TREEPEDIA

Doc 5.4 Credit guarantee funds

In some circumstances, a credit guarantee fund can facilitate access to credit. Many micro- and small-entrepreneurs with good business plans cannot access bank loans because they do not have suitable collateral. A guarantee fund is especially created to guarantee the loans for which entrepreneurs apply for at the bank. Well-designed guarantee funds apply a risk-sharing mechanism: both the bank and the guarantee fund share part of the credit risk in case the entrepreneur cannot repay their loan.

Credit guarantees are not free. The entrepreneur has to pay a fee for the guarantee coverage that is offered. There are a number of reasons to be cautious with credit guarantee funds:

- Moral hazard. An entrepreneur, who knows that their loan is guaranteed, may feel less pressure to repay the loan.
- High operational costs. Usually both the bank and the guarantee fund have to evaluate credit applications and monitor the performance of the client.
- Sustainability concerns. It is not easy to create a guarantee fund that can cover its losses with the income from guarantee fees.

Whenever TREE decides to create a credit guarantee fund, care should be taken that the design is adapted to the local context and that previous experiences and good practices are taken into account.

Source: SFP-IPEC (2004) "Technical Guidelines: Microfinance against Child Labour" ILO, Geneva.