

## **SECTION 4: Analysis – empirical data and graphics**

### **Literature Review**

**Issue 1: Reduction in Demand of the Scheme and fee based income - The number and amount of approval under this scheme has reduced since it was introduced in Year 2006**

(a) Customer fear being denied for further loans

Self selection bias takes place when firms choose whether or not to participate in the programme. Better informed entrepreneurs are more likely to aware of the scheme and its advantages. Also, it can be argued that better informed entrepreneurs are likely to be more bankable than the ill informed entrepreneurs. Committee selection bias can take place if the bankers themselves choose to inform potential entrepreneurs that such a scheme is available. The bankers may selectively choose to inform only the bankable entrepreneurs about the scheme. Evaluation showed that the bankers may selectively choose to inform only the bankable entrepreneurs about the scheme. (Roy)

As a lender, the bank will make assessment based on the past experience before approving any financing. The good paymaster usually will be given priority before considering other potential customers who have track record particularly with the Bank. This is to avoid from giving financing to uncertain borrowers and to mitigate risk. No doubt that this practice may jeopardise the Bank from obtaining good customers that not in the list of the committee selection, but it is safer for the Bank.

In other occasion, the reason is more to readiness of the Bank to give the Credit Guarantee due to the latest development in the economy itself, whereby it may new to the market and not experience yet by the Bank. The Bank not wants to be risky by providing facilities to certain customers within particular industry that is not tested yet by them.

Romanian Loan Guarantee Fund for Private Entrepreneurs (RLGF) is a new financial instrument that was introduced in 1994. It was established as a reaction to the large gap between the demand for financial support the private sector has showed on the market and the low supply of bank credits. Under circumstances of a general framework that has been unpropitious for entrepreneurial development and given that the economic environment has displayed unpredictable movements of the macroeconomic indicators, the Romanian banks were reluctant to crediting the private firms because the banks themselves going through a learning process concerning the rules of the market economy. (Szabó (2005))

Some government agencies and commercial banks in Hungary have held the view that the CGC is not using all its guarantee capacity and is over-cautious in issuing guarantees. Fees of the CGC and the HFGP are also considered too high. There are complaints that the CGC changes its conditions too often. (Szabó (2005))

(b) Waiting time is long

In doing business, time and money is equally important. Every seconds its will count. The more time takes for waiting the facility more would be the cost involved including the lost of opportunity cost. The slow delivery may cause customers to shy away from applying the scheme and approach to whom that could assist them providing the credit guarantee for their financing with other bank.

The comprehensive analysis conducted by Llanto and Magno involved a survey of borrowers and non borrowers of three programs selected in three regions. Guarantees did not affect the size of loans received because the banks and cooperatives follow a set formula in making production loans. Some guaranteed borrowers were able to get lower interest rates than nonguaranteed borrowers because of rediscount facilities available with guarantees. Procedures were streamlined so the transaction costs for guaranteed and nonguaranteed borrowers were similar, but waiting times for loan disbursement were still longer for guaranteed loans. (Meyer and Nagarajan (1996)

The internal policy and procedure has direct impact on the time of delivery. The stringent is the policy and procedure is definitely good as control to prevent misconduct and fraud in giving out the credit guarantee, but it will delay the operational process of the scheme. Customers do not like long winded list of requirement that they need to comply since this will involve time and a lot of documentation.

In the CIT, credit guarantee schemes appeared in the early days as a very attractive and effective instrument for financing SME and this view was fostered by various donors including PHARE Programme, the Austrian and German technical assistance programme (GTZ) as well as, to a lesser extent the Canadian US and UK bilateral aid

organisations. Lack of collateral appeared as a major problem as the new private enterprises in the CIT approached relatively new and inexperienced banking and financial institutions for loans either to start or expand their businesses. The experience of the CIT, as in other countries, has shown that the design and implementation of Credit Guarantee Scheme takes longer than originally envisaged and a part of this is due to inexperience of the banks and a fear by the lending institutions that loan recovery and repayment of guarantees in the event of default would prove difficult. (Szabó (2005))

Inexperience staff would also be cost to the Bank since its involved training and courses that need to be attended by them. As per above literature, this may cause the delay in delivery of credit guarantee besides the sufficient number of staff handling the processing of the scheme.

Early guarantee schemes in developing countries failed to put in place suitable procedures or adequate staff for handling claims for payment of the guarantee. The procedures for when and how such claims could be made tended to be imprecise. Such phrases as 'the guarantee shall ensure that the lender has diligently taken all required steps to recover the loan', were used. This type of language can lead to disputes and delays in the early years of a scheme, undermining the lender's trust in the reliability of the guarantee agreement. (Levitsky (1997))

(c) lack confidence

The acceptability of Credit Guarantee by the lender is important in scheme to ensure that the customers could get their financing. Otherwise, it defeats the purpose of having the scheme. This mostly depends on the trustiness and confidence of the financier towards the viability of the scheme.

The fear of moral hazard affecting the lenders is ever present with the guarantors. Lenders for their part have not trusted government-supported Credit Guarantee Schemes and lack confidence that the guarantees will be paid out quickly and without dispute when a claim is made. The more successful schemes have, after 5 to 10 years, developed the necessary collaborative relationships. (Levitsky (1997))

The practice of slow claim payment to the financier would create unnecessary bad perception on the scheme. The faster claim payment would portray good image of the guarantor.

Judicial processes are slow in most developing countries so that the guarantor usually cannot insist on a legal judgement before paying a guarantee, but simply on the initiation of legal proceedings. (Levitsky (1997))

The judicial process is an external factor beyond the control of the Bank, but this may depreciating the confidence level of the scheme.

(d) guarantee programs are unclear

The objectives of the three agents - guarantor, lender and borrower - may conflict and some guarantee programs are unclear about their objectives. Rhyne analyzed this problem in the U.S. Small Business Administration guarantee program. If the guarantee is designed to reduce credit market failure, the issue of impact on borrowers is less significant. The crucial issue is whether or not market failure is reduced. However, if the guarantee is designed to stimulate economic growth, it is important to determine if the firms of guaranteed borrowers grow faster than nonguaranteed borrowers. (Meyer and Nagarajan (1996)

The framework of credit guarantee scheme must be clearly explained among others are the process flow and responsibility and duty of parties involved. This will make sure that its operations are running smoothly and efficiently towards achieving the mandate and objective of the scheme. Mechanism of contractual agreement between the parties must also be established. This will indirectly create the confidence of the public in applying the credit guarantee scheme for their financing.

(e) lack of incentives

Often there is a demand for governments, donors, and banks to assist a target group such as micro enterprises in developing countries. The easiest way to respond and spend money, short of making subsidized loans, may be to fund a guarantee program. Immediate political benefits may be obtained by creating the program. Even if it accomplishes little or produces unexpected negative results, the problems may emerge only during the next political administration. (Meyer and Nagarajan (1996)

In the long run, this negative impact does not give much incentive for the Bank to give credit guarantee since it will create unnecessary bad loans, claims and losses.

(f) The fear of moral hazard

There are still strong doubts on the rationale for Credit Guarantee Scheme s among those who believe that business development should be left to market forces. The most that one such market economist (Vogel, 1996) would concede was that guarantees 'did less damage than other forms of subsidies, such as those that lower interest rates'. The most serious argument against Credit Guarantee Scheme s, which cannot be totally refuted, is the 'moral hazard' issue, namely that such schemes weaken the will and commitment of the borrowers to repay the loan, when they know that a guarantee fund will reimburse the lending institution. There is also a danger of moral hazard on the part of the lending bank, which it is feared has less incentive to supervise the loan properly or to pursue vigorously the collection of repayments. (Levitsky (1997))

This moral hazard may lead to the caution of the guarantor from giving out the credit guarantee due to the riskiness of negative attitude of the lenders and borrowers. It is considered as a hidden cost to the guarantee which needs to be explored further by the Bank.

In other occasion, moral hazard may be less of a real danger, since competent lending banks are zealous of their reputation for high loan-portfolio performance, and will make strenuous efforts to avoid loan defaults. Also, SME borrowers will fear being denied

further loans if they fail to repay, even if the loss is covered by a guarantee. (Levitsky (1997))

(g) Afraid of loss in case of under-collateralization

The lack of adequate collateral is commonly stated as one of the significant constraints to SMEs obtaining access to credit from commercial financial institutions. Banks generally afraid of loss in case of under-collateralization of SMEs and this is why they do not like to lend credit to SMEs. The objectives of credit guarantee schemes (Credit Guarantee Scheme ) is to share the risks of the lending through reimbursing the lenders part of the losses incurred from loan defaults by SME borrowers, are now seen as filling a gap in helping SMEs, especially those with growth potentials, obtaining access to formal bank credit. In the last few years there has been a resurgence of interest in such schemes. The observations and recommendations of the Round Table Meeting on Credit Guarantee System held in 1996 by the Inter-American Bank are valid and highlight the issues of Credit Guarantee Scheme . (Szabó (2005))

Usually good credit rating customers will not face much problem on the collateral requirement during application, whereby they may not require any credit guarantee. However, the customer no or inadequate collateral may be considered risky in the event of default. The Bank is required to analyse the acceptability level to provide guarantee on financing to this type of customers.



(h) Asymmetry of information

Banks that lend money are used to managing risk and regard it as the very essence of successful banking. Many financial economists believe that a major reason for the banks perceiving lending to SME as especially risky is due to the so-called 'asymmetry of information', namely that information on SME borrowers is inadequate and costly to obtain. It is only through a 'learning process' in assessing the risk involved in small clients that banks will acquire the skill to make appropriate lending decisions. It is advisable, therefore, that in every guarantee scheme the lending institution should assume some of the risk. (Levitsky (1997))

The solution given Levitsky (1997) is practical for the Bank to mitigate the risk of asymmetry of information. In the event of default, both parties namely the lender and guarantor should bear together on the losses. The credit guarantee scheme can be offered more aggressively to the potential borrowers in order to achieve the mandate and objective of the scheme. Furthermore, it is also illustrated by Uesugi and Sakai (2005) as below.

Japan's credit guarantee system assures 100% repayment, in principle, which incurs a moral hazard problem on the part of the financial institutions. These institutions may contact borrowing firms and demand documents less frequently than those that lend without guarantees; they produce less credit information on their borrowers than they would without the credit guarantee. Once the credit risk of individual firms becomes unavailable to financial institutions, the information asymmetry problem becomes acute. This, in turn, creates a moral hazard problem on the part of SMEs. Borrowing firms may

harm their own profitability and viability by investing in risky projects. They are more likely to gamble their assets when their net worth is low. (Uesugi and Sakai (2005))

**Issue 2: Increase in claims - The accounts under this scheme have high tendency in turning non-performing, whereby this will lead to higher and frequent claims submitted by the Participating Financial Institution.**

(a) Adverse selection and moral hazard problems

The impact of credit guarantees is unclear and there is plenty of skepticism by both theorists and practitioners. Since most crop insurance programs that cover specific insurable risks are subsidized, it is logical to expect that a comprehensive credit guarantee with its severe adverse selection and moral hazard problems would be even less viable. (Meyer and Nagarajan (1996))

The adverse selection would be costly for not guarantee the good rating customers, but otherwise credit guarantee is given to potential defaulter. This will increase the possibility of incurring claims on the credit guarantee in the event of loan default.

The introduction of the special guarantee program has been said to cause a gigantic impact in the credit market, both positively and negatively. Some commentators point out that the special guarantees provided sufficient credit to companies that were suffering from the credit crunch and close to bankruptcy. This view emphasizes the

importance of easing borrowing constraints. However, critical assessments are more common than the positive ones. This critical stance is shared by most of the mass media and economists in Japan. According to the critics, several defects may distort the incentives of financial institutions and firms, including the 100% guarantee practice whereby private banks are guaranteed full repayment of their loans even when their borrowers become delinquent. Banks thus have no incentive to monitor their borrowers, which can lead to “empire building” by SMEs. Such firms may over-borrow and overinvest, especially when they are close to default. This behaviour decreases their profitability and viability. These are what economists call moral hazard problems, for both financial institutions and firms. (Uesugi and Sakai (2005))

There are still strong doubts on the rationale for CGSs among those who believe that business development should be left to market forces. The most that one such market economist (Vogel, 1996) would concede was that guarantees 'did less damage than other forms of subsidies, such as those that lower interest rates'. The most serious argument against CGSs, which cannot be totally refuted, is the 'moral hazard' issue, namely that such schemes weaken the will and commitment of the borrowers to repay the loan, when they know that a guarantee fund will reimburse the lending institution. There is also a danger of moral hazard on the part of the lending bank which, it is feared, has less incentive to supervise the loan properly or to pursue vigorously the collection of repayments. (Levitsky (1997))

The negative attitude of the borrower for ignoring to settle their financing on time will contribute to the claim cost to the Bank. The bad attitude of lender for not properly supervising the guaranteed loan will also cause the similar losses.

(b) Use for other purpose

The difficulty of analyzing the impact of credit programs is well understood (David and Meyer; Von Pischke and Adams; MSI, Feb. 1990). An important attribute of money is its fungibility; it can be used for a variety of uses and one unit from one source is completely substitutable for one unit from another source. Fungibility makes money a valuable commodity but creates a problem when evaluating the impact of a borrower getting a loan, especially if it was intended for a specific purpose. Assume that a loan was intended for a particular purpose, say, buy a production input. The borrower may not have been able to buy the input without the loan. (Meyer and Nagarajan (1996))

In this case, the loan "caused" the purchase of the input, and the "additionality" attributable to the loan is the full value of the input purchase. Alternatively, the borrower may have purchased the input even without the loan, but with it is able to use his own resources for other purposes. The additionality "caused" by the loan is whatever the borrower did with the resources previously destined for the purchase. When loan monitoring is lax or difficult, the borrower may divert the loan funds earmarked for the input to different purposes. (Meyer and Nagarajan (1996))

There is risk for the Bank if the loan is used for other different purpose compared the one that it is access before. The credit assessment and rating given is based on the picture given initially which may change the view of the guarantor for different scenario.

To assess the impact of a loan it is necessary to estimate the "counter factual," that is, what would the borrower have done without the loan, then compare that with what was

done with the loan. The counterfactual can never be measured so some proxy is needed. Frequently this involves comparing the current situation of borrowers with some earlier baseline data, and attributing some portion of the observed changes to borrowing. Alternatively, the performance of borrowers (the treatment group) is compared with nonborrowers (the control group) and any improvement observed in the treatment group is attributed to borrowing. (Meyer and Nagarajan (1996))

(c) Insufficient collateral

Collateral is a buffer for lender and guarantor in the case of loan defaulting. The higher the coverage of the collateral amount, the safer would be the financing to them.

Access to bank loans is particularly difficult for these SMEs because of insufficient collateral. Certain developments in the European financial sector may also increase the difficulty for SMEs to obtain sufficient amounts of bank lending at reasonable interest rates, such as the forthcoming capital adequacy accord (Basel II). The problem of insufficient collateral can be overcome by guarantees given by public or private guarantee or mutual guarantee institutions. (Szabó (2005))

(d) New business start up

In Hungary there are three credit guarantee institutions issuing guarantees for credits guaranteed to small businesses, the Credit Guarantee Company (CGC), the Rural Credit Guarantee Foundation (RCGF) and the Start Credit Guarantee Fund. If the credit has a rural or agricultural client, the bank will use the RCGF. If it is for a start-up, it will use the Start CGF which is operated by the Hungarian Foundation for Enterprise

Promotion (HFEP). In all other cases the bank will use the CGC, which is, in fact, the largest of the Hungarian credit guarantee schemes. (Szabó (2005))

The proportion of credit leading to guarantee claims is highest for the Start Credit Guarantee Scheme and lowest for the CGC. There is some feeling in Hungary that the Start Credit Guarantee Fund has been an over-costly programme. (Szabó (2005))

The new set up usually does not have enough experience, networking, capital and also collateral. Therefore, the credit guarantee given to the new set up would be riskier than the long time running businesses. This creates the possibility of high non performing loan in this category of customer, and increase the potential amount of claims and losses for the Bank.

(e) Dispute over documentation

One study analyzed a private development bank in the Northern Mindanao region (Llanto and Casuga). In October of 1991, about 15 percent of its outstanding loans were guaranteed through one of the guarantees operated by the Comprehensive Agricultural Loan Fund. The borrowers were mainly small farmers unable to provide the collateral normally required by the bank. Over 300 farmers received guaranteed loans from November 1987 to July 1991. The guarantee alone, however, could not be credited with these loans because the bank used a “systems” approach in which the borrowers received technical information, production inputs, and a secure market. This combination made the borrowers creditworthy. Even so, about 10 percent of the outstanding loans were in default in July 1991 and claims for guarantee payments filed

in 1989 were still unpaid in February 1992 because of a dispute between the bank and guarantor over documentation. (Meyer and Nagarajan (1996))

Proper contractual agreement is required in Credit Guarantee Scheme. If there is a dispute, the agreement will be referred for claims and damages.

(f) Adequate staff

The KCGF in Korea at last count (1995) employed 2100 persons and KOTEC, the other scheme in Korea, has 800 employees. In India more than 400 employees (1995) in the DICGC tried to grapple with an ever increasing volume of and were falling behind. These examples show that the need for adequate staff to deal with claims without undue delay and to pursue debt recovery raise the administrative costs of the guarantee organization substantially. (Levitsky (1997))

A sufficient strength of manpower to monitor and supervise the scheme is required by the guarantor and the lender. Both parties is required to play role to prevent the guaranteed loan become bad and raise unnecessary claims to the Bank.

**Issue 3: Viability of the scheme - The scheme is not able to deliver the expected profit, but in fact it is making losses from the huge sum of claims paid.**

(a) High Administrative Cost

Administrative expenses such as payroll of staff, utilities and rental of office and building need to be incurred to run credit guarantee scheme. Income derived from the scheme must be more than the administrative and operational cost to make it operating viably.

The Credit Guarantee Corporation in Nepal illustrates the problem. It guarantees commercial bank loans to small enterprises. Although it guaranteed less than half of the loans made to the priority sectors in the mid-1980s and many defaulted loans were never submitted for claims, the fund failed and had to be recapitalized (Kongsiri). Little information exists about the efficiency of fund operations. Some funds provide global portfolio guarantees so they avoid the task of evaluating applications for individual guarantees. Schemes with selective guarantees, however, require staff to review individual loans proposed for guarantees. The efficiency of this process influences operating costs, and the transaction costs and waiting time borne by banks and borrowers. (Meyer and Nagarajan (1996))

The cost is related to the efficiency of handling the administration of the scheme. Inefficient in managing the administration would cause to incur unnecessary expenses and the scheme not viable to be established.



The agricultural loan guarantees made in Mexico by FEGA (Fondo Especial de Asistencia Tecnica y Garantia para Creditos Agropecuarios) illustrates the problem (World Bank). The FEGA staff essentially replicate the functions of and, in some cases, substitute for bank staff in appraising, monitoring and collecting loans. These services were free until 1988 when charges of two to three percent of the value of loans made were introduced, but this income has been too low to cover high administrative costs and loan losses. (Meyer and Nagarajan (1996))

The cost of administration must be less than the guarantee fee income, whereby the available resources need to be utilised wisely in the task mentioned in Meyer and Nagarajan (1996) above.

Most SME specialists would agree that the high administrative costs in relation to loan size which result in low profitability in SME lending is the most serious disincentive to commercial bank lending to these enterprises. Commercial banks also regard lending to SME as a high risk, however, and the inability of such borrowers to offer adequate collateral is also a major deterrent. (Levitsky (1997))

#### (b) Operating costs and claims exceeded investment income

The first important aspect to evaluate is the status of the fund or annual appropriations used to cover operations and loan losses. The data and anecdotes available suggest that many programs fail because the payments to lenders for loan losses exceed the revenues and reserves of the guarantee funds. For example, the Nigerian Agricultural Credit Guarantee Scheme was set up in 1977 with a capital fund of N100 million to

stimulate lending to small farmers. It was slowly decapitalized because the operating costs and claims in several years exceeded investment income. In 1988 about 15 percent of the guaranteed loans were reported in default (Njoku and Obasi). (Meyer and Nagarajan (1996)

(c) Regular evaluation and assessment on the policies

A number of entrepreneurship policies deployed in India have been copied from entrepreneurship policies prevalent in developed economies. Often, this happens as a result of the recommendation of the World Bank, UNIDO or some other international development agency. Many of these entrepreneurship policies are regularly monitored and evaluated but such practices are not prevalent in India. Blindly copying what has been successful in the west may not be a very good idea. These entrepreneurship policies need to be regularly evaluated and assessed. (Roy)

The above literature suggests that policies that are used by other places may not suit to the requirement to the Bank. It may successfully be implemented in other banks but may not in SME Bank. Therefore, the policies adopted need to be assessed systematically to ensure the effectiveness of the policies in achieving the mandate and objective of the scheme.

For instance, while the Indian government has been fairly progressive in coming up with policies, their actual implementation and their effectiveness has not been systematically assessed. There have been a number of impact assessment studies carried out in Europe and the USA (Chrisman and McMullan, 1996; Lundstrom and Stevenson, 2001;

Lerner, 1999; Wallsten, 2000) but very few such have been carried out in emerging economies. Implementing all the entrepreneurial policies has a cost associated with it and the government and the taxpayers should know if the envisioned objectives are met. The fundamental principle of evaluation requires that the objectives of the entrepreneurship policy be specified. Objectives are usually expressed in general terms like the increase in entrepreneurial activity or increasing the chances of survival of new firms. A sketchy description of objectives helps policymakers as that makes it easier to point out success. Conversely, it also helps to mask failure. Harrison and Leitch (1996) suggest that it is unsatisfactory for the government to claim that the target is anything it happens to achieve. (Roy)

**Issue 4: The Bank's capacity to issue Letter of Guarantee has been depreciated due to depleting balances available in the Guarantee Fund Account.**

Poor management

The success of the scheme is also contributed by the process of managing it properly, whereby poor management will increase the possibility of high claims and losses.

Oehring (1995) recently reported on the status of 12 Latin American guarantee schemes. Two existed for over two years, are insufficiently used and show deficits, but possess sufficient assets to cover guarantees and losses. A third microenterprise scheme was restructured two years ago, and so far shows good results. The other nine have no assets left or have been closed. Some failed because of poor design, others because of poor management and undiversified investment strategies, and in other cases, through corruption or political intrigue, guaranteed loans were granted to borrowers with no intention of repaying. (Meyer and Nagarajan (1996)

If complete information were available, we suspect it would show that the financial landscape in developing countries is littered with failed guarantee schemes. There are allegations that some guarantee funds have failed to pay losses or have dragged out the payment process to avoid exhausting the fund. It appears that many guarantee schemes have been set up and are viable for a few years. Then loan losses emerge and eventually mushroom; the fund is recapitalized, and the cycle starts again. (Meyer and Nagarajan (1996)

Poor management is costly and it will reduce the available guarantee fund balance for further new borrowers.

The Credit Guarantee Corporation in Nepal illustrates the problem. It guarantees commercial bank loans to small enterprises. Although it guaranteed less than half of the loans made to the priority sectors in the mid-1980s and many defaulted loans were never submitted for claims, the fund failed and had to be recapitalized (Kongsiri). Little information exists about the efficiency of fund operations. Some funds provide global portfolio guarantees so they avoid the task of evaluating applications for individual guarantees. Schemes with selective guarantees, however, require staff to review individual loans proposed for guarantees. The efficiency of this process influences operating costs, and the transaction costs and waiting time borne by banks and borrowers. (Meyer and Nagarajan (1996)

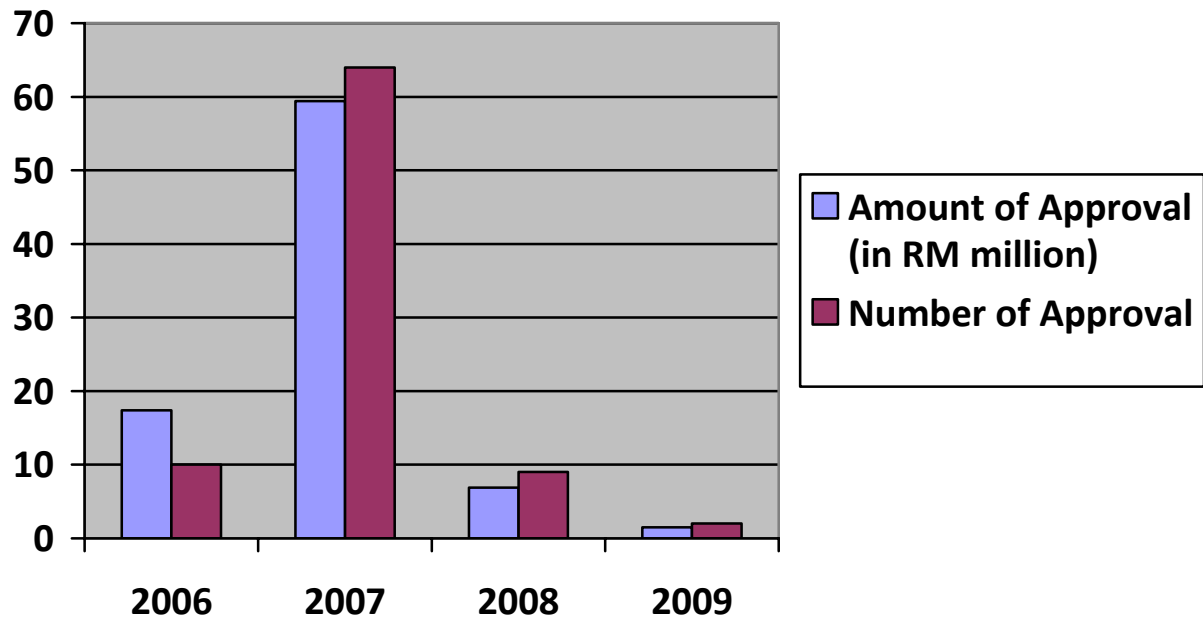
## Analysis – empirical data and graphics

**Diagram 1: Number and Amount of Approval for Credit Guarantee Scheme**

<b>Year</b>	<b>Approval Target</b>  (RM million)	<b>Actual Approval</b>  (RM million)	<b>Number of Approval</b>	<b>Actual Approval against Target</b>  (%)
2009	Not Available	1.5	2	Not Applicable
2008	190.0	6.9	9	3.63
2007	150.0	59.4	64	39.6
2006	Not Available	17.4	10	Not Applicable
<b>Total</b>		<b>85.2</b>	<b>85</b>	

The Bank has not been able to record sizable percentage of amount approved against the target since the scheme was offered to the public in November 2006. There is a sharp decline in both the number and amount of approval for Credit Guarantee Scheme by the Bank in 2009 and 2008 compared to 2007.

**Graph 1: Number and Amount of Approval for Credit Guarantee Scheme**

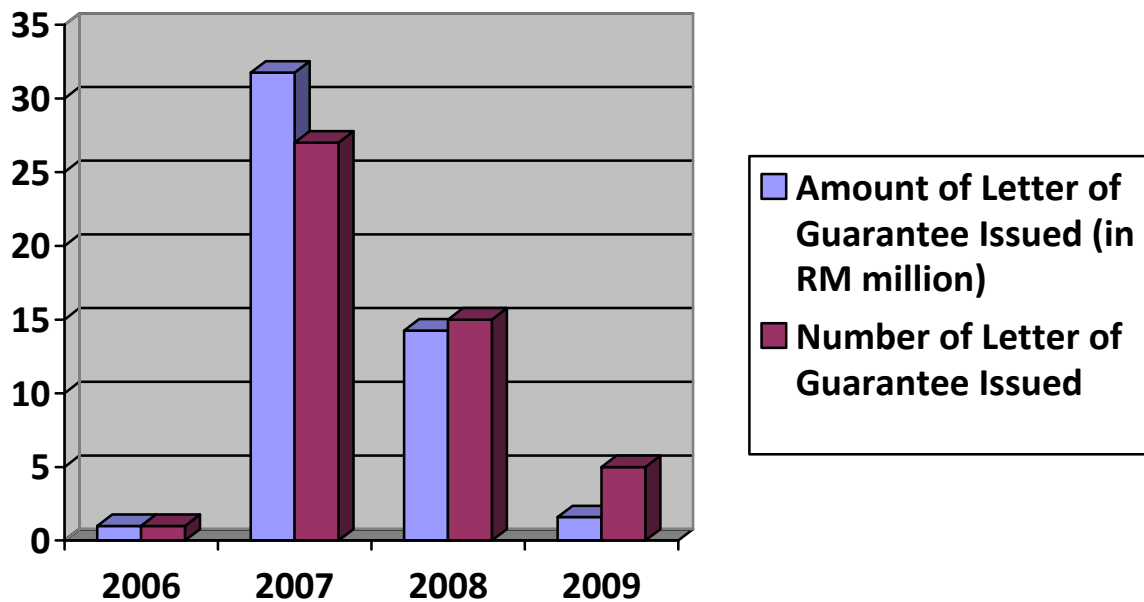


**Diagram 2: Total Amount and Number of Letter of Guarantee Issued.**

Year	Amount of Letter of Guarantee Issued (RM million)	Number of Letter of Guarantee Issued
2009	1.6	5
2008	14.26	15
2007	31.75	27
2006	1.0	1
<b>Total</b>	<b>48.61</b>	<b>48</b>

The Bank has issued a total of 48 Letter of Guarantees amounting RM 48.6 million since 2006. The highest was in 2007 amounting RM 31.7 million or 65.3% of the total amount of Letter of Guarantee issued. From then it indicates a continuous decrease of Letter of Guarantee issued in 2008 and 2009, which consistent with the drop in number and amount approval as described in Diagram 1 above.

**Graph 2: Total Amount and Number of Letter of Guarantee Issued.**





**Diagram 3: Percentages of Claims against Amount of Approval and Issuance of Letter of Guarantee.**

	<b>Claims</b>		<b>Actual Approval</b> (RM million)	<b>Amount of Letter of Guarantee Issued</b> (RM million)
	<b>Actual Paid</b> (RM million)	<b>Actual Paid + Potential</b> (RM million)		
Cumulative Sums from Year 2006 - 2009	18.45	22.98	85.20	48.61
Percentage of <b>actual claims paid</b> against approval Letter of Guarantee Issued			22%	38%
Percentage of <b>actual claims paid + potential claims</b> against approval Letter of Guarantee Issued			27%	47%

The scheme is introduced around four years ago and the percentage of actual and potential claims against letter of guaranteed issued is very high at 47%. This is mainly due to financing that being guaranteed by the Bank turning bad.

**Diagram 4: Guarantee Reserve Account**

	<b>Amount</b> (RM million)
Initial Sum	50.0
Cumulative Claims paid from Year 2006 – 2009	18.5
<b>Available Balance as at 31 December 2009</b>	<b>31.5</b>

The Guarantee Reserve Account is created to back all the Letter of Guarantees issued under the scheme. The balance in the Guarantee Reserve Account determines the Bank's capacity to issue further Letter of Guarantees. The initial sum placed was RM50.0 million and all claims are paid by the Bank are paid out from this account. The balance is reduced by total claims amounting RM 18.5 million as explained in Diagram 3 above.

**Diagram 5: Capacity to Issue New Letter of Guarantee**

	<b>Amount</b> (RM million)
Balance Available	31.54
Capacity to issue new Letter of Guarantee (multiplier effect of 4)	126.16
Less: Total Letter of Guarantee (active in circulation)	(31.01)
<b>Available capacity to issue further new Letter of Guarantee by SME Bank as at 31 December 2009</b>	<b>95.15</b>

In summary, the guarantee mechanism adopts multiplier effect, whereby for every Ringgit of reserve the Bank has, the Bank can provide 4 times in loan value to the borrowers. The bank is restricted to offer lower amount of guarantee to its customers based on the lower available balance in the Guarantee Reserve Account as in Diagram 4 above.