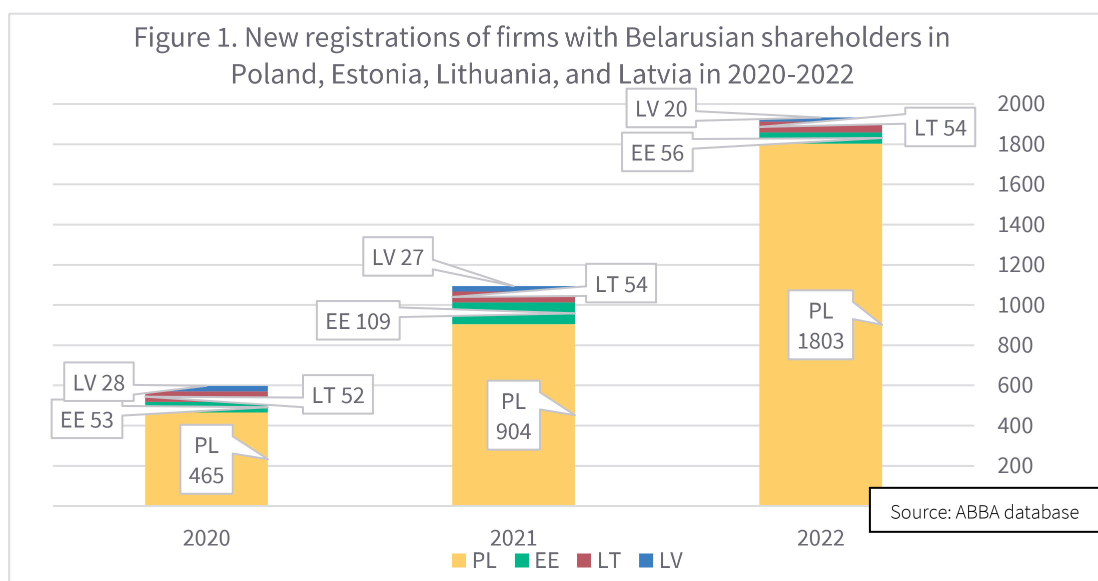
[1] CASE Belarus team is part of CASE – Center for Social and Economic Research

[2] Naurodski, S. (2022), Business Migration From Belarus To The Eu After August, 2020. German Economic Team Policy-Paper No1, 2022. Access: https://www.german-economic-team.com/en/publication/business-migration-from-belarus-to-the-eu-after-august-2020-2/

[3] www.en.bgk.pl

November 2021, the political crisis led to financial losses for more than 60% of the businesses surveyed.[4] After the Russian invasion of Ukraine on 24 February 2022, the private sector experienced further pressure to relocate from Belarus because of the challenges related to new economic sanctions against Belarus. The key challenges included: i) the toxicity of Belarusian export companies (including in IT) that led to western clients being lost and additional costs in performing existing contracts; ii) significant restrictions related to the Belarusian banking sector that made international wire transfers to and from Belarus increasingly difficult, risky and expensive; iii) western companies boycotting supplies to Belarus, resulting in a drop in imports to Belarus, supply chain deterioration, and high logistics costs; iv) increasing uncertainty and business costs due to the Belarusian rouble exchange rate instability and the drop in consumers' buying power.

As a result, between August 2020 and June 2022 the cumulative potential of the Belarusian business community in the EU was estimated to increase by around 4,100 private businesses varying in scale and legal form, including self-employment.[5] This number covered company transfers, full or partial, as well as the self-employed. Most of them relocated to Poland, and Estonia, Lithuania, and Latvia are also on the list of most frequently chosen EU countries.



The relocation of Belarusian businesses to the EU continued into 2022, when it reached its peak (Figure 1). According to statistics acquired from open data platforms,[6] as of August 2023 there were at least 8,103 companies with Belarusian shareholders registered in the EU (see Figure 2). Poland, Estonia, Lithuania and Latvia are the four key destination EU countries for Belarusian entrepreneurs.

[4] Survey conducted in October-November 2021, covering 154 companies: https://bel.biz/how- to-2/rezultaty-issledovaniya-o-vliyanii-krizisa-na-belorusskij-biznes/

[5] Naurodski, S. (2022), Business Migration From Belarus To The EU After August, 2020. German Economic Team Policy-Paper No1, 2022. Access: https://www.german-economic-team.com/en/publication/business-migration-from-belarus-to-the-eu-after-august-2020-2/

[6] Open data is available for Poland (www.coig.com.pl), Estonia, Lithuania, and Latvia (www.okredo.com). When estimating the number of businesses with Belarusian capital in the EU, we made the assumption that a country's share in the total number of Belarusian firms in the EU is equal to the country's share in the total number of Belarusian immigrants in the EU. We use Eurostat's data for first resident permits in the EU for 2020-2022 as a proxy of total number of Belarusian immigrants in EU countries, and use this proxy to estimate the share of "Other EU countries" (countries other than Poland, Estonia, Lithuania, and Latvia) in the total number of firms with Belarusian capital in the EU.

58% of all businesses were registered in 2020-2023. The vast majority of businesses are SMEs engaged in service sectors. The top 4 sectors in terms of number of businesses are retail and wholesale, transport, and construction.

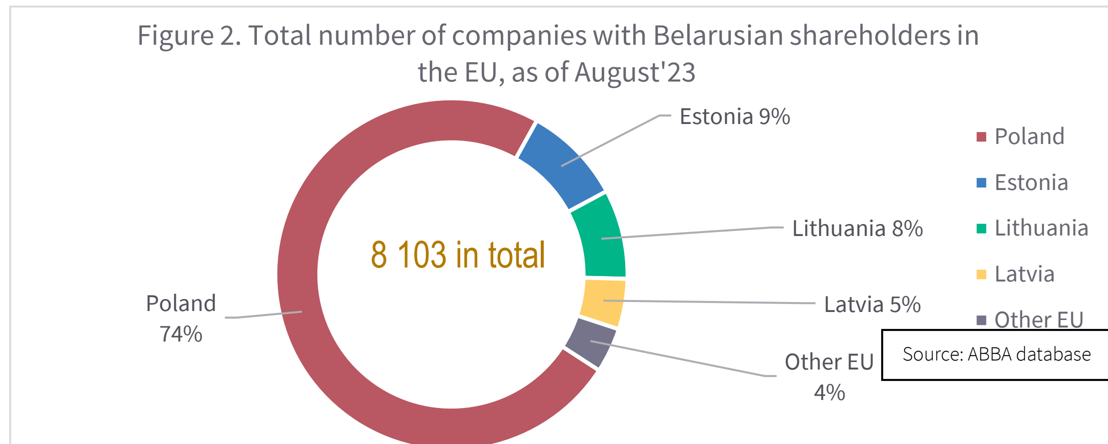


Figure 2. Total number of companies with Belarusian shareholders in the EU, as of August'23

The situation of Belarusian businesses in the EU is quite unique at the moment, compared to businesses registered by immigrants from elsewhere, for five key reasons: i) restrictions related to financial assets[7] and the unavailability of bank transfers to and from Belarus due to financial sanctions imposed by the EU; ii) the toxicity of the Belarusian passport when carrying out formalities in EU countries and in banking operations; iii) uncertainty regarding the extension of EU legal status due to some EU countries introducing restrictions on Belarusian nationals, and Belarusians being treated in general as a security risk;[8] iv) the inability to provide collateral for a loan because of a combination of the three first factors; and finally v) credit history in the EU too short to be able to apply for a loan. Altogether, this significantly complicates investments for potential entrepreneurs, despite their will to register new businesses and invest in their development.

Restricted access to finance for SMEs does not come as a surprise, as it is usually a significant growth constraint for small and medium enterprises worldwide.[9] EU evidence indicates however that access to finance is reported is not the major concern by euro area firms (around 25% of firms reported access to finance as a major concern for their business in 2023, down from around 40% in 2012[10]). We therefore make the assumption that a Belarusian immigrant in the EU will have relatively more restricted access to funding for starting and developing their own business than is the case for EU citizens.

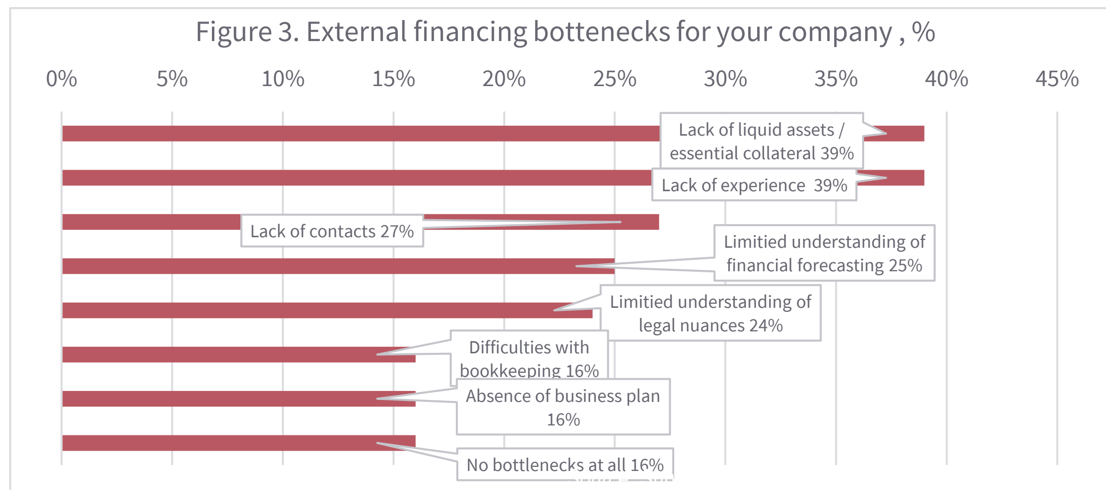
[7] In 2022 the EC prohibited the acceptance of deposits exceeding €100,000 from Belarusian nationals or residents, the holding of accounts of Belarusian clients by the EU central securities depositories, as well as the selling of euro-denominated securities to Belarusian clients. Source: https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1649

[8] Recent changes in the legislation of Estonia, Latvia, and Lithuania tend to set tougher conditions for holders of Belarusian passports to obtain a visa or residence permit, to buy property, or even to drive a car with Belarusian plates.

[9] See, for instance, Beck, T. and Demirgüç-Kunt, A. (2006), Small and medium-size enterprises: access to finance as a growth constraint, Journal of Banking & Finance, 30.

[10] European Central Bank (2023) Survey on the access to finance of enterprises in the euro area. April 2023 to September 2023.

This assumption was studied in the two surveys of businesses with Belarusian shareholders in EU countries conducted in 2022-2023. The first survey of the financial needs of Belarusian companies and self-employed in the EU in December 2022 – January 2023[11] showed that 80% of the companies expressed the need for a loan in the coming year of operations. The average financial need was between 50,000 and 100,000 euros. Of the companies surveyed, 18% had previously applied for a bank loan. Of those who had applied, 35% obtained a positive response from a bank. Companies with positive responses were registered in 2012, 2017, 2020, 2021 and 2022, which suggests that the year of registration was not a critical factor for bank decisions.



Most of the received loans (57%) ranged in value from 10,000 to 50,000 euros, although there were also positive cases for loans of above 100,000 and even above 500,000 euros.

The second survey of Belarusian entrepreneurs, in September – October 2023,[12] showed that almost every second business (47%) lacked the financial resources needed to develop their business. The key bottlenecks for external financing in the studied EU countries (Figure 3) are lack of liquid assets and essential collateral (answered by 39% of those who indicated a need for external financing) and lack of experience in obtaining external financing (39%). As a result of the above-mentioned restrictions observed by entrepreneurs from Belarus in the surveyed EU countries, only 17% of the respondents applied to banks for loans in 2022-2023, while 28% said they planned to apply. The success rate among those who had already applied for a business loan was 24%, while 71% were rejected. We also asked Belarusian businesses in the EU about their preferences when taking out a loan. For the majority of respondents (58%) the amount of external financing required

[11] Survey conducted in December 2022 – January 2023, addressed to businesses with Belarusian shareholders and self-employed registered in Poland, Lithuania, and Germany. The responses were controlled for diversity in terms of country and region of registration, annual turnover, number of employees, and sector of operations. In total, 77 responses were collected and analysed, 61 (79%) of them were from Poland. Self-employed persons were included in the analysis.

[12] Survey of businesses with Belarusian shareholders in the EU conducted in September-October 2023 by ABBA – Association of Belarusian Business Abroad, CASE – Center for Social and Economic Research, and the Center for New Ideas (CNI). 102 Belarusian owners of businesses in the EU were surveyed, and a focus group with 5 owners was conducted. Sample profile: 69% of the respondents were from Poland, 20% from Lithuania, 11% from other EU countries, representing 15 various sectors of the EU economy. The share of micro-enterprises (up to 9 employees) in the survey was 89%, small businesses (11-49 employees) accounted for 8%, and 3% of the businesses were medium-sized (50-249 employees). 71% of the business owners were male, and 68% of all respondents had higher education. The survey was the first round of the quarterly monitoring of Belarusian business in the EU in 2023-2024, financially supported by the EU.

did not exceed 50,000 euros. Respondents who had applied for a loan in the past or planned to apply in the near future indicated that the optimal repayment period for them would be 2-3 years and 3-5 years (29% in each case, or 58% taken together). The maximum acceptable cost of the loan in euros was estimated by the respondents at an interest rate of between 2% and 10%. The average (arithmetic and median) acceptable cost of the loan in euros was 5%. These results illustrate a typical need of micro and small enterprises at the earlier stages of their lives.

The survey findings suggest that the market gap in terms of financing resources available for businesses with Belarusian capital is between 65% and 70% of the total financial need assessment. On the basis of the available statistics and data acquired from surveys, it is difficult to estimate the actual financial needs of Belarusian enterprises registered in the EU. Simple calculations based on the distribution of businesses' responses regarding the scale of their requirement and total number of Belarusian firms in the EU[13] indicate that the total financial need would be a 6-digit number, i.e. over EUR 100 million.

Bearing in mind that there is a market gap in external financing for Belarusian businesses in the EU, and the fact that a business with a Belarusian owner belongs to a risky category of borrowers, there need to be regulatory incentives for banks to offset the impediments to accessing money. Using a guarantee leverage could help partly cover the needs of Belarusian firms and spur their investment potential in EU countries. Launching a credit guarantee scheme dedicated to businesses with Belarusian shareholders in a EU country, for instance in Poland, could allow companies to have better access to financing while at the same time reduce the risk of default from the viewpoint of the lender, and bring about positive effects for the hosting economy. Guarantees for Belarusian entrepreneurs have to be properly structured, and tailored to the situation of the beneficiaries, which makes them a political rather than a market-based instrument.

How credit guarantee schemes work

Essence

Information asymmetry is among the core reasons why commercial banks are reluctant to provide loans to SMEs. Simply put, SMEs are often unable to provide information on their creditworthiness to banks due to lack of appropriate accounting records or collateral. Credit Guarantee Schemes (CGS) exist to ease the problem of information asymmetry and provide better access to loans for SMEs around the world. In fact, CGSs help reduce the credit gap, mostly in emerging markets, and serve as a countercyclical boost to private lending. Many developing countries adopted credit guarantee schemes in response to the Global Financial Crisis of 2008-2009, and these schemes were not closed down afterwards. Recently, developed countries joined the club to utilise credit guarantee schemes in response to the COVID-19 crisis. Today, thousands of CGSs of different types exist in the world, providing billions in guaranteed value each year. The topic of CGSs and their impact is appearing more and more frequently in economic literature, and they are often used as a government financial policy instrument.

[13] We realize that not all of the EU-registered firms have started operations. Data from the open data platforms show that only around half of the businesses have employees and turnover. We therefore took a threshold of 50% of the total number of businesses to be included in the market size for the calculations.

The idea of a CGS is very simple, and it works as follows. A CGS accumulates private or public funds, and issues financial guarantees covering up to 100% of the unpaid debt of a borrower. If a borrower is guaranteed by a CGS and fails to pay back their debt, the CGS will pay off their debt to the lender.

Information asymmetry can constitute a bigger problem in the case of SMEs started by immigrants. A recent meta-analysis of the literature on sources of financing among immigrant entrepreneurs indicates that the information asymmetry theory in finance is often used to explain obstacles to accessing finance faced by immigrant entrepreneurs.[14] For Belarusian immigrants who relocated to the EU after August 2020, it would seem that their limited access to finance for starting a business is due to information asymmetry. As shown in section 1 of the paper, SMEs with Belarusian owners or founders are unable to provide a credit history due to the brief lifespan of their company, cannot find collateral due to the toxicity of Belarusian capital in the EU, and are unable to transfer cash from their account in Belarus to the EU due to sanctions and restrictions. It is challenging and costly for them to gather such information and find sources of investment. This leads to uncertainty regarding a project's expected rates of return and the integrity of the borrower. Many banks and leasing companies in Poland, Lithuania, and other EU countries consider the credit risk particularly high for SMEs with Belarusian origin. What those immigrants are left with is entrepreneurial spirit and ideas to invest in.

Benefits

The key benefits of credit guarantee schemes are risk transfer and diversification. Firstly, by covering part of the default risk, a lender's risk is lowered;– the schemes guarantee secure repayment of all or part of the loan in case of default. Secondly, CGSs absorb an significant share of the borrower's risk. CGSs can also compensate for factors such as insufficient collateral and weak creditor history. Therefore, CGSs can improve loan terms and facilitate access to formal credit for small firms. Additionally, by allowing loans to be granted to borrowers that otherwise would have been excluded from the lending market, these businesses 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. In this way, a multiplier effect for the economy is often achieved. Experience suggests that credit guarantee schemes do indeed play a role in expanding credit to SMEs.[15]

Credit guarantee schemes have the opportunity to contribute not only to credit additionality, but also to technology and knowledge spillover as well as economic additionality, e.g. increases in profit or employment. By improving access to formal credit, CGSs help enterprises acquire finance for investments that can increase productivity.[16]

Guarantee schemes thus have both an economic role and a social function. Their economic role is activated by facilitating access to more credit, or better credit for micro-entrepreneurs and SMEs, by providing substitute collaterals. In doing so, CGSs perform a social function and allow

[14] Malki et al. (2020)

[15] See, for instance, Cusmano (2018), Asdrubali and Signore (2015)

[16] For example, credit guarantee scheme by Korean guarantee fund KOTEC had a positive effect on sales growth and productivity in the firms to which it caters. In particular, the firm evaluation process and the system to support technology implementation have contributed to a high survival probability of loans. Source: http://www.kotec.or.kr/

entrepreneurs to overcome various obstacles to bringing credit to viable but non-bankable projects. This combination makes them a particularly valuable instrument that can be used by SMEs with Belarusian capital in the EU, which otherwise would not have been financed by banks. On the other hand, one can expect positive spillover effects for the hosting economies through new jobs created and more taxes paid.

Categories and types

The most common practice around the world is for guarantee schemes to usually be classified into two categories: guarantee companies, and guarantee programmes.

Guarantee companies are subject to the law applicable to commercial firms. In this legal framework, their status is the result of an agreement between shareholders that provide private and/or public equity permanently in the course of time. Shareholders participate in the functioning of the company boards and bodies in accordance with corporate law. The purpose is exclusively the provision of guarantees.

Guarantee programmes exist when the guarantee is exercised within the legal or normative framework of a public or administrative institution according to a regulation governed by an administrative or political decision. Limited and temporary public resources (guarantee funds) are then devoted to a specific purpose and are generally administered like autonomous assets. Supervision is exercised according to the rules of control of public accounts, or under the rules that govern the institution in charge of management.

Guarantee programmes are of prime interest in the case of companies with Belarusian capital in the EU. In practice, schemes in this category can be implemented in one of two options:

– Programmes managed by specialised institutions: their execution is decentralised towards a third-party body specialising in economic promotion or support for SMEs (a public agency, development bank, or public financial institution; in our case this could be the Polish Development Bank – BGK). The financial responsibility of the "guarantee" activity is detached from the institution's equity, and ultimately relies on the public budget that created the programme.

– Programmes run by the public administration, which manages the account and settlements in keeping with the current objectives of the public authority. Although no company is created, there may be a committee in charge of decision-taking and management.

Nowadays, although financial guarantees are mainly provided by government agencies, the trend is towards an increase in private financial guarantees backed by banks, insurance companies, and development finance organisations.[17]

The World Bank (2009) and OECD (2010) describe the types of the CGSs somewhat differently.[18] By asking questions such as "How has the fund been capitalised?", "What is the ownership structure?" and "How are the guarantees delivered?" the OECD identifies four major types of guarantee fund: public guarantee schemes, corporate funds, international schemes and mutual guarantee associations.

[17] See for instance Facundo and Schmukler (2017), World Bank (2015), Arping. S., Morrison. A., Lóránth. G., 2008
[18] OECD (2010)

Public Guarantee Schemes: public guarantee schemes are established by public policy. They usually involve state subsidies, especially initially. They are typically managed by a private organisation or an administrative unit of the government. An advantage of this system is that, in the event 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 sometimes chambers of commerce. Corporate guarantee schemes have the advantage of being managed by experienced corporate leaders, and 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 a guarantee fund with technical assistance for businesses.

Mutual Guarantee Schemes: mutual guarantee schemes are also sometimes known as mutual guarantee associations, societies or funds. They are private and independent organisations formed and managed by borrowers with limited access to bank loans. Although they are largely funded through membership fees, etc., in many instances they operate with some form of governmental or international support. Mutual guarantee schemes benefit from the active involvement and experience of their members. Each member contributes to a common fund that is used to provide guarantees on loans procured by its members. An important characteristic of a mutual guarantee scheme is that it also relies on social capital, that is, the fund creates social norms and positive peer pressure to encourage repayment amongst its members.

The European Fund for Sustainable Development Plus (EFSD+)

EFSD+ is part of the European Union’s investment framework for external action. It is a comprehensive instrument that includes

- guarantees
- grants provided through “blending” (a mix of EU grants with bank loans)
- technical assistance to help improve the quality of projects and the implementation of reforms
- other support tools to support the development of partner countries

EFSD+ raises financial resources for sustainable development from the private sector for inclusive economic development. It supports investment in partner countries to promote decent job creation, strengthen public and private infrastructure, foster renewable energy and sustainable agriculture, and support the digital economy.

The investment framework also includes the External Action Guarantee, and together the two components deliver a firepower of €53.45 billion for sustainable development. The External Action Guarantee has a capacity of €130 billion to guarantee EFSD+ operations. Together with the private sector and thanks to the leverage effect, this may mobilise more than half a trillion euros in investments for 2021-2027.

The EFSD+ guarantees are offered on favourable, highly competitive conditions. They allow private investors to finance projects in more challenging markets, by assuming the risks of more unstable environments while avoiding market distortions. Because the EFSD+ covers a share of the risks, the EU's development finance partners can match the EFSD+ guarantees with their own resources, which in turn will attract additional investors. The instrument makes available €40 billion in guarantee capacity.

The investment programmes are implemented through two main paths:

- In a partnership with the EIB, the EU is providing €26.7 billion guarantee for financing to support investments in sectors such as clean energy, green infrastructure and health. The guarantee will have a maximum impact on Global Gateway investments in partner countries where sovereign and other public sector risks are still a major bottleneck.
- Through sectoral windows amounting to €13 billion. The European Commission is proposing a specific "Global Gateway window", which focuses on sectors like sustainable energy, clean transport and digital.

Source: https://international-partnerships.ec.europa.eu/funding-and-technical-assistance/funding-instruments/european-fund-sustainable-development-plus-efsd_en

A 2009 World Bank study of 76 guarantee schemes across 46 developed and developing countries[19] showed that prior to COVID-19 mutual guarantee funds tended to operate in high-income countries, while most middle and low-income countries had publicly operated funds. The report also found that public schemes were, on average, younger than mutual funds, and were more likely to operate in emerging markets. The study suggests that mutual guarantee schemes tend to be financially more sustainable due to the ownership and involvement of their members.

Mutual guarantees experience: Confidi (Italy)

Confidi are born from the association of small entrepreneurs, based on cooperation and mutuality, in order to overcome huge difficulties to access external financing sources while pre- serving the economical and legal autonomy of each enterprise. They are not based upon a business-policy attitude adopted by public authorities.

Confidis form a nationwide network composed of 600 entities. This way, there is close vicinity between the schemes and the local applicants. There is a perfect knowledge of the field elements. Their sectorial base (handicraft, commerce, industry and agriculture) allows them as well to have an in-depth knowledge of the characteristics of the values that are determinant for the good management of a business. The decision-making and administrative bodies of the Confidi are based on affiliate enterprises, which play a fundamental role. These enterprises have a central assessment role as they directly or indirectly manage their organisation and technical committees.

[19] See World Bank (2009)

The voluntary aspect of this SME aggregation usually implies the existence of a promoter, a role which was played by their entrepreneurial associations. The Confidi are born as a natural answer to the need of placing a further intermediary at the centre of the relationship between banks and SMEs.

They have focused their activities on getting additionality for their members:

- obtaining additional credits compared to the amounts for which they were "normally" available;
- obtaining interest rates in line with "prime rate" as well as more transparent additional terms;
- focusing the credit analysis on corporate profitability capacity, rather than on the mere assessment of collateral value.

Source: European Communities (2006)

Challenges

The OECD (2010) highlights three main challenges for a credit guarantee scheme to achieve sustainability and additionality: (i) proper regulation and supervision; (ii) the role and involvement of the private sector; and (iii) the appropriate design of CGSs. We have adapted these guidelines to the current situation of Belarusian firms in the EU, and highlight the following three issues that seem crucial for designing a successful designated guarantee scheme:

- market conditions of funds allocation and supervision of defaults
- transparency of the public funds used to design a CGS
- capital replenishing and private sector involvement in a CGS.

One must bear in mind that a credit guarantee scheme is designed to find the golden mean between the interests of the borrower, who would like the most favourable terms for their business, and the interests of the creditor, who would like to minimise losses in order not to exceed the assumed risk level. This aspect comes to the forefront because Belarusian firms in the EU might be treated as riskier borrowers, as well as the fact that part of the guarantee may come from public funds. A guarantee and a loan should therefore be based on the market conditions and clearly specify default conditions for borrowers to avoid ineffectiveness and misuse of the guarantee funds. Guarantee payouts should only be used as a last resort. Before it comes to this, both guarantor and lender should be involved in negotiating rescheduled payments.

Improving access to finance for firms with Belarusian shareholders in the EU via a CGS seems impossible without the involvement of public funds, at least as a pilot project. Particular transparency is therefore required, in terms of the guarantee operating principles, borrower analyses, the decisions taken and the financial dimension of loans provided. Guarantee reinsurance should be considered, for instance as a counter-guarantee or co-guarantee with private sector funds involved.

Finally, a good standard would be to involve private funds for a guarantee to attain its sustainability. One of the reasons for this is the "wearing out" of funds after a certain period of time, for example 10 years. Over time, the capital has to be systematically replenished so that credit additionality is sustained, and borrowers' benefits are maintained higher than the insurer's losses while market mechanisms determine the price and quantity of credit. If a guarantee coming from public funds is a one-off grant, until the funds are exhausted, then replenished capital must come from the private sector. The involvement of private funds is necessary if a CGS is planned for a certain period of time, clearly defined, during which both public and private funders would replenish the capital.

Credit guarantee schemes for Belarusian firms in the EU

In this part we discuss specific solutions and descriptions of credit guarantee schemes that are relevant for companies with Belarusian founders or owners in the EU, and the implementation of which is feasible in the current political and economic conditions. It should be clearly stated that the solutions proposed should be treated as a direction of intervention rather than exclusive policy instruments. We consider two possible options: the first is an international CGS within the European Commission's commitment to support Belarusian businesses abroad.[20] The second option is a mutual guarantee scheme that an association of businesses, for instance, ABBA – Association of Belarusian Business Abroad, could create and lead in order to support loan provision to Belarusian businesses in exile using their own funds.

The key characteristics that will be relevant for a credit guarantee scheme for businesses with Belarusian capital in the EU are coverage ratio, loan size, maximum guarantee amount, duration, and eligibility criteria. Below we describe the options and some best practices for each of the characteristics.

The **guarantee coverage ratio** (the percentage of the loan being guaranteed). In practice, there are two regimes in effect: complete coverage, and partial coverage. The partial coverage ratio approach has been widely tried out around the world, and represents the most common form of guarantee contract. A World Bank study[21] points to the fact that coverage ratios worldwide are generally above 50 per cent, then providing a lower limit. However, choosing the optimal coverage ratio is an important issue to deal with. If the ratio is set too low, banks may not lend to riskier, high-need borrowers, and the programme will not support those it is intended to aid. However, if the coverage ratio is 100% and the programme fully protects banks against default risk, banks may lower their lending standards while borrowers may be more reckless in their borrowing decisions. The guarantee coverage ratio should therefore reflect a balance between the lender's appetite for risk and the borrowing capacities of loanees.

The **size of loans** eligible for the guarantee should be clearly chosen, and a **limit for the guaranteed amount** should be clearly set. Sometimes the loan amount plays an important role in the likelihood of default. In the case of Belarusian-owned businesses in the EU, the survey results could be used

[20] https://ec.europa.eu/commission/presscorner/detail/en/IP_21_6794
[21] See World Bank (2009).

to determine the optimal loan size.[22] A maximum guarantee limit per beneficiary can be used to expand access and increase usage.

The usual practice is to extend the duration of the guarantee coverage to the whole maturity period of the loan. However, in terms of best practices seen in the literature, an absolute limit – for example of two to five years – could be set, with both parties (the guarantor and the delivery financial institution) having the ability to terminate the guarantee.

Existing studies suggest that policymakers should target viable SMEs with high growth and productivity potential that are financially constrained due to insufficient bankable collateral.[23] The approach can be sectoral or company size based, depending on the needs of the CGS. The intermediaries or delivery financial institutions should also be properly chosen. Since lenders or financial institutions are responsible for selecting beneficiaries, they should enjoy a good reputation and have the required expertise in loan underwriting and monitoring.

International Scheme

The International scheme is directly connected to the European Commission's commitment to support Belarusian businesses abroad and its ability to provide a significant amount to it. This could be a pilot guarantee mechanism implemented in Poland as the key destination country for Belarusian business relocation. The pilot CGS would be used as collateral by the Polish Development Bank (BGK) to enable loans in non-bank financial institutions in Poland dedicated to entrepreneurs with Belarusian passports. The BGK, as a bank of a special nature, has a lot of experience in the role of guarantor in different programmes in Poland, and was directly involved in discussing the possibility of a guarantee mechanism for Belarusian businesses with the European Commission. The choice of non-bank financial institutions was made mainly to ensure a higher eligibility rate for borrowers with Belarusian capital, since i) the appetite of non-bank financial institutions to provide loans for small and micro firms is usually higher than in banks; ii) there are certain restrictions in Polish banking law on granting bank loans to businesses with limited borrowing capacity;[24] and iii) Belarusian owners of the borrowers might seem quite toxic and risky to banks due to the stricter capital control within banking anti-money laundering regulations.[25]

The proposed international guarantee mechanism would be an optimal pilot solution and could operate as presented in Figure 4 and explained below.

Figure 4. International credit guarantee scheme for businesses registered in the EU with Belarusian shareholders

[22] For instance, the results of the survey of financial needs of Belarusian businesses in the EU in September 2023 - October 2023 presented in section one of the paper. More information and results are available at: https://www.abbabusiness.org/belarusian-business-barometer-october-2023/

[23] See, for instance, Soumaré (2022).

[24] According to Art. 70 of the Banking Act of Poland, a bank can issue a loan as maintained by the borrowing capacity of the borrower. If the borrower does not have borrowing capacity, collateral is needed along with the borrower's financial revitalizing plan. Source: https://lexlege.pl/prawo-bankowe/rozdzial-5-kredyty-i-pozyczki-pieniezne-oraz-zasady-koncentracji-zaangazowan/2553/

[25] Due to the fact that Belarus is the fifth most-sanctioned country in the world (https://www.statista.com/chart/27015/number-of-currently-active-sanctions-by-target-country/) and quite a significant amount of Belarusian citizens being on the international sanctions list, banks may treat the risks of dealing with Belarusian capital as high, with a negative impact on loan profitability, contributing to their general unwillingness to deal with high risks

Source: own contribution

1. The European Commission allocates funds to BGK to become collateral in the designated programme for loans for Belarusian-owned firms in Poland.
2. The Polish Development Bank (BGK) selects partner non-bank financial institutions in Poland, eligible and willing to participate in the programme, through a tender process.
3. An enterprise with a Belarusian shareholder (company) applies to a non-bank financial institution (financial institution) from the list for a loan, with collateral.
4. The financial institution evaluates the application and decides whether the collateral balance will be covered by a guarantee mechanism allocated at BGK, i.e. transfer of a part of the risk to BGK.
5. The financial institution and the company conclude a loan agreement on the terms available in the market.
6. Whenever a company defaults on a loan repayment, in part or in full, the lender must attempt to negotiate rescheduled payments, informing BGK about the commencement of negotiations and their result.
7. Should negotiations for rescheduled payments not prove fruitful, the financial institution applies to BGK for a guarantee payment to cover the actual losses.
8. When approved, BGK executes the guarantee mechanism for the financial institution, and receives the right to regress the claim, i.e. the claim on the borrower will then shift to BGK, rather than remain with the financial institution.
9. BGK deals with the regressed claim according to Polish Law.

The technical details proposed for the International CGS are given in Table 1. For each loan issued, a certain guaranteed amount would be blocked within the CGS. The guaranteed amount would be calculated using the following formula: loan amount * probability of loan default. Example: if a EUR 100,000 loan is issued and the probability of default (ultimately calculated by the implementing agency) is 25%, then EUR 25,000 is blocked as the guaranteed amount.

We propose setting a maximum guaranteed amount per loan equal to EUR 100,000. The maximum loan amount within the programme would be calculated as follows: guarantee amount / probability of loan default: EUR 100,000 EUR / 0.25 = EUR 400,000 maximum loan amount.

Guarantees are proposed for covering up to 75% of the borrowed amount. For a reference, we use the coverage ratio of the de minimis guarantee programme, in which BGK provided guarantees to banks lending to small and medium-sized enterprises and required an own contribution of 40% before the COVID-19 pandemic; this was later lowered to 20% to reduce the impact of the pandemic

and Russia's aggression against Ukraine.26 The own contribution should stimulate beneficiaries of the guarantee fund to bear part of the risk, and to avoid treating the guarantee as a source of money rather than as a security for the loan.

We adopt a significant default probability of 25%, assuming a lack of historical data for the guarantor, a lack of credit history on the part of the entrepreneur, limited access to collateral, and several other factors necessary for the lender to assess the risk of the guarantee's beneficiary. This probability, however, may be revised after a certain period, for instance after two years when risk assessment data will have been gathered from programme beneficiaries.

The cost of the guarantee is benchmarked against the BGK's de minimis programme since March 2020, in which the annual cost equals 0% of the guarantee amount.

The size of the pilot international guarantee mechanism is assumed to be limited by the commitment of the European Commission within its support for Belarusian business.[27] Idle funds within the Guarantee Fund will be invested in safe instruments that bring income in the form of interest, and this will partially cover the administration costs.

Table 1. Technical details of the proposed International CGS

Funding of the guarantee mechanism:	European Commission, potentially other international financial organisations
Implementing agency:	Polish Development Bank (BGK)
Financial institutions facilitating business loans issuance:	Non-bank financial institutions
Guarantee funds allocated:	5 million euro
Criteria to qualify as business of Belarusian descent:	- Minimum 50% ownership by Belarusian citizen(s) - Preference for companies registered after 2020 - SMEs with growth and productivity potential

[26] See the BGK report on the de minimis programme: https://www.bgk.pl/files/public/Pliki/Ekspertyzy_i_badania/Raport_de_minimis_2023_ver_eng_.pdf?__cf_chl_tk=0KDw1Z5URvulW9EfmuGgnRZbgUHfA.QWF60_ZhP1Cbo-1702899677-0-gaNycGzNDZA

[27] See official European Commission statements (https://ec.europa.eu/commission/presscorner/detail/en/IP_21_6794). Authors' communication with EC representatives at online and offline events in Vilnius and Warsaw between January and October 2023 is also considered.

Countries where this mechanism can be implemented:	Phase 1: Poland Phase 2: Lithuania, Latvia, Estonia through partnership with BGK development banks
Loan usage:	Facilitating SME access to working capital and investment loans
Maximum guarantee amount per loan:	100,000 euro
Coverage ratio:	75%
Annual cost:	0% of the guarantee amount
Duration of the coverage:	Up to 24 months for working capital loans Up to 36 months for investment loans
Estimated probability of default:	25%
Optimal number of loans:	100
Minimum number of loans:	50

The final terms of the guarantee should be set by BGK following preliminary market assessment and consultations with potential lenders. As a pilot project, we propose that BGK assess the risk, in particular the probability of default, and take responsibility for this assessment. The actual lender's key responsibility should be evaluation of the loan application in keeping with internal and national regulations, so as to ensure that loans are granted to competitive businesses with growth and productivity potential. The borrower's key responsibility is to provide a business plan and relevant company information to enable as detailed a loan assessment as possible. There should be a clear procedure for the exchange of information between BGK and lender, and between lender and borrower, throughout the pilot programme, as well as a clear division of responsibility for each participating party in the case of a default occurring.

Mutual Guarantee Association of Belarusian business

The second potential option is a more complicated approach, and could be used after the implementation of a pilot international CGS using funding from the European Commission. The second option is based on the worldwide experience of mutual guarantee associations (MGA), and

could be initiated as a financial institution affiliated with ABBA – Association of Belarusian Business Abroad and thus utilizing opportunities of ABBA network.

To put the idea simply, ABBA could initiate the establishing of a financial institution as an ABBA subsidiary, open for ABBA members and other businesses with Belarusian capital from around the world to join. The essence of the scheme would be to attract verified members (with a membership fee), and help its members obtain financing by reducing the risk of a loan granted to them, limiting transaction costs and guaranteeing payment in the case of default. Such a financial institution could be registered in Poland to be regulated by local financial law, and compliance with the regulations would be supervised by the regulator, financial supervision authority, and auditors.

At least half of the scheme's funding should come from members' fees, while the other half could be fundraised from private investment funds,[28] as well as through support from international donors. We assume that if a pilot guarantee scheme as described above is successful, it could serve as an argument for attracting international financial organizations' support to fund between 10% and 20% of the mutual guarantee.

In this way, the MGA could give a more powerful bargaining position to SMEs that joined the mutual guarantee association as members. The MGA would play the role of a quasi-borrower in relation to banks, and would be a more influential negotiating partner than a single small business. Members would thus be able to obtain loans with better terms and possibly lower costs.[29]

Although the organisation of MGAs varies, they typically share some common characteristics. For instance, a proposed MGA should have:

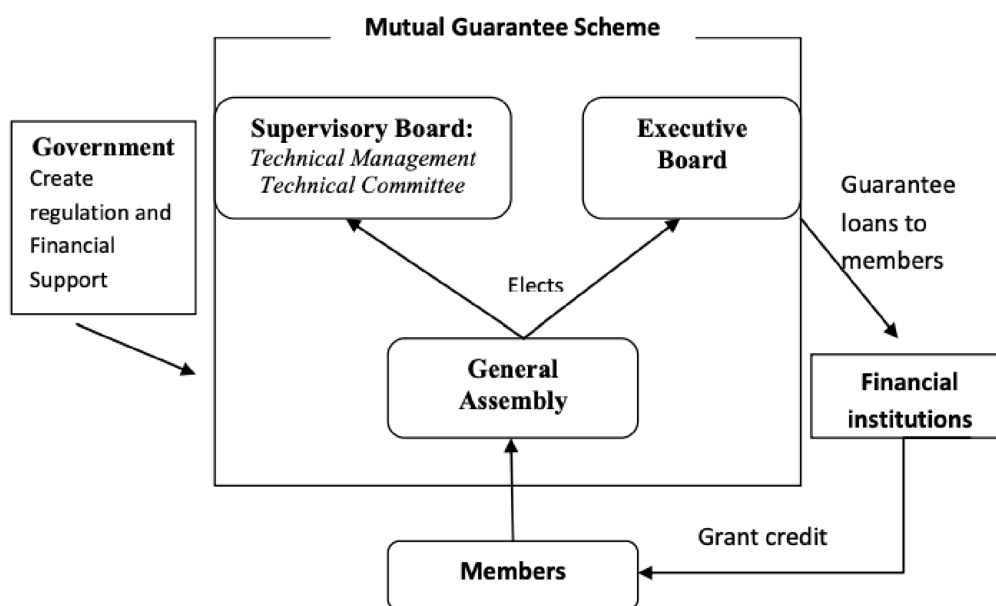
– A General Assembly composed of all members. The General Assembly determines the regulations for issuing guarantees and elects members to the Executive and Supervisory Boards. It can approve or veto actions planned by the Boards.

– An Executive Board that monitors and supervises the technical management of the fund and takes decisions on which guarantee applications to accept. The Executive Board also decides whether to admit new members to the fund.

The structure of a typical MGA is presented below.

[28] There are investment funds with Belarusian origin around the world, for instance Zubr Capital, Kolas Ventures, Geek Ventures, etc.
[29] Green (2003).

Figure 3. Organisational chart of a Mutual Guarantee Association



Source: Green (2003)

Despite its relatively puzzling implementation due to regulatory constraints, such an MGA could have a competitive advantage over the other types of guarantee funds. One of the main advantages of an MGA would be its expertise and knowledge of the business sectors covered by the members of the association, of the region in which the MGA is based, and of the market trends and production techniques of the enterprises whose loans the association guarantees. MGAs are thus often in a better position to evaluate the feasibility and risk of a project. This knowledge advantage they hold could decrease the costs of gathering information and thereby reduce overall transaction costs when association members apply for a loan in a bank or non-bank financial institution.[30]

The technical details of such a proposed MGA are provided in Table 2.

Table 2. Technical details of proposed Mutual Guarantee Association

Funding of the guarantee mechanism:	- Member fees (minimum 50% of funding) - Private investment funds owned by Belarusians (20%-30%) - European Commission, other international financial organisations (10%-20%)
Implementing agency:	ABBA Mutual Guarantee Association

[30] ibid.

Financial institutions facilitating business loans issuance:	Banks and non-bank financial institutions across the EU and the USA
Guarantee funds allocated:	1 million euro
Criteria to qualify for a loan guarantee:	- Membership in the MGA - Preference sectors specified by the MGA General Assembly
Countries, where this mechanism will be implemented:	EU and USA
Loan usage:	Facilitating access of MGA members to working capital and investment loans
Maximum guaranteed amount per loan:	100,000 euro
Coverage ratio: **Duration of the coverage:**	Up to 75% Up to 24 months for working capital loans Up to 72 months for investment loans
Annual cost:	0.5%-1% of the guarantee amount
Estimated probability of default:	5%
Optimal number of loans:	100
Minimum number of loans:	50

Compared to the international CGS, the MGA would need a smaller guarantee fund (1 m euro vs. 5 m euro) for the same optimal amount of guaranteed loans (100). This will be possible due to the MGA format, with higher social capital and a lower default probability for participating MGA members. We estimate that the probability of default would be significantly lower in the case of the

MGA (5%) than for the international CGS (25%), because the former would create social capital for members from peer verification to join the association, peer monitoring and peer pressure, together conducive for a higher level of loan repayment. The social capital is expected to bring a risk-diminishing effect because each call on the guarantee reduces the capital allocated to the guarantee fund by the loss on the loan in question. This hits the beneficiaries of the guarantee fund, and de facto all members of the association.

The annual cost of the guarantee is expected to be between 0.5% and 1% of the guaranteed amount (payable by the borrower), to ensure that the risk is paid for. The price of risk and the cost of the service must aim for long-term sustainability of the guarantor, encouraging participation by private and international investors as guarantee funders.

The proposal is for the MGA to cover up to 75% of the borrowed amount. Similarly as in the case of the international guarantee scheme, businesses' own contribution should stimulate them as beneficiaries of the guarantee fund to bear part of the risk and avoid treating the guarantee as a source of money rather than as a security for the loan.

Korean Credit Guarantee Scheme

Despite the success of the Korean Credit Guarantee Scheme, it maintained a default rate of 4 percent which was considered high by international standards. This was because the main goal of the scheme was to improve the credit environment for SMEs. Indeed, the fund provided credit to 230 SMEs and the total amount of credit guaranteed surpassed USD 33 million. The government only contributed USD 100 million to the scheme. The remaining USD 700 million in the scheme came from commercial banks. The financial involvement of the private sector enabled the fund to remain financially stable over time, despite its relatively high default rate. In the 1980s while the Korean economy was growing rapidly, the fund issued many credit guarantees. However, in the late 1990s Korea experienced a very serious economic crisis and a financial downturn. To contribute to the normalisation of the financial market, the fund decided not to stop distributing guarantees. As a result, the default rate increased and remains relatively high. However, the fund expected it to decrease over time – starting in the early 2000s the economy began improving and the fund quit expanding its credit portfolio. Since then, the fund puts more emphasis on improving the quality of the portfolio.

Source: World Bank (2009)

Annex 1. Issues related to the EU assistance for fair Belarusian businesses

Issue	Solution
Direct transfers of support funds to Belarusian business accounts became impossible in 2021 because of sanctions and political repressions from the Belarusian government towards the support beneficiaries	The EU assistance is now delivered to one of the EU countries, mostly via Poland or Lithuania as the country to which most Belarusian businesses currently relocate
Business emigration from Belarus started in 2020 and accelerated after the outbreak of the Russia-Ukraine war	EU countries created new opportunities for easier relocation of companies and their employees, such as the "Poland. Business Harbour" programme in Poland, and full relocation services in Lithuania
Émigré business has neither credit history nor the collateral for starting a new business or investment in the EU	A Guarantee Fund mechanism should be launched to create better access and potentially cheaper bank loans for relocating Belarusian companies and start-ups
Belarusian business holders and self-employed are deprived of their basic economic rights in the EU because EU banks have considered Belarus capital toxic since Lukashenka contributed to Russia's invasion of Ukraine	The authorities of the EU countries have to strictly follow the principle of non-discrimination by nationality. ABBA introduced a mechanism of business verification. ABBA makes sure that companies and their founders run fair business operations in the EU, and have no relationship to sanctions or the Lukashenka/Putin regime. ABBA has a very strict Code of Business Ethics and thoroughly monitors that its members follow it. There is potential for cooperation between ABBA and EU countries' governments

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