Loan Guarantee Programs May Include Nonbanks

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Original post here.

Loan guarantee programs that involve nonbank lenders may be more effective than bank-only programs at getting credit quickly to small businesses that need it during the coronavirus crisis.

Small and medium-sized enterprises (SMEs) play a major role in the world economy, representing roughly 90% of businesses and 50% of employment worldwide. Many countries operate credit guarantee programs to encourage lending to SMEs. These programs are typically limited to bank loans. For example, the UK launched a Coronavirus Business Interruption Loan Scheme this week, taking advantage of existing programs, but the program is limited to forty previously accredited bank lenders.

This may limit its value. Since the Global Financial Crisis, other types of financing beyond traditional bank lending--such as online sources of alternative lending and short-term loans from non-financial corporations--have become increasingly important for SMEs. Expanding the scope of eligible lenders for guarantee programs could be a valuable tool for credit guarantee programs developed or expanded during times of crisis.

Some guarantee programs involve nonbanks already. The Netherlands expanded the BMKB program in 2012 and GO facility in 2013 to include other types of financial institutions, such as credit unions, SME funds, and crowdfunding as eligible lenders. The Growth Facility offers banks or private equity firms a 50% guarantee on newly issued equity or mezzanine loans. Mezzanine loans are a hybrid instrument, which gives the right to convert debt to equity if the loan is not paid back.