DCA LOAN GUARANTEE GHANA

IMPACT BRIEF



BACKGROUND

Macroeconomic conditions in Ghana in 2000 severely constrained private sector access to credit. High levels of government borrowing pushed interest rates up and crowded the private sector out of financial markets. With government treasuries paying real interest of 16.8 percent, banks had little incentive to take on riskier private sector debt. High interest rates and exchange rate volatility also created financial uncertainty that made both borrowers and lenders hesitant to take on the risks associated with loans, particularly medium to long-term loans.

Limited access to credit and its high cost significantly restricted the growth of Ghanaian enterprises. These constraints hit micro-, small-, and medium-enterprises (MSMEs) especially hard because of a number of factors that make it difficult for banks to assess the risk associated with loans to MSMEs. This situation is of particular concern to USAID because its current Economic Growth strategy relies on growth in the MSME sector.

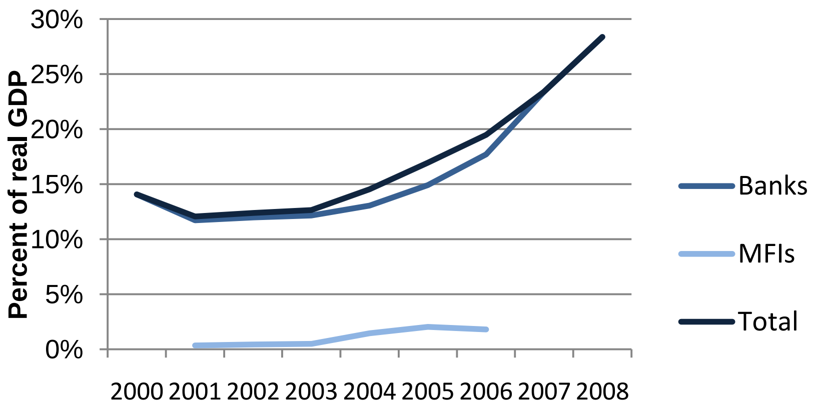
Recent monetary policy and financial sector reforms have substantially increased banks' lending to the private sector (see graph above) but limited access to credit, high interest rates, and prohibitive collateral requirements still pose significant constraints to the growth of many MSMEs. Access to the medium to long-term financing necessary for capital investments is tight.

In response to this environment, USAID implemented two DCA loan guarantees with EcoBank, a prominent bank in Ghana, in 2003 and 2005. Under the guarantees USAID agreed to cover 50 percent of EcoBank's losses of principle on guaranteed loans up to a specified ceiling. The guarantees reduce the bank's risk and thereby encourage it to make loans to specific sectors that support USAID/Ghana's development objectives. USAID structured the two DCA guarantees to support its Economic Growth strategy and specified MSMEs, microfinance institutions (MFIs), and NGOs with activities in specific sectors with potential for growth as qualified recipients of guaranteed loans. The guarantees' Action Packages also emphasized a particular desire to improve access to larger, medium to long-term loans for these sectors. The table below summarizes key characteristics of the two guarantees.

ABOUT DCA

USAID's Development Credit Authority (DCA) was created in 1998 to mobilize local private capital through the establishment of real risk sharing relationships with private financial institutions in USAID countries. The tool is available to all USAID overseas missions and can be used as a vehicle for providing much needed credit to an array of enterprises and underserved sectors. DCA is already active with credit guarantee agreements in many USAID countries. This Impact Brief examines the findings from an evaluation of two guarantees in Ghana.

LENDING TO THE PRIVATE SECTOR AS PERCENT OF REAL GDP



Source: Bank of Ghana & Ghana Microfinance Institutions Network (GHAMFIN)

EVALUATION OBJECTIVES

USAID's Economic Growth Agriculture and Trade Bureau's Office of Development Credit (EGAT/DC), which administers the DCA guarantees, commissioned the evaluation of these two DCA guarantees in Ghana. This evaluation assesses the performance of the DCA guarantees relative to their objectives as defined in the Action Packages developed by USAID/Ghana, i.e., increasing access to credit for firms in the target sectors. Three broad avenues of questioning – output,

DCA LOAN GUARANTEES IN GHANA

Starting year	Ending year	Guarantee ceiling	Number of loans	Aggregate amount of loans	Utilization rate (percent of ceiling)	Median loan size	Average loan tenor (months)
2003	2008	$3,000,000	6	$2,208,830	73.63%	$359,395	40
2005	2012	$7,000,000	4	$4,446,664	63.52%	$1,203,503	27

Source: USAID Credit Management System (CMS) and EcoBank.

outcome, and impact –guided the evaluation.

The scope of the evaluation covers EcoBank's lending behavior and potential demonstration effects in the broader banking sector. It does not examine EGAT/DC's administration of the guarantees nor does it assess the impacts of any associated technical assistance to borrowers or on the guarantees' success in achieving USAID/Ghana's strategic objectives.

EVALUATION METHODOLOGY

The evaluation began with a desktop analysis of the available literature on the guarantees. A three-person team then traveled to Ghana to conduct the rest of the evaluation in Accra from February 16 to 27, 2009. During that time the team reviewed documents, conducted structured interviews with stakeholders, and collected secondary quantitative data.

KEY FINDINGS AND CONCLUSIONS

OUTPUT

Conclusions The DCA guarantees complemented EcoBank's ongoing strategy to transition from a wholesale bank to a fully fledged retail bank with a correspondingly greater focus on the SME sector. The bank used the guarantees to gain experience with new borrowers and industries and, in compliance with USAID/Ghana objectives, to provide larger and longer-term loans associated with financing capital expenditures. Guaranteed loans were much larger, and consequently far fewer in number, than initially anticipated by USAID/Ghana but still fell within the size and tenor parameters established in the guarantee agreements.

Findings in support of those conclusions include:

- EcoBank used the guarantees to test new borrowers. Of the nine unique borrowers (there were ten loans but two were to the same borrower) under the DCA guarantees, six (66 percent) were new clients.
- The bank also used the guarantees to gain experience with new sectors/industries. Three of the eight sectors/industries represented by loan recipients were sectors/industries in which EcoBank had no previous lending experience.
- EcoBank also focused its use of the guarantees on larger loans with longer tenors necessary for capital investments – a particular objective of the DCA agreements. Guaranteed loans were significantly larger and had longer tenors than EcoBank's typical SME loan. All of the guaranteed loans fell within the top 8 percent (by size) of loans in the bank's SME portfolio and 60 percent fell within the top 2 percent. The guaranteed loans had an average tenor of 35 months compared to an average 12 month tenor for the bank's overall SME portfolio.
- All nine of the unique borrowers under the DCA guarantees received medium to long-term loans, eight to finance capital expenditures and one, an MFI, for on-lending to micro-enterprises. None had received medium to long-term loans prior to the guarantee.
- In spite of the relatively large loan sizes, loan recipients likely fall within target sectors, i.e., they appear to be largely medium-sized enterprises and MFIs. (EcoBank defines SMEs as companies with assets under $250,000 excluding land and property, and an annual turnover between $250,000 and $5 million).

EVALUATION QUESTIONS

Output level – Did the guarantee partners use the guarantees to improve access to credit for enterprises in the target sectors?

Outcome level – Did the guarantee partner's experience with the guarantees improve access to credit for enterprises in the target sectors outside of guarantee coverage?

Impact level – Did the guarantees have a demonstration effect that improved access to credit for enterprises in the target sectors from the broader banking sector?

OUTCOME

Conclusions EcoBank has substantially increased lending to SMEs since it began utilizing the DCA guarantees. However, the growth largely reflects the bank's ongoing strategy to increase retail lending rather than being attributable to the guarantees. Experience with the guarantees prompted EcoBank to increase lending to some new industries and to extend some long-term loans for capital expenditures outside of the guarantee coverage. However, these increases were small relative to the bank's overall SME portfolio.

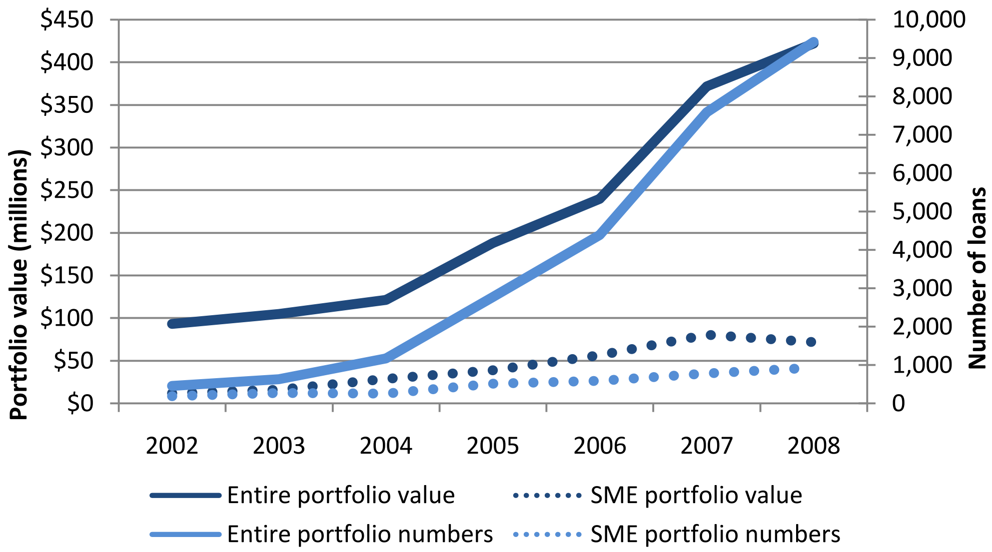
Findings in support of those conclusions include:

- EcoBank has substantially increased its lending to SMEs (see following graph). The bank increased the number of loans in its SME portfolio by 380 percent (from 194 to 932) and the value of the portfolio by 500 percent (from $11.9 million to $72.0 million). The number of loans in the bank's entire loan portfolio grew faster (1944 percent from 461 to 9,422 loans) than its SME portfolio but the value of overall portfolio grew more slowly (353 percent from $93.2 million to $422.0 million) than the SME portfolio.
- EcoBank used the guarantees to develop new clients and markets. The bank has continued to lend outside of the guarantees to seven of the eight industries/sectors represented by recipients of guaranteed loans. It has also

extended loan tenors for borrowers in these industries as it focuses on financing capital expenditures.

- The DCA guarantees contributed to changes in EcoBank's lending behavior. EcoBank personnel stated that the bank's experience with the DCA guarantees was crucial to the bank increasing the number of larger, long-term loans for capital expenditures in recent years. EcoBank has increased lending to MFIs outside of the guarantees and is now extending medium to long-term credit to MFIs.
- The DCA guarantees prompted EcoBank to expand lending into new sectors/industries. Bank personnel said that the ability to test new industries/sectors within the guarantee was critical to the bank's lending in these industries/sectors outside of the guarantee coverage but said that the guarantees made, at most, a minor contribution to the growth in EcoBank's SME portfolio. Guaranteed loans accounted for only one percent of the number and nine percent of the value of all SME loans in 2008.

GROWTH IN NUMBER AND VALUE OF ECOBANK LOANS, 2002-2008



IMPACT

Conclusions Lending to SMEs (a proxy for the target sectors of the guarantee) has increased substantially in Ghana since 2002 (pre-guarantee). Anecdotal evidence suggests that loan guarantees may be responsible for some of this increase. However, given the small number of industries/sectors represented by EcoBank's guaranteed loans, the effect of the DCA guarantees is likely modest. Factors external to the guarantees are likely responsible for most of the observed increase in lending to SMEs.

Findings

Key findings in support of the conclusion of increased financial sector lending to SMEs include:

- Bank lending to the private sector (as a percentage of real GDP to control for inflation and overall growth in the economy) increased from 14.0 percent to 28.8 percent (a 106 percent increase) between 2000 and 2008. Lending to the commerce and finance sector, a sector dominated by SMEs according to a banking official and a government SME specialist, grew substantially more than most other sectors increasing by 300 percent from 1.2 percent to 4.8 percent.
- Microfinance institutions increased lending from 0.3 percent to 1.8 percent of real GDP between 2002 and 2006, a 500 percent increase. At least three banks in Ghana have partnered with financial institutions, enabling those institutions to obtain needed capital for on-lending.
- The Bank of Ghana's SME Survey in 2005 found that "the share of SMEs in total exposure of banks has increased from 0.95 percent of GDP in 2001 to 1.54 percent of GDP by 2004."
- Two of the three banks that responded to a survey of five banks with SME departments reported increases in SME lending of 257 and 450 percent between 2002 and 2008.

Qualitative findings on the potential for EcoBank's DCA guarantees to influence broader SME lending include:

- Three individuals prominent in the banking and development sectors stated that they have witnessed banks observing and learning from other banks' experience when deciding to enter new industries or sectors.
- The three banks that responded to the evaluation team's survey of five banks that competed with EcoBank in the SME market said that other banks' experience in new industries and with different loan sizes and tenors were either "somewhat" or "very" important in determining the banks' lending strategy. Twenty-two percent of the recipients of guaranteed loans have received long-term financing from other banks since receiving the guaranteed loans.

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