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STRENGTHEN2

► Credit guarantee schemes, MSME access to finance and labour productivity in Africa

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STRENGTHEN2:
Employment impact assessment
to maximize job creation in Africa



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► Acronyms and abbreviations

aBi	Agricultural Business Initiative
ACGSF	Agricultural Credit Guarantee Scheme Fund
AfDB	African Development Bank
AFI	Alliance for Financial Inclusion
AGF	African Guarantee Fund
AGRA	Alliance for a Green Revolution in Africa
BDF	Business Development Fund
BRD	Development Bank of Rwanda
CGS	Credit guarantee schemes
EIB	European Investment Bank
EU	European Union
FAGACE	African Fund for Guarantee and Economic Cooperation
FGPME	Fonds de Garantie des Crédits aux Petites et Moyennes Entreprises
FGSP SA	Fonds de Garantie pour le Secteur Privé
ILO	International Labour Organization
MFIs	Microfinance Institutions
MSMEs	Micro, small, and medium-sized enterprises
RWF	Rwandan Francs
S2	STRENGTHEN2
SACCOs	Saving and credit cooperatives
SDGs	Sustainable Development Goals
SIDO	Small Industries Development Fund
SMEs	Small and medium-sized enterprises
SOFIGIB	Société Financière de Garantie Interbancaire du Burkina
SSA	Sub-Saharan Africa
UNECA	United Nations Economic Commission for Africa

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Together, we have produced this report, which we hope will inform MSME access to finance and productive employment policy.

► Executive summary

One of the ambitions of the ILO STRENGTHEN2 project is to study how credit guarantees impact access to finance for micro, small and medium-sized enterprises (MSMEs) and job creation. This research aims to evaluate how credit guarantee schemes (CGS) affect MSMEs' ability to access money and create decent jobs – filling important gaps in research. It is hoped to gather important insights that can help shape policies and interventions to support MSMEs across Africa.

Data for this analysis comes from three surveys: two conducted with financial institutions at both regional (sub-Saharan Africa) and national (Rwanda) levels, and one survey conducted with businesses in Rwanda. These surveys were designed to assess how credit guarantees impact both financial institutions and businesses. This two-sided approach, looking at both businesses and financial institutions, helps to obtain a comprehensive view of CGS's effects on MSMEs, providing valuable insights into access to finance and job creation dynamics.

Key findings:

- The credit guarantee leverage ratio shows that for every monetary unit in the CGS, MSMEs get nearly double the CGS size, indicating the positive impact of CGS on MSMEs' access to finance. While CGS help MSMEs' to access finance, this does not always mean that they get favourable loan terms. Many MSMEs struggle to provide enough security or collateral for loans, and the owners' educational background also plays a significant role in their ability to secure credit.
- CGS have a positive impact on employment, particularly in wholesale and retail sectors, with significant benefits for women's employment. However, more targeted efforts are needed to improve youth employment.
- Analysis of labour productivity across sectors reveals high productivity in wholesale and retail trade, agriculture and accommodation, underscoring the positive impact of CGS in these sectors. However, there are areas for improvement in other sectors.

This paper is not a full survey on CGS or a comprehensive assessment of their effectiveness but provides a factual analysis of their role in MSMEs' access to finance and to labour productivity. It is important to interpret the results carefully due to limitations in data collection, such as reliance on estimates by microfinance institutions (MFIs) and MSMEs. To address these limitations in future studies, alternative data collection methods such as business diaries could be explored.

Effective policymaking requires the provision of technical assistance throughout the development, implementation, and evaluation phases of CGS. The ILO can leverage its expertise to ensure that the socio-economic outcomes of CGS are optimized and suggests some policy recommendations in this report.

► Résumé exécutif

L'une des ambitions du projet STRENGTHEN2 est d'éclairer les politiques sur l'impact des systèmes de garanties de crédit (CGS) sur l'accès au financement des micro, petites et moyennes entreprises (MPME), ainsi que sur la création d'emplois décents. Cette recherche vise à évaluer comment les régimes de garantie de crédit influent sur la capacité des MPME à obtenir des fonds et à créer des emplois décents, contribuant ainsi à combler les lacunes en matière d'information et de connaissance dans ce domaine. Nous espérons recueillir des informations importantes qui pourront aider à façonner les politiques et interventions visant à soutenir les MPME en Afrique.

Les données pour cette analyse proviennent de trois enquêtes : deux menées auprès d'institutions financières au niveau régional (Afrique subsaharienne) et national (Rwanda), et une menée auprès d'entreprises au Rwanda. Ces enquêtes ont été conçues pour évaluer l'impact des garanties de crédit tant sur les institutions financières que sur les entreprises. Cette approche à double volet, qui examine à la fois les entreprises et les institutions financières, permet d'obtenir une vision globale des effets des garanties de crédit sur les MPME, fournissant ainsi des informations précieuses sur l'accès au financement et la dynamique de création d'emplois.

Les principales conclusions sont les suivantes :

- Pour chaque unité monétaire dans le CGS, les MPME obtiennent près du double de la taille du CGS, ce qui indique un impact positif des CGS sur l'accès au financement des MPME. Cependant, l'accès au financement favorable n'est pas toujours garanti, de nombreuses MPME ayant du mal à fournir suffisamment de garanties ou de collatéraux pour les prêts, et le niveau d'éducation des propriétaires jouant également un rôle significatif dans leur capacité à obtenir du crédit.
- Les CGS ont un impact positif sur l'emploi, notamment dans les secteurs du commerce de gros et de détail, avec des avantages significatifs pour l'emploi des femmes. Toutefois, des efforts plus ciblés sont nécessaires pour améliorer l'emploi des jeunes.
- L'analyse de la productivité du travail à travers les secteurs révèle une productivité élevée dans le commerce de gros et de détail, l'agriculture et l'hébergement, soulignant ainsi un impact positif des CGS dans ces secteurs. Cependant, des domaines d'amélioration sont identifiés dans d'autres secteurs.

Ce document ne constitue pas une enquête exhaustive sur les CGS ni une évaluation complète de leur efficacité. Il offre cependant une analyse factuelle de leur rôle dans l'accès au financement et la productivité du travail des MPME. Il convient d'interpréter les résultats avec prudence en raison des limites de la collecte de données, telles que la dépendance aux estimations des institutions de microfinance (IMF) et des MPME. Pour pallier ces limites dans les études futures, des méthodes alternatives de collecte de données pourraient être explorées.

Une assistance technique tout au long des phases de développement, de mise en œuvre et d'évaluation des CGS est nécessaire pour éclairer les politiques visant à améliorer l'accès au financement et la productivité des MPME. L'OIT peut tirer parti de son expertise pour garantir que les résultats socio-économiques des CGS sont optimisés, et propose certaines recommandations politiques dans ce rapport.

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► 1. Introduction

The global economy has been disrupted by the COVID-19 pandemic and the global polycrisis, and the situation is likely to worsen with military crises around the world. These crises have reduced Africa's real GDP growth from 4.8 per cent in 2021 to 3.8 per cent in 2022. However, African economies remain resilient, with average growth projected to stabilize at 4.1 per cent in 2023–24 (AfDB 2023). Nevertheless, the positive economic outlook for the continent has not benefited the African labour market. Even before the global polycrisis, Africa's economy was largely informal and known for joblessness with low productivity growth (ILO 2020a).

So far, Africa's growth has failed to guarantee productive employment to eradicate working poverty or to achieve the other Sustainable Development Goals (SDGs). Increasing the role of the private sector in Africa, particularly small and medium-sized enterprises (SMEs), stands out among the widely advocated options to achieve the SDGs by 2030 and the African Union's Agenda 2063.

Globally, creating decent jobs for all, especially SMEs' productive employment, is recognized as an important instrument towards achieving sustained and inclusive economic growth. Put differently, SME decent job creation is promoted as an engine for ending poverty and inequalities, promoting decent work, especially addressing youth unemployment, and facing up to the challenges of rapid population growth in Africa. Nevertheless, lack of access to finance has been identified as one of the major constraints for business development in Africa, and this is particularly true for growth and job creation in SMEs. Because of their lack of access to financial resources, many SMEs in Africa do not contribute adequately to economic prosperity and job creation to their full potential. SMEs access to finance has become increasingly difficult, particularly for informal workers without tangible assets to use as security. Among the reasons highlighted are the high cost of credit, the limited supply of credit, the complicated application procedures, and the collateral requirements. The lack of access to finance has a significant negative impact on SME growth and productivity (Fowowe 2017). Therefore, addressing the challenges faced by SMEs in accessing credit is essential to inform policies and decisions aimed at creating more and better jobs in Africa.

Credit guarantee schemes (CGS) have emerged as an effective instrument to help leverage more and better credit by providing substitutes for SMEs' insufficient collateral. CGS enable SMEs to access much-needed financing, thereby allowing them to sustain and potentially expand their businesses and hence create more and better job opportunities.

It is in that perspective that the European Union (EU) has recently joined forces with the International Labour Office (ILO) through the STRENGTHEN2 (S2) project: Employment impact assessment to maximize job creation in Africa. Launched in 2020, S2 is a strategic partnership with the overall goal of leveraging employment impact assessments to promote the creation of more and better jobs in sub-Saharan African countries. A particular area of attention of S2 is to assess credit guarantees' impact on SMEs' access to finance and productive employment creation.

Despite the significant expansion of CGS and the increasing interest of development organizations and policymakers, particularly in Africa, there is little empirical evidence on the merit of CGS in enhancing MSMEs' access to finance and decent job creation in Africa (Soumare 2022). CGS are usually justified based on social objectives, and the rationale underlying the choice of credit guarantees instead of other forms of government intervention is often left unexplained (Gozzi and Schmukler 2016). Therefore, in collaboration with the African Development Bank (AfDB), Rwanda's Business Development Fund (BDF), and the Development Bank of Rwanda (BRD), the ILO initiated this empirical study on credit guarantees, MSME access to finance, and productive employment in Africa to take a deep dive into these linkages and shed light on major findings and lessons to be learned for better financing leverage for MSME and decent job creation.

The main objective of this research study is to gather primary data from financial institutions and MSMEs to evaluate the impact of CGS on MSME access to finance and decent job creation. The aim is to generate insights that will inform policies and interventions aimed at supporting MSMEs across the continent. It is important to note that this paper is neither a full-fledged survey on CGS nor a comprehensive assessment of their effectiveness. Rather, it provides a short factual analysis of how CGS play a crucial role in mitigating the credit risk faced by financial institutions in their transactions with MSMEs, leveraging additional financing to help close the funding gap experienced by MSMEs. In theory, this increased financial support should enable banks to assume greater risk and lower lending conditions to MSMEs. This may result in expanded credit offerings, reduced interest rates, extended maturity periods, and to some extent, eased collateral requirements. As mentioned earlier, in Africa there is not enough evidence on the merit of CGS and this paper contributes to closing the knowledge gap by responding to the following research questions.

- Do CGS reduce the monetary value of collateral requirements?
- To what extent do CGS increase access to finance for MSMEs?
- What is the impact of CGS on MSMEs' labour productivity?

The data employed in this analysis were derived from three surveys, two conducted with financial institutions at regional (sub-Saharan Africa) and country (Rwanda/Gasabo) levels, and one conducted with businesses in Rwanda. The surveys were designed to assess the impact of credit guarantees on both financial institutions and businesses. This two-pronged approach, investigating both businesses and financial institutions, enhances the comprehensiveness of economic analysis regarding the dynamic interplay between financial entities and MSMEs. In Rwanda, the surveys were exclusively focused on Gasabo, which was strategically chosen due to its diverse economic landscape, offering valuable insights into the regional dynamics of credit mechanisms and job creation.

After this introductory section, section 2 focuses on assessing CGS impact on MSME access to finance as established in the literature after presenting a general overview and rationale of CGS in Africa. Section 3 describes the methodology and data while sections 4 and 5 focus on CGS impact on MSMEs' access to finance and labour productivity, respectively. Section 6 concludes with the research limitations and some policy recommendations and interventions to contribute to overcoming barriers to access to finance and decent job creation in Africa.

► 2. Credit guarantee scheme overviews in Africa

In this section, we briefly review the main issues related to MSME access to finance and some of the CGS that have been set up to overcome some of the barriers faced by MSMEs in Africa. For a more detailed overview of these CGS, see [Soumaré 2022, 55](#).

2.1. Challenges pertaining to financing MSME's productive growth in Africa

Financing structural transformation remains a challenge in many African countries characterized by underdeveloped financial systems (see, for example, Allen, Otchere, and Senbet 2011; Allen et al. 2014; Beck and Cull 2013; Otchere, Senbet, and Simbanegavi 2017; and, more recently, Soumaré et al. 2021; Tyson 2021, among many others). According to the United Nations Economic Commission for Africa (UNECA)'s *Economic Report on Africa 2020*, the unavailability of finance has been identified as the most severe obstacle to doing business in Africa. Precisely, access to finance is the second main obstacle – the first being electricity – affecting the operation of businesses in Africa (UNECA 2020). For example, the World Bank Enterprise surveys show that approximately 23 per cent of small companies and 16 per cent of medium-sized firms consider access to finance as the main obstacle affecting business operations in Africa. “Such financial constraints worsen the ‘valley of death’ in which business start-ups in Africa do not survive their first three years” (UNECA 2020, ix). MSMEs, which account for 90 per cent of Africa's private sector (AGRA 2021), are crucial to contributing substantially to the Africa's employment and GDP if properly financed. Moreover, the private sector generates more than 70 per cent of jobs in all countries, with most jobs created by young firms and MSMEs (less than 10 years of existence).

The lack of access to finance has a significant impact on firms' growth and performance, as shown by Fowowe (2017). Using data for 10,888 firms across 30 African countries extracted from the World Bank's Enterprise Surveys database, the author found that firms that are not credit-constrained experience faster growth than those that are. This finding and the above ones support the idea that access to credit is crucial for enterprise growth and job creation (see, for example, Demirhan and Aldan 2021; IFC 2021; Cao and Leung 2020; Ayyagari, Demirgüç-Kunt, and Maksimovic 2021; Campello and Larrain 2015; Chodorow-Reich 2014; Nigrini and Schoombee 2002) and justify measures such as CGS to alleviate financing barriers for African firms, especially MSMEs.

2.2. Regional and national credit guarantee schemes in Africa

There are many types of CGS across sub-Saharan Africa (SSA), with some specifically dedicated to MSMEs. African CGS can be classified into regional schemes and national ones. The well-known regional CGS include the African Guarantee Fund (AGF), the African Fund for Guarantee and Economic Cooperation (FAGACE), and Afreximbank. These CGS are primarily funded by African governments, pan-African financial institutions, development finance institutions, and international development partners. As for the national CGS, those identified in this report are all public institutions with government and/or donor funding. The CGS reviewed are those with sufficient information on their mission, operations and product offers: the Business Development Fund (BDF) in Rwanda, the Small Industries Development Fund (SIDO) in the United Republic of Tanzania, the Agricultural Business Initiative (aBi) in Uganda, the Agricultural Credit Guarantee Scheme Fund (ACGSF) in Nigeria, the Fonds de Garantie des Crédits aux Petites et Moyennes Entreprises (FGPME) in Côte d'Ivoire, the Fonds de Garantie pour le Secteur Privé (FGSP SA) in Mali, and the Société Financière de Garantie Interbancaire du Burkina (SOFIGIB) in Burkina Faso. This report compares the practices of these regional and national African CGS to their peers¹ in selected developed countries to learn from their experience, and the following observations can be drawn.

¹ Including: Small Business Administration (SBA) and the Export-Import Bank (EXIM) in the United States, British Business Bank in the United Kingdom, Banque Publique d'Investissement (Bpifrance) in France, and Investment Québec in Canada) and emerging markets (Export-Import Bank (CEXIM) in China and the Philippine Guarantee Corporation (PHILGUARANTEE).

On average, the maximum guarantee coverage ratio offered by African CGS ranges from 50 to 75 per cent. In developed countries and emerging markets, the guarantee coverage ratio varies between 50 and 85 per cent (Soumaré, 2022). Like their international peers, most of the CGS studied offer advisory services and capacity development support in addition to credit guarantees. CGS in sub-Saharan Africa, like their peers outside the continent, offer a wide range of guarantee products, including sectoral guarantees, export credit guarantees, individual loan guarantees and portfolio guarantees, among others.

2.3. Rationale and literature review of MSME access to finance and job creation

It is widely recognized that SMEs account for most job creation in the economy (see for example Adelino, Ma, and Robinson 2017; Ayyagari, Demirgüç-Kunt, and Maksimovic 2014; Rispoli, Leung, and Baldwin 2013; De Kok et al. 2011; Kongolo 2010). In Africa, MSMEs constitute nearly 90 per cent of all businesses and generate over two-thirds of employment opportunities. However, while there is wide evidence of job creation potential by SMEs, most of them struggle to grow due to a lack of finance (AFI 2020).

Empirical evidence highlights the impact of increasing access to finance for SMEs on job creation (Ayyagari et al. 2021; Campello and Larrain 2015). Improving access to finance appears to have positive effect on SME growth and job creation (Demirhan and Aldan 2021; IFC 2021; Cao and Leung 2020; ILO 2020b; Chodorow-Reich 2014; Nigrini and Schoombee 2002). The main channel of transmission appears to be driven by the linkage between financial access and productivity through investment and labour demand.

To alleviate the credit constraints faced by SMEs, many countries around the world use CGS to expand lending to SMEs (see, for instance, Rocha et al. 2011 and Beck, Clapper, and Mendoza 2010 for a review of some of these CGS). Indeed, one way for lenders to hedge against credit risk is to receive financial guarantees for the loans they make.

CGS play a critical role in mitigating the credit risk faced by financial institutions in their transactions with MSMEs. CGS are a promise from a third party to make good on payments to the fund provider when the borrower defaults. In theory, this increased financial support should enable banks to assume greater risk by expanding credit volume, and/or offering more favourable lending conditions to MSMEs. This may result in expanded credit offerings, reduced interest rates, extended maturity periods, and to some extent, eased collateral requirements. So, to have access to funds at lower costs, firms can resort to guarantees to improve their credit rating and debt capacity (Soumaré and Tafolong 2017; Merton and Bodie 1992; Merton 1977). A CGS not only enhances access to finance by improving the lending capacity of the lender and its risk-sharing, but also may reduce the interest rate that the borrower needs to pay e.g., Soumaré and Tafolong 2017; Soumaré et al. 2021; Lai and Soumaré 2010; Deelen and Molenaar 2004). Credit guarantees, therefore, reduce the likelihood of MSME defaults and allow companies to access lower-cost financing. Depending on the amount of guarantee pledged by the CGS and its design, the guarantee can increase MSME's access to finance (Soumaré and Tafolong 2017; Lai and Soumaré 2016).

► 3. Survey, methodologies, and data sources

3.1. Survey and analysis

The data employed in this qualitative analysis were derived from three sets of surveys conducted with financial institutions and businesses. The two main quantitative surveys were designed to assess the impact of credit guarantees on financial institutions and businesses in Rwanda, with a specific emphasis on the Gasabo region. This two-pronged approach, investigating both businesses and financial institutions, enhances the comprehensiveness of economic analysis regarding the dynamic interplay between financial entities and MSMEs. Gasabo was strategically chosen due to its diverse economic landscape, offering valuable insights into the regional dynamics of credit mechanisms.

The businesses surveyed were chosen in collaboration with the Business Development Fund (BDF), with the intention of representing various sectors that had applied for and been approved for credit guarantees. However, due to procedural delays and logistical challenges, not all approved businesses ultimately received loans linked to credit guarantees. To gain insights into credit guarantee effects on MSMEs in the market, a representative sample of these cases was also included in the study. While the primary emphasis was on MSMEs, it's important to note that most applicants for the BDF credit guarantee were small businesses. In addition, the survey's scope was limited to currently operational businesses, excluding those that have closed. The resulting business sample encompasses businesses from various sectors with varying degrees of formality.

This survey aims to present case studies on credit access and the impact of credit guarantees on MSMEs. However, it is crucial to acknowledge that, due to the limited number of interviews conducted, the sample is not intended to be fully representative of the broader sector, region, or country under examination.

3.2. Business survey

The primary goal of the business survey was to enhance understanding of the impact of credit access facilitated by credit guarantee schemes on MSMEs in a developing country. The survey was conducted with a random sample of 100 MSMEs that received CGS-backed loans in Gasabo. The comprehensive questionnaire explored various aspects of the business environment and performance, including general firm characteristics, sales and supplies, credit history and expenditure, competition, innovation, and labour, and included inquiries about gender aspects in ownership/ management, and workforce composition. Additionally, the questionnaire investigated the perception of credit access and business environment.

Specifically, the surveys addressed the following research questions:

1. What role does access to credit play in the generation of employment, particularly in developing countries?
2. What impacts do credit access have on the productivity and growth of surveyed businesses, with a particular focus on MSMEs in developing countries?
3. How do MSMEs perceive credit access and credit guarantee schemes?

3.3. Surveys of financial institutions by S2 and EIB

In addition to the business-focused survey, a complementary survey was conducted in Rwanda with financial institutions on the credit practices, exploring criteria employed, business sector compositions, and the integration of credit guarantees. This survey targeted financial institutions that have recently (within the last two years) used CGS to extend credit to businesses within the Gasabo region, including banks, microfinance institutions (MFIs), and saving and credit cooperatives (SACCOs). By examining a wide array of institutions, this survey provides a nuanced understanding of credit practices and insights into the role of credit guarantees within the broader financial landscape.

The surveys were conducted with the credit managers of the banks and MFIs and the general managers of the SACCOs. In total, data were collected from eight SACCOs, four MFIs, and six commercial banks. In other words, 18 financial institutions were surveyed, representing all major financial institutions that have provided BDF CGS-backed loans to businesses in Gasabo, except for two banks. This survey is complemented by the EIB report on banking in Africa (EIB 2023).

With assistance from Making Finance Work for Africa, the European Investment Bank (EIB) conducted a survey of 33 banks across sub-Saharan Africa in 2023. While the survey findings may not encompass the entire banking landscape, they offer valuable insights into how banks utilize credit guarantees and their corresponding leverage ratios, as perceived by the banks surveyed. Nearly 80 per cent of the banks participating in the survey reported utilizing a credit guarantee within the preceding year. The primary source of these guarantees is international financial institutions, which provide guarantees for over 60 per cent of the surveyed banks (EIB 2023).

It is important to exercise caution when interpreting the credit guarantee ratios derived from the EIB survey, as the sample size was limited to 33 banks. Among these, only 21 banks utilized credit guarantee schemes in the past 12 months, with only 20 providing information on the typical ratio between the guarantee and the size of the loan. Consequently, the extent of leverage facilitated by guarantees may not be universally applicable or statistically representative in Africa.

► 4. Credit guarantee impact on MSMEs' access to finance in Africa: Evidence from Rwanda

4.1. Credit guarantee leverage ratio

CGS have gained popularity as a mechanism and tool to enhance access to credit for MSMEs perceived to be financially constrained. In theory, CGS should enable banks to assume greater risk, thereby expanding credit volume (leverage ratio) and offering better or more favourable lending conditions to MSMEs. Leverage enables a financial institution to increase potential gains or losses on investments beyond what it could achieve through direct funding. The credit guarantee leverage ratio is a financial metric used to assess the extent to which credit guarantees are utilized to expand lending by financial institutions. The credit guarantee leverage ratio is calculated by dividing the total value of loans extended with the assistance of credit guarantees by the total amount of credit guarantees provided.

► **Table 1. Credit guarantee leverage ratio in Africa**

Guarantee leverage ratio	East Africa	Southern Africa	West Africa
<i>1:1 and 1:3 1.2 on average</i>	80	33.33	45.5
<i>1:3 and 1:5 1.4 on average</i>	0	0	27.3
<i>1:5 and 1:9 1.7 on average</i>	20	33.3	9.1
<i>Other over 1.7 on average</i>	0	33.3	18.2
Total	100	100	100

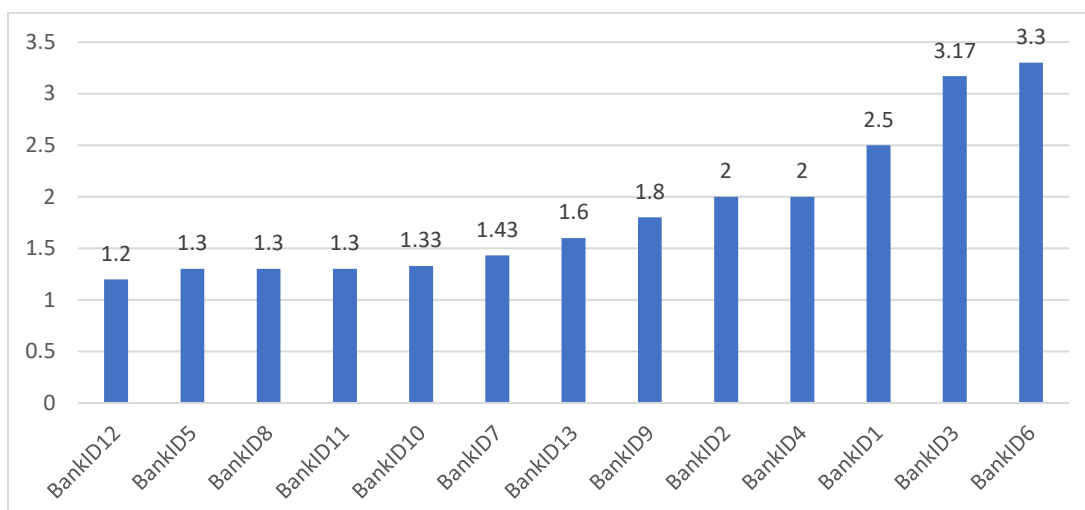
Source: EIB 2023.

In practice, the EIB survey shows that the majority (80 per cent, n= 5 banks) of banks in East Africa report an average guarantee leverage ratio of 1.2. In Southern and West Africa, the percentages are 33.33 per cent (n = 3 banks) and 45.5 per cent (n=11 banks) respectively. On the other hand, one monetary unit of CGS is likely to increase the volume of credit to MSMEs by an average range of 1.2 to 1.7 in East Africa. Figure 1 provides a more detailed assessment of CGS and MSME access to finance, focusing on Rwanda.

The surveys in Rwanda were conducted with the credit managers of the banks and MFIs and the general managers of the SACCOs. In total, data were collected from eight SACCOs, four MFIs, and six commercial banks. In another words, 18 financial institutions were surveyed, representing all major financial institutions that have provided BDF CGS-backed loans to businesses in Gasabo, except for two banks.

Using SACCOs, MFIs and banks data, the credit guarantee leverage ratio in Rwanda ranges from 1.2 to 3.3 (figure 1). In other words, one unit of CGS is likely to increase the volume of credit to MSMEs by an average multiple of 1.9, almost 2. This demonstrates the potential of CGS to increase MSMEs' access to finance. Nevertheless, rigorous evidence on the extent to which guarantees contribute to financial additionality – that is, increase access to finance for MSMEs – is still scarce. More in-depth impact assessment as well as an evaluation of credit guarantees against alternative policy instruments are needed (Gozzi and Schmukler 2016).

► **Figure 1. Guarantee leverage ratio in Gasabo,Rwanda**



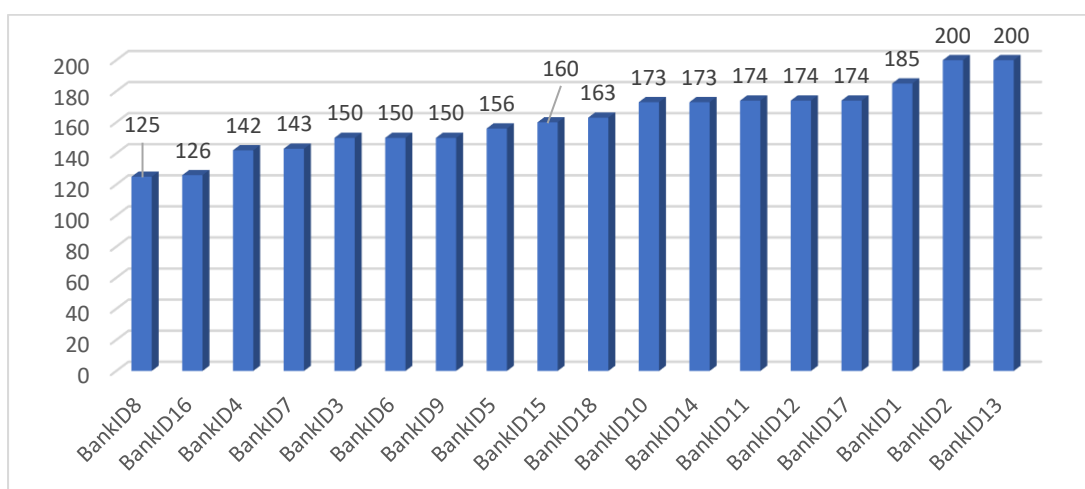
Source: S2 survey in Rwanda, 2023.

4.2. Credit guarantee impact on collateral requirement

CGS are mechanisms in which a third party pledges to repay all or a part of the loan amount to the lender in event of MSME default; in this case BDF pledging to pay 50 to 75 per cent. Therefore, in addition to expanding the supply of credit, the lender is expected to reduce interest rates, extend maturities, and/or ease collateral requirements.

However, the results presented in figure 2 reveal that despite the guarantor assuming a portion of the risk, thus reducing the risk associated with the loan, financial institutions still consider the provision of credit to MSMEs to be risky: the level of risk perceived by them ranges from 120 to 200 per cent, averaging 163 per cent, which is 63 percentage points over 100. This ratio represents a higher risk, especially under CGS, as a ratio significantly lower than 100 per cent would be expected. Many banks require collateral as security for a loan. The collateral protects the lenders if the borrowers default.

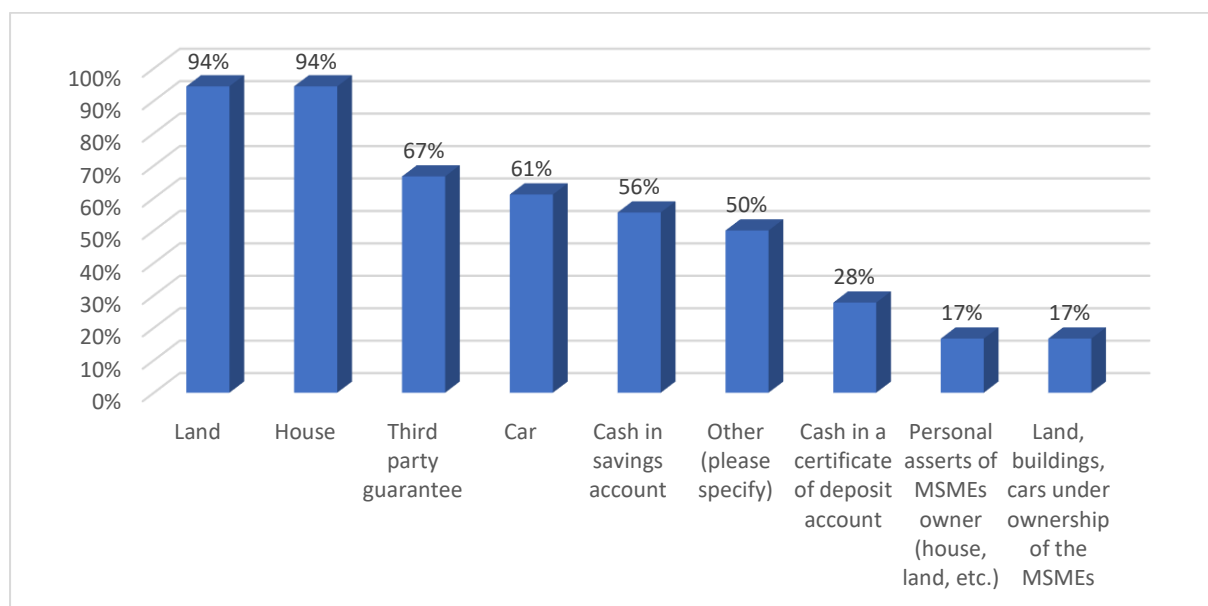
► **Figure 2. Collateral-to- loan ratio**



Source: S2 survey in Rwanda, 2023.

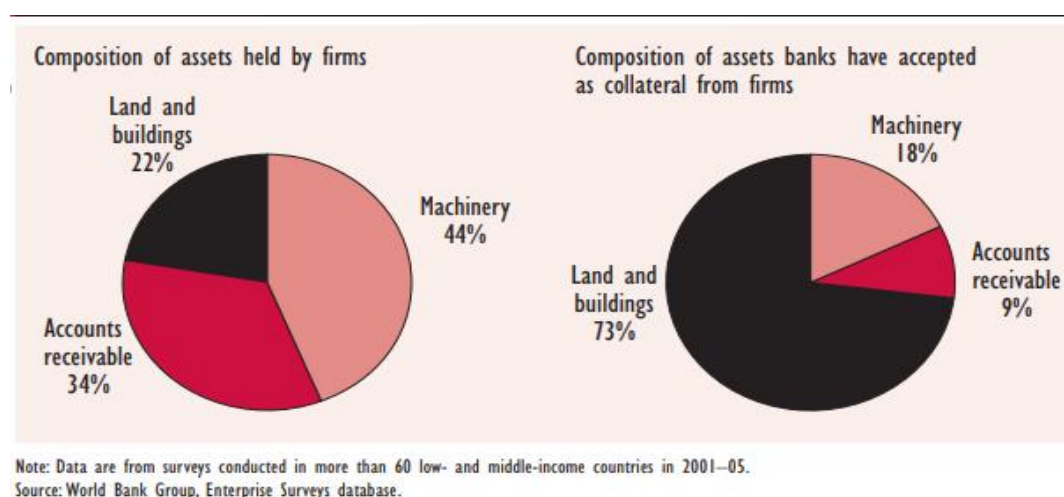
Figures 3 and 4 show the types of collateral for a CGS-backed loan and those required traditionally (non-CGS-backed loan), respectively.

► **Figure 3. Collateral usually accepted to secure CGS-backed loan**



Source: S2 survey in Rwanda, 2023.

► **Figure 4. Collateral usually accepted to secure non-CGS-backed loans**

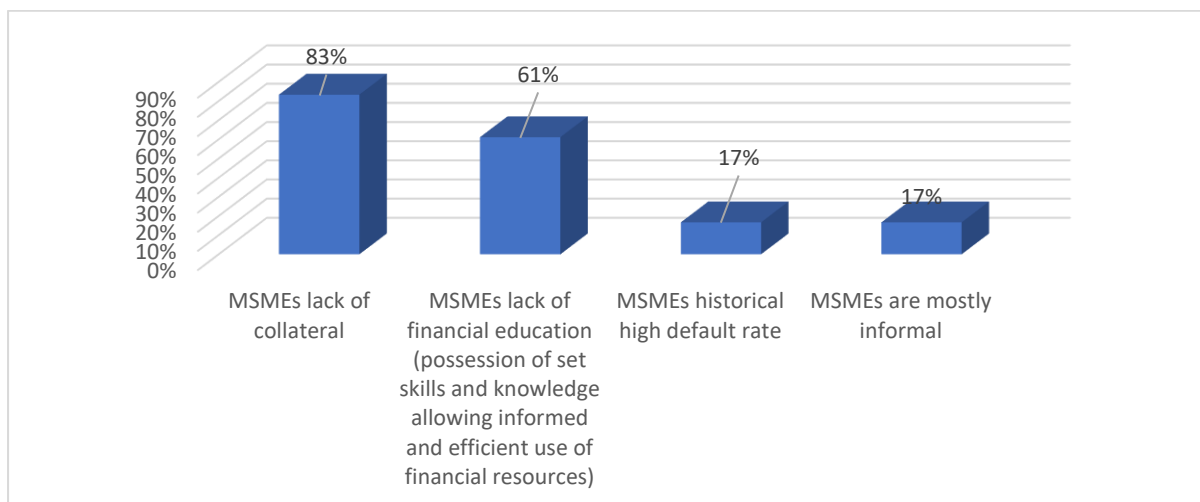


Source: the figure is taken from Safavian, Fleisig, and Steinbuks 2006.

From figures 3 and 4 it can be concluded that CGS has no influence on the main types of collateral accepted by banks. With or without CGS facilities, financial institutions typically accept tangible and immovable assets, such as houses and land (figure 3), to counter the perception of high risk; 94 per cent of financial institutions surveyed reported that land and building assets are the most accepted collateral for MSME lending.

While CGS may improve MSMEs' access to finance, it may not necessarily result in affordable terms. Even with the development of CGS, MSMEs without MFIs' preferred assets may still face challenges in accessing credit. In addition to the mismatch between the assets held by firms and those banks accept as collateral (figure 4), the S2 survey highlights the key challenges associated with lending to MSMEs (see figure 5).

► **Figure 5. Key challenges associated with lending to MSMEs**



Source: S2 survey in Rwanda, 2023.

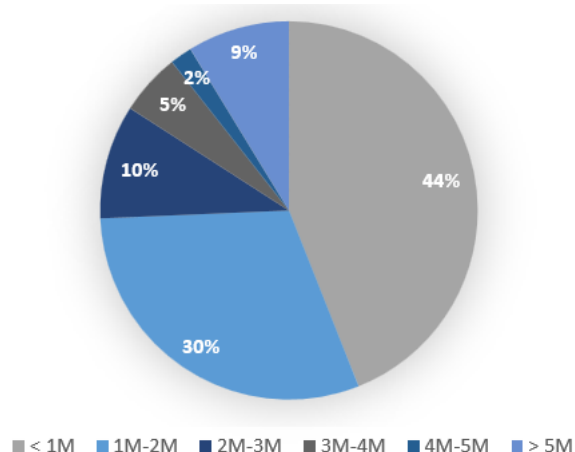
Unsurprisingly, the main challenge to MSME lending is the lack of collateral, cited by 83 per cent of the financial institutions surveyed. This is followed by SMEs lacking financial literacy (61 per cent). However, the lack of sufficient collateral is not truly the reason that firms cannot access finance. In general, the problem lies in the mismatch between the assets firms own and the assets banks accept as collateral (Safavian, Fleisig, and Steinbuks 2006).

► 5. Financing MSMEs' labour productivity

5.1. Credit guarantee amount distribution

To assess the impact of CGS on MSMEs in Rwanda, the loan distribution pattern is first examined. As depicted in figure 6, approximately 74 per cent of the number of approved loans are below 2 million Rwandan francs (RWF). Within this majority, a significant portion (44 per cent) is specifically allocated for amounts below RWF 1 million, underscoring the role of CGS in supporting micro-enterprises and individuals with limited investment capital. On the other hand, only a marginal 9 per cent of approved loans were pursued by businesses seeking more substantial amounts exceeding RWF 5 million. Moreover, out of the 100 businesses surveyed for this study, 65 per cent rely on cash collateral, which constrains the amount they can accumulate before securing a loan. This distribution pattern highlights the need for action in facilitating access to finance for smaller ventures and contributing to the overarching goals of promoting job creation and economic development. CGS is one of the primary tools that may be employed to respond to this need.

► **Figure 6. Distribution of CGS-backed loans**

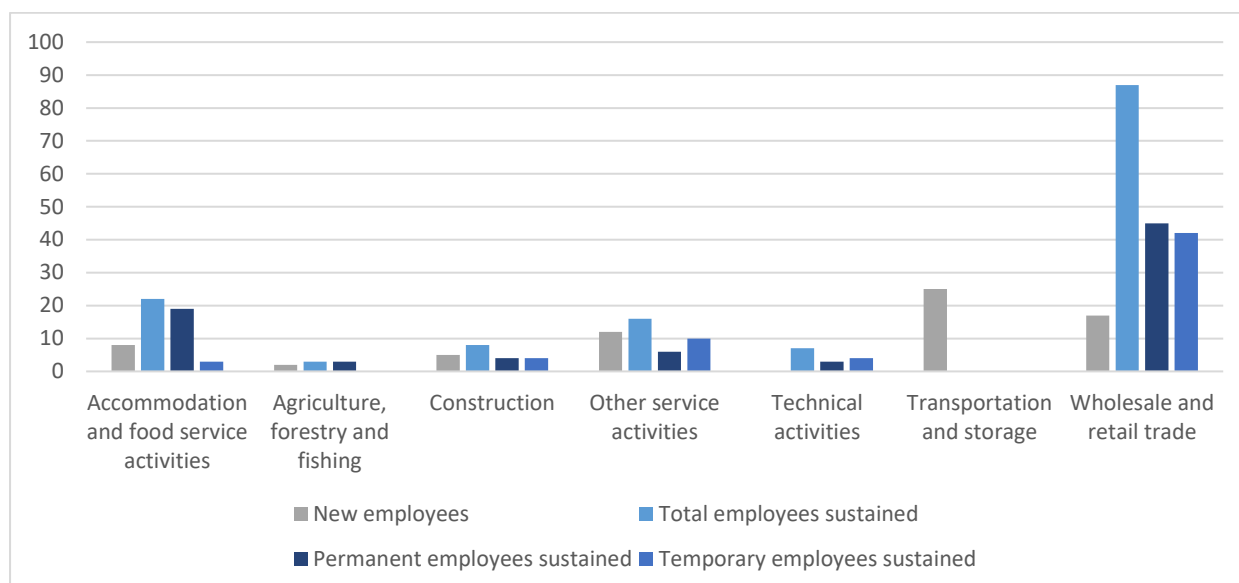


Source: S2 survey in Rwanda, 2023.

5.2. Direct jobs creation disaggregated by age and sex

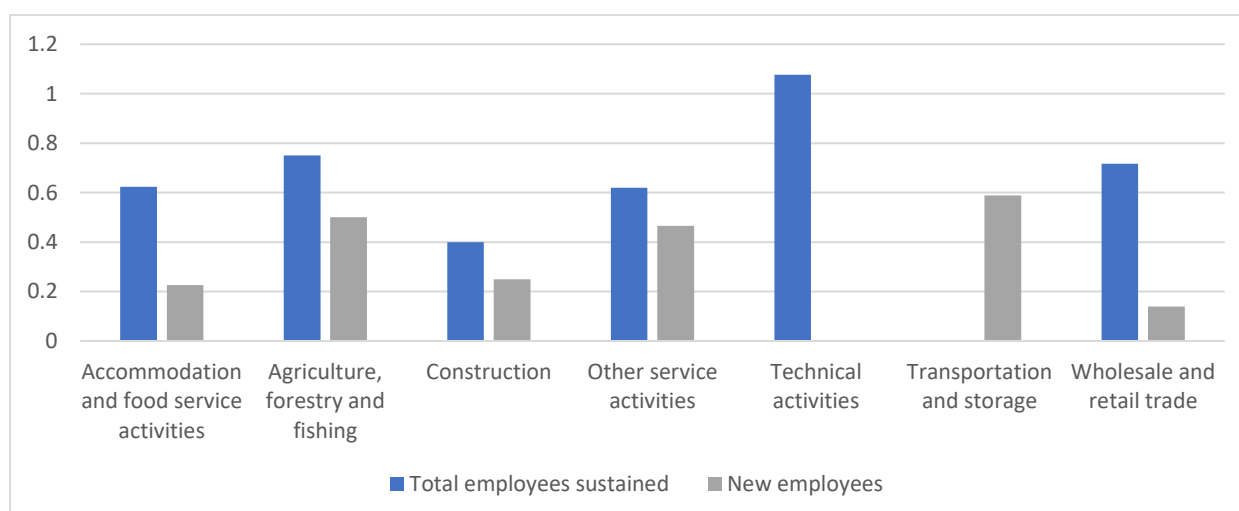
Using data from a random sample of 100 businesses in Gasabo district that received loans supported by CGS, the employment impact of the scheme on the Gasabo district economy was examined. As observed in figure 7, these SMEs collectively generated 69 new jobs and sustained 143 positions, with 56 per cent representing permanent employees. Permanent workers are defined as all full-time workers who work for at least one fiscal year and are guaranteed renewal of their employment. The primary sector contributing to job creation was the transportation and storage sector, where 26 new jobs were generated. In contrast, other sectors, as seen in figure 7, primarily utilized the loans to sustain existing positions. Furthermore, figure 8 highlights the jobs generated per million RWF of credit, revealing that the transportation and storage sector exhibited the highest job generation, with 0.588 jobs. This can be attributed to credit seekers in the transportation sector utilizing the loan as investment capital to establish motorcycle taxi businesses, whereas creditors in other sectors mainly utilized the loan as working capital to expand their operations. Additionally, sectors such as agriculture and other service activities showed a comparable number of jobs generated per million RWF credit provided, with ratios of 0.5 and 0.48, respectively. Moreover, except for the construction and transportation sectors, all sectors indicated a higher utilization of credit for employment sustainability, with a ratio of more than 0.6 jobs sustained per million RWF credited. This highlights the tangible and sector-specific positive effects of CGS-backed loans on job creation and sustainability.

► **Figure 7. Employment generated, by sector²**



Source: S2 survey in Rwanda, 2023.

► **Figure 8. Employment generated per million Rwanda Francs, by sector**



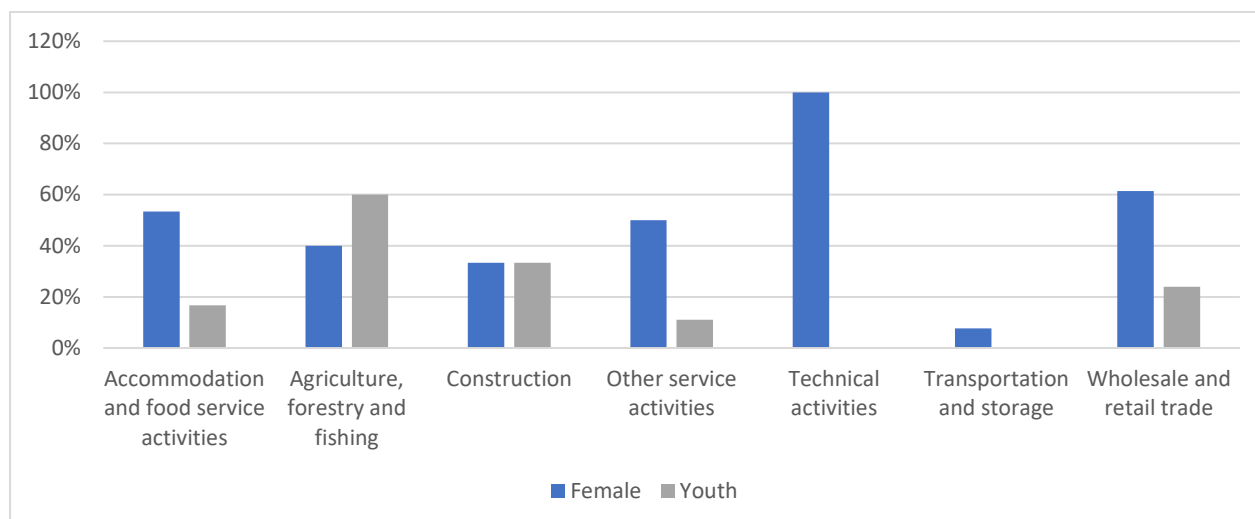
Source: S2 survey in Rwanda, 2023.

One of the primary goals of CGS in Rwanda is to enhance access to finance for women and youth, accomplished by providing a substantial 75 per cent collateral coverage compared to 50 per cent for adult male applicants. This strategic approach has led to a significant increase in female representation among surveyed businesses, with 61 out of 100 businesses being owned by women; a much higher share than the 32.7 per cent share of formal female entrepreneurship in SME accounts countrywide (AFI 2023), hinting at the effectiveness of CGS in reducing financial barriers for women. The positive impact extends further, as depicted in figure 9, revealing a notable representation of female employment with the female workforce share averaging 48 per cent and thus exceeding the national average of female employment at 47 per cent. Moreover, examining the sector level reveals even higher shares of female employment compared to national averages. As shown in figure 10, sectors such as technical activities, accommodation and food services, and construction sectors, indicate the CGS impact on female diversification into these sectors. The only exception is the agriculture sector, which, despite its high female representation nationally due to its predominantly informal market structure, shows a lower share of female employment in this study.

² Other service sector includes the activities such as repair of computers and household goods and a variety of personal service activities such as services such as washing and (dry-)cleaning of textiles and hairdressing. The transportation sector includes the provision transport services, whether scheduled or not, by road or water and associated activities such as motorcycle taxi. The technical activities sector includes specialized design activities, such as fashion design related to textiles, wearing apparel, shoes, jewellery, furniture and other interior decoration and other fashion goods.

In contrast, the scheme's focus on youth employment, while impactful, shows that only around 19 per cent of jobs were being occupied by youth. For this study, “youth” are defined according to the ILO definition, encompassing individuals aged between 15 and 24 years. This suggests a need for different adjustments or other targeted intervention to further improve youth employment, particularly considering that the employment shares of youth in most sectors fall below national averages (figure 10).

► **Figure 9. Shares of youth and female employment generated, by sector**



Source: S2 survey in Rwanda, 2023.

► **Figure 10. Youth and female employment bias, by sector**

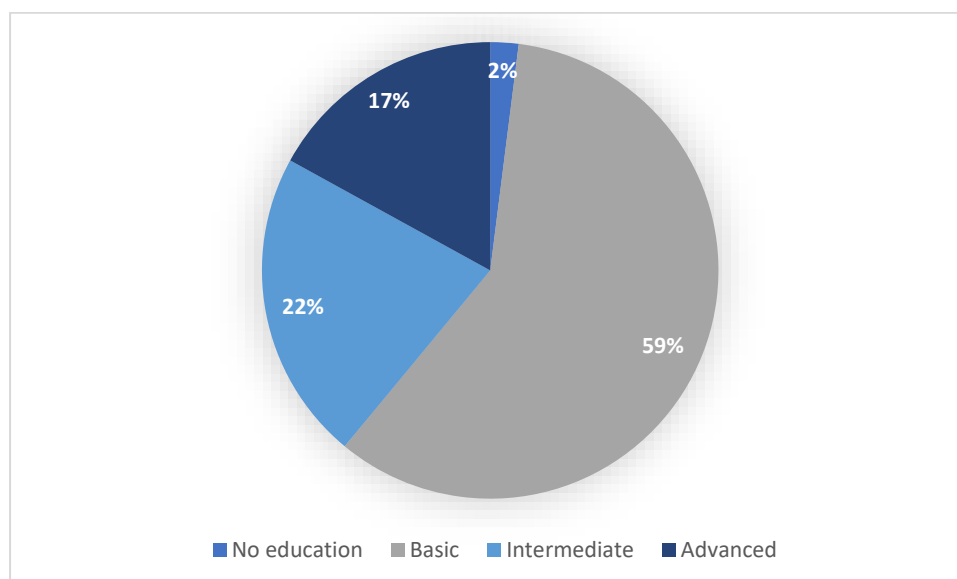


Source: S2 survey in Rwanda, 2023 and ILO database.

5.3. Skills, employment, and business development

Furthermore, examining the skill levels associated with businesses supported by CGS-backed loans sheds light on the impact of these initiatives on employment. The data indicate that 61 per cent of business owners possess an educational background below the lower secondary school level (basic education level) (figure 11). In comparison, the national average indicates that 86 per cent of self-employed individuals have basic education level and below (ILO, n.d.). This suggests that, on average, the CGS beneficiaries have higher education qualifications than the national self-employed population. The employment outcomes highlight that having above-average education levels may be essential or advantageous for participation in the CGS, especially for those with intermediate education levels (upper secondary education). This is significant given that the unemployment rate for this demographic is the highest in the country, reaching 25 per cent in 2020 (NISR 2021).

► **Figure 11. Business managers' education levels**



Source: S2 survey in Rwanda, 2023.

To analyze the capital requirements for businesses aiming to expand their workforce, the survey asked about the amount of capital needed to grow the business and employ additional workers (table 2). On average, business managers indicated that they would require at least twice the initial approved loan amount to achieve sufficient business growth and add an extra employee. However, the sectoral breakdown highlights substantial variations. Specifically, businesses in the agriculture sector expressed a need for 1.5 times the loan amount to facilitate business growth, indicating a likely comparatively more efficient utilization of funds in this sector. On the other hand, other sectors such as accommodation and food service activities, construction, and wholesale and retail trade indicated a demand for capital above three times the approved loan for employment growth. However, it is important to note that investments in these sectors resulted in a larger share of employees per business (figure 7), and therefore, these higher costs underscore the critical role of adequate financing in facilitating business growth and thereby employment growth within these sectors.

► **Table 2. Capital needed for employment growth**

Business sector	Investment multiplier
Accommodation and food service activities	3.40
Agriculture, forestry, and fishing	1.50
Construction	3.52
Other service activities	2.61
Technical activities	2.81
Transportation and storage	2.21
Wholesale and retail trade	3.39

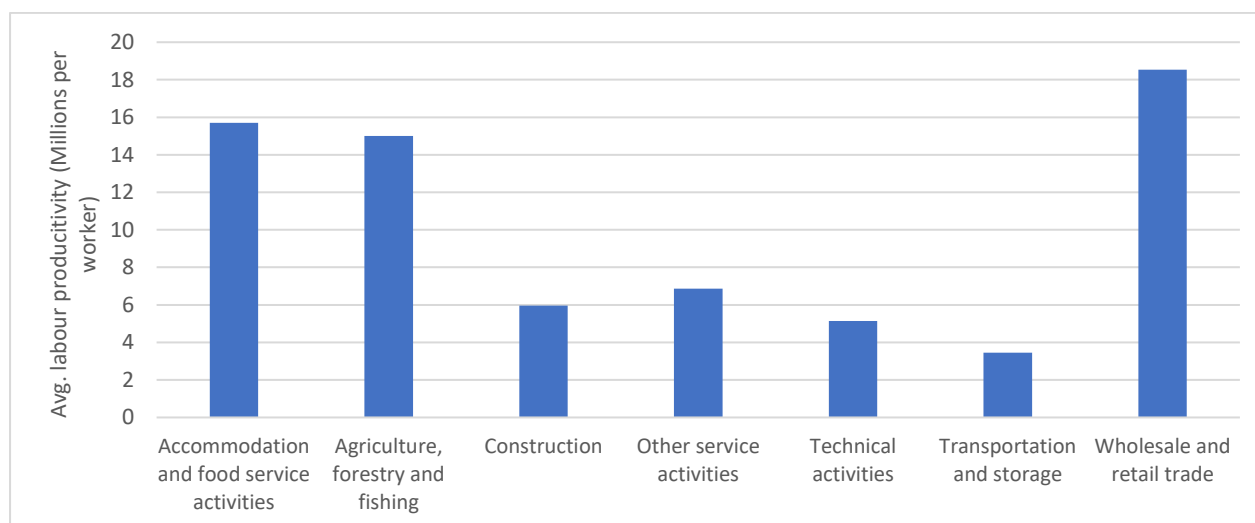
Note: Investment multiplier calculated from the business manager's response to the survey question on the amount of capital needed to grow the business and employ one additional worker.

Source: S2 survey in Rwanda, 2023.

5.4. Loan size, skills, and labour productivity

Analyzing the labour productivity across sectors reveals variations in resource efficiency and job creation. Labour productivity is estimated by dividing total revenue by the number of workers employed by the business. Figure 12 suggests that businesses in these sectors generate differing outputs per unit of labour, influencing overall economic productivity. For example, businesses in the wholesale and retail trade, agriculture and accommodation sectors exhibit high average labour productivity, standing at 25, 15.7, and 15 million per unit of labour, respectively. Conversely, sectors like transportation and storage, technical activities, and other service activities show lower average labour productivity, indicating potential areas for improvement in resource utilization and efficiency. Moreover, the sectors attracting the most CGS loan seekers are typically those with high productivity levels, with the exception being the transportation sector, which, despite its lower productivity, still has significant investment.

► **Figure 12. Average labour productivity, by sector**

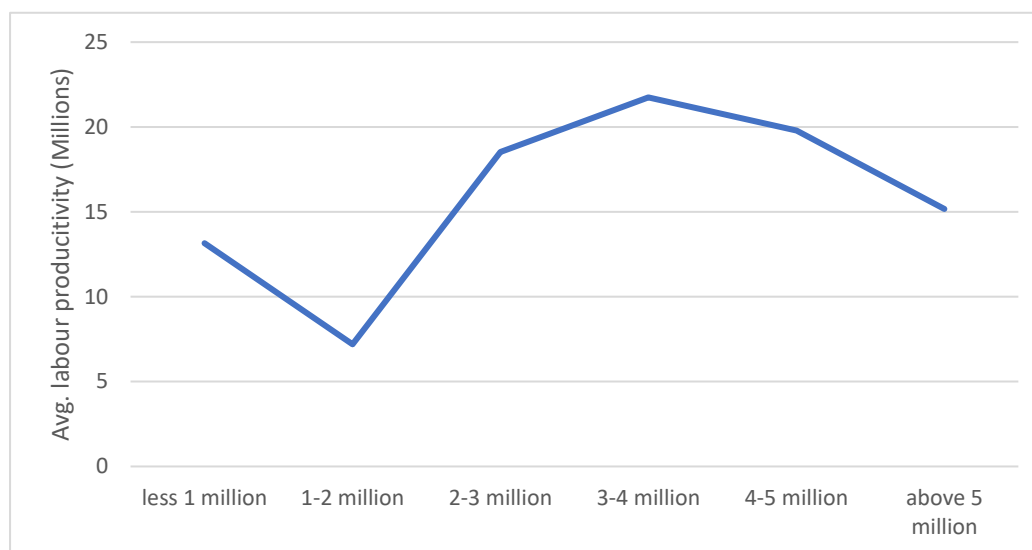


Source: S2 survey in Rwanda, 2023.

5.4.1. Influence of loan size on labour productivity

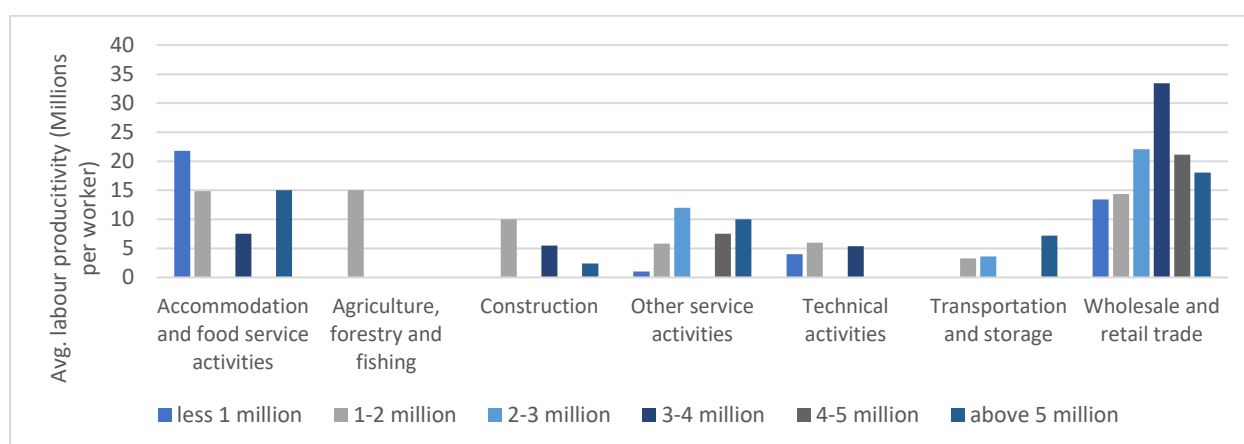
Furthermore, delving into the correlation between loan size and labour productivity offers profound insights into the efficiency of capital utilization. Figure 13 illustrates a non-linear correlation pattern, suggesting that the impact of loan size on labour productivity is not consistently proportional across different ranges. Notably, loans below RWF 1 million result in average labour productivity of 13.15 million per employee, indicating efficient capital utilization for this loan size. However, as loan sizes increase above the RWF 1 million range, there is a significant drop in labour productivity, which is concerning, given that this is one of the major loan sizes provided by CGS. This could be influenced by the fact that the majority of these loans are allocated to the transport and storage sector, which, as observed in figure 14, has the lowest labour productivity per worker across all sectors. Beyond this point, a positive trend emerges, showcasing an incremental increase in labour productivity for each additional million RWF given to the business, reaching a peak at 3–4 million with 21.74 million per worker.

► **Figure 13. Average labour productivity, by loan size**



Source: S2 survey in Rwanda, 2023.

► **Figure 14. Average labour productivity, by sector and loan size**



Source: S2 survey in Rwanda, 2023.

To understand the underlying factors contributing to this trend, labour productivity based on sector and loan size was further examined. Figure 14 illustrates that the wholesale and retail trade sector consistently produces higher productivity for most loan sizes compared to other sectors, emphasizing efficient capital utilization. This holds particular significance as the majority of CGS loans are directed towards this sector, which also serves as a significant contributor to employment generation, as depicted in figure 7. Moreover, most sectors display no clear correlation between loan size and labour productivity. However, a positive impact of smaller loan sizes on output is evident in sectors such as construction, accommodation and food services, and wholesale and retail trade, where the labour productivity of smaller loans equals or even surpasses the productivity of larger loans.

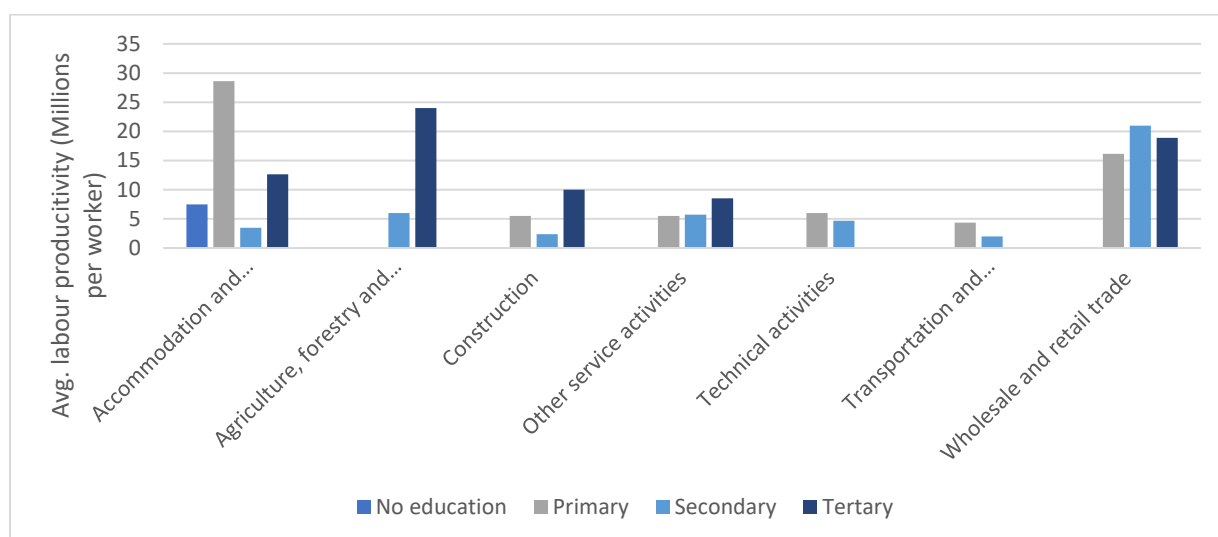
5.4.2. Educational background of managers and labour productivity

The educational background of business managers emerges as a significant factor influencing labour productivity across sectors, although no uniform trend is observed. In sectors such as agriculture, construction, and other services, an increase in the manager's education level correlates with enhanced productivity. In contrast, sectors such as accommodation and food services, and wholesale and retail trade, exhibit varying trends with no clear correlation between the manager's education and labour productivity (figure 15).

For instance, businesses in the agriculture sector show higher average productivity (24 million per worker) when managed by individuals with secondary education, indicating a positive impact of formal education in this domain. Similarly, the construction sector experiences increased productivity with higher manager education levels. Conversely, accommodation and food services businesses exhibit nuanced trends, with higher productivity (28.6 million) associated with primary education managers compared to 12.65 million when managed by tertiary-educated individuals.

These findings align with the notion that in Rwanda the accommodation and food services sector places more emphasis on practical skills and managerial experience than on formal education, especially for small and micro enterprises. Moreover, the positive correlation observed between smaller loan sizes and higher labour productivity in this sector, as discussed above (figure 14), suggests that efficient capital utilization plays a crucial role, potentially compensating for the lower educational background of business owners. While financial institutions emphasize the lack of financial education as a significant barrier to lending to MSMEs, these results also imply that the educational background of business managers in specific sectors should be considered with less weight.

► **Figure 15. Average labour productivity, by sector and level of manager education**



Source: S2 survey in Rwanda, 2023.

For example, skills development is more needed in the construction and transport sectors compared to the accommodation and food services sectors. Moreover, the need for equipment in the construction and transportation sectors is significantly greater than in the accommodation and food services sectors. These two factors together—education and need for equipment—likely explain why the accommodation and food services sectors have a low investment-to-high labour productivity linkage, while the construction and transportation sectors have a high investment-to-lower labour productivity linkage.

► 6. Concluding remarks, limitations, and policy recommendations

6.1. Conclusions

In summary, the examination of credit guarantee schemes in Rwanda offers valuable insights into their diverse effects on MSMEs, encompassing aspects such as access to finance and productive employment.

The credit guarantee leverage ratio stands at nearly two (2) units of monetary value for each unit in the CGS. To put it another way, the total loan size to MSMEs is nearly double the size of the credit guarantee, demonstrating the positive influence of CGS on MSMEs' access to finance.

While CGS enhance access to finance for MSMEs, this does not necessarily translate into favourable loan terms. Despite the implementation of CGS, the collateral-to-loan ratio exceeds 100 per cent, and MSMEs lacking preferred collaterals face difficulties in securing credit from financial institutions. Furthermore, in addition to the disparity between the assets firms possess and those accepted by banks as collateral, the report underscores education as a significant challenge associated with lending to MSMEs.

The positive employment impact, especially in wholesale and retail sectors, further underscores the CGS contributions to job generation. Moreover, the nuanced gender and age dynamics highlight the schemes' success in reducing financial barriers for women, resulting in increased female employment. However, targeted interventions are still required to further enhance youth employment.

The analysis of labour productivity across sectors sheds light on resource efficiency and job creation. Sectors such as wholesale and retail trade, agriculture, and accommodation demonstrate high average labour productivity, emphasizing the positive impact of CGS-backed initiatives in these sectors. Meanwhile, other sectors have potential areas for improvement. The correlation between labour productivity and loan size or manager's education level introduces a non-linear relationship, emphasizing the importance for sector-specific considerations in CGS planning and lending strategies to optimize economic outcomes.

For example, skills development is more needed in the construction and transport sectors compared to the accommodation and food services sectors. Moreover, the need for equipment in the construction and transportation sectors is significantly greater than in the accommodation and food services sectors. These two factors—education and need for equipment together—likely explain why, in this case, the accommodation and food services sectors have a low investment-to-high labour productivity linkage, while the construction and transportation sectors have a high investment-to-lower labour productivity linkage.

6.2. Limitations

One limitation of this study stems from the restricted number of interviews conducted with financial institutions and MSMEs, encompassing only a random sample of 100 businesses and 18 financial institutions. As a result, this sample may not fully represent the broader sector and country under examination. Furthermore, the absence of good financial bookkeeping practices among many MSMEs results in their reliance on estimates when responding to survey questions about business expenses. This reliance introduces a level of uncertainty and potential bias into the data, potentially affecting the findings.

To mitigate these limitations in future studies, researchers could explore alternative data collection methods such as business diaries to measure economic additionality more accurately through business expenditures on employment, investment, growth and innovation.

Additionally, alternative analyses such as difference-in-differences analysis or propensity score matching, which compare the financial and economic performance of guaranteed users to non-users, could offer a more comprehensive understanding of the effectiveness of credit guarantee schemes in supporting MSMEs (Soumaré 2022).

6.3. Policy recommendations

To inform policymakers effectively about the impact of credit guarantees on MSMEs' access to finance and productive employment, it is essential to provide technical assistance throughout the development, implementation, and evaluation phases of CGS. Leveraging its specialized knowledge, skills and experience, the ILO can play a crucial role in developing a comprehensive framework aimed at achieving the following objectives, rephrased as policy recommendations.

- **Assist to provide alternatives for MEMEs with insufficient collateral**

The utilization of cash collateral in the BDF CGS reveals a common challenge faced by MSMEs regarding collateral requirements when seeking financial support. This underscores the vital importance of well-crafted CGS that provide alternatives for insufficient security. By addressing the discrepancy between the assets held by firms and those accepted by banks as collateral, CGS effectively reduce risk for financial institutions, thereby facilitating MSMEs' access to financing, particularly beneficial for those lacking tangible assets to pledge. This expanded access to financing enables SMEs to invest in business growth, innovation and workforce development, ultimately leading to the creation of quality jobs. This study suggests that loans backed by CGS have significantly contributed to both job creation and the sustainability of existing positions, indicating a likely correlation between access to finance through CGS and employment growth.

- **Assist to promote cooperation among MSMEs**

Given that the majority of MSMEs are small, they are likely to be informal, with shortcomings in access to finance and the provision of social security for workers, as it is less enforced for such businesses. Cooperating MSMEs can apply for loans collectively. Sharing the credit risk among several MSMEs can help secure a significant amount of credit that may have been unattainable for individual businesses. In addition, cooperating MSMEs can provide an incentive for financial institutions to adopt alternative assessment measures based on factors beyond collateral, such as expected returns and business viability.

- **Assist to enhance access to finance for youth-led enterprises**

The negative bias in youth employment points to the need for supportive policies and interventions to address structural barriers to youth employment and to ensure that the benefits of credit guarantees reach unemployed youth. Improving access to finance for youth-led enterprises and implementing targeted training and mentoring can help unlock the entrepreneurial potential of young people, fostering innovation and economic growth. In addition, policies aimed at reducing bureaucratic hurdles and streamlining administrative processes related to CGS applications can speed up the provision of finance to MSMEs, including youth-led enterprises, thereby promoting decent job creation and economic development.

- **Assist to facilitate synergies between CGS and other initiatives promoting decent work**

Policymakers should foster synergies between CGS and other initiatives geared towards advancing the Decent Work Agenda, such as skills development programmes, entrepreneurship support and labour market policies. By aligning CGS with broader policies aimed at enhancing human capital and productivity, policymakers can optimize the employment outcomes of guaranteed credit.

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