Privatizing Profits and Socializing Losses in Turkish Economy: The Example of Credit Guarantee Fund

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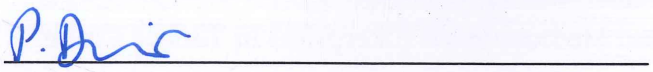
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Declaration of Originality

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Abstract

Privatizing Profits and Socializing Losses in Turkish Economy:
The Example of Credit Guarantee Fund

Pınar Demir, Master's Candidate at the Atatürk Institute
for Modern Turkish History at Boğaziçi University, 2019

Professor Nadir Özbek, Thesis Advisor

This thesis examines the loan guarantee system developed in order for banks to encourage lending Small and Medium Sized Enterprises in Turkey. Credit Guarantee Fund Inc. (KGF was established in 1991 to provide collateral for the purpose of taking the credit risk of a firm which cannot meet the criteria of the bank because of lack of collateral or corporate credit rating, by offering guarantee on the amount agreed with exposed creditor. The largest part of its capital is based on the state Treasury. The examples from the other countries and the international principles of credit guarantee schemes are explained as comparisons on both country and timely basis. This thesis approaches to the loan guarantee schemes as a system of privatizing gains while socializing losses. The terms that Akerlof and Romer gained to the literature which are asymmetrical information, adverse selection, moral hazard and bankruptcy for profit are used to explain this argument. The informational advantages of banks compared to Credit Guarantee Fund enable banks to cheat the Fund about the financial situation of the customers who they demand for guarantee. This situation paves the way for the main argument of this thesis.

24,000 words

Özet

Türkiye Ekonomisinde Karlarının Bireyselleştirilmesi ve Zararların Sosyalleştirilmesi: Kredi Garanti Fonu Örneği

Pınar Demir, Yüksek Lisans Adayı, 2019
Boğaziçi Üniversitesi Atatürk İlkeleri ve İnkılap Tarihi Enstitüsü

Profesör Nadir Özbek, Tez Danışmanı

Bu tez, Türkiye'de bankaların küçük ve orta boy işletmelere kredi vermesini teşvik etmek için gelişen kredi garanti sistemini incelemektedir. Kredi Garanti Fonu A.Ş. (KGF 1991 yılında teminat veya kurumsal kredi notu eksikliği nedeniyle bankanın kriterlerini yerine getiremeyen bir firmanın kredi riskini almak için ilgili alacaklı ile anlaşılan tutarda garanti sağlayarak teminat vermek amacıyla kurulmuştur. Sermayesinin en büyük kısmı devletin Hazinesine dayanmaktadır. Başka ülkelerden kredi garanti fonu örnekleri ve uluslararası prensipler ülke bazlı ve zaman bazlı karşılaştırmalar için açıklanmıştır. Bu tez kredi garanti projelerine, zararların toplumsallaştırılırken kazançların özelleştirilmesi olarak yaklaşmaktadır. Akerlof ve Romer'ın literatüre kazandırdığı asimetrik bilgi, ters seçim, ahlaki tehlike ve kar için iflas terimleri, bu argümanı açıklamak için kullanılmaktadır. Bankaların Kredi Garanti Fonu ile karşılaştırıldığında sahip olduğu bilgi avantajı, bankaların, Fonu teminat isteyen müşterilerin finansal durumları hakkında kandırabilmesine imkan vermektedir. Bu durum, tezin ana argümanının oluşmasına zemin hazırlamaktadır.

24.000 kelime

Çiğdem'e ve Bilge'ye,

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Abbreviations and Acronyms

BEL	Bankruptcy and Enforcement Law
BERR	Business, Enterprise and Regulatory Reform
CGS	Credit Guarantee Scheme
COSME	Competitiveness of Small and Medium Sized Enterprises
CSBF	Canadian Small Business Financing Program
DIUS	Department for Innovation, Universities and Skills
EIF	European Investment Fund
GDP	Gross Domestic Product
ILO	International Labor Organization
JASME	Japan Small and Medium Sized Entrepreneurship Firm
JFC	Japan Finance Corporation
KGF	Turkish Credit Guarantee Fund
KOBIT	Bail Approval Information Operating Technologies
KODIT	Korean Credit Guarantee Fund
KOSGEB	Small and Medium Industry Development Organization
MEKSA	Foundation of Vocational Training and Supporting Small Industries
NPL	Non Performing Loan
OECD	Organisation for Economic Cooperation and Development
SBA	United States Small Business Administration
SBLA	Small Business Loans Act
SCGF	Small and Medium Sized Credit Guarantee Fund
SFLGS	Small Firms Loan Guarantee Scheme
SME	Small and Medium Sized Enterprises
TARP	Troubled Asset Relief Program
TESKOMB	Center Association of Turkish Tradesmen and Artisans Credit and Bail Cooperatives
TOBB	Union of Chambers and Commodity Exchanges of Turkey
TOSYÖV	Turkey Small and Medium Sized Enterprises, Self Employed and Managers Foundation
UNIDO	United Nations Industrial Development Organization
VDB	Association of German Guarantee Banks

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1

Introduction

First, Joseph Stiglitz made popular the term of "Privatizing profits and socializing losses" in a TV programme that implies to the gains of a company return profit to its own partners, when the losses cost to the whole society, just like the corporations which are promoted by the government or bailout packages.[1] He used this term to address the US intervention to the economy in order not to allow big companies to fall after the 2008 crisis.

The main argument under this act was that they should be protected because they are too big to fall. If the big companies will fail, the consequences of this would be more dramatic for all society. Many banks and financial institutions that bankrupted during a financial crisis were rescued by the state, in a sense, they were nationalized. This can be perceived as step back from the privatization principle of Washington Consensus. This attitude of the states causes the satirical definitions like "privatize profits and socialize losses"[2]. This term is generally associated with bank and state relations because banking sector is too important to be run according to the interests of the capitalist profit

1 "US Does Not Have Capitalism Now: Stiglitz", https://www.cnbc. com/id/34921639, accessed on 01.02.2019

2 Ertuna, Özer. "Krizden Alınacak Dersler Yeni Bir Fırsat mı?" *Muhasebe ve Finansman Dergisi* 43 (2009: 6-13.

motive.[3] In fact, the notion that firms privatize their gains but do not take losses themselves and push the costs onto society instead usually through the government, dates to the 19th century on the construction of roadways, public buildings, navy yards and army posts outsourced to private contractors. [4]

However, mostly in developing countries, loss socialization is made not focusing on big companies but on small and medium enterprises. The focus on microfinance and micro credits has been increasing because small sized companies have seen as the heart of the development thanks to their potential to grow. Credit guarantee schemes have been founded as a tool to help this process because they target the SME sector. They are willing to support banks for financing SMEs which have difficulties in accession to pecuniary resources, while being reduced the risks involved. This thesis describes how the credit guarantee scheme run by Credit Guarantee Fund (KGF is being implemented in Turkey with some examples from different countries and points to how public losses system works when the benefits belong to private firms due to the asymmetrical information between the banks and the Fund, and between the borrower and the banks. Information which is not same between buyers and sellers prevents market from running properly. Adverse selection and moral hazard accompany to asymmetrical information on financial sector and this situation leads KGF to fall short of the record completely.

This thesis is made up of three parts as a basis. In first part, the explanatory frameworks of credit guarantee schemes has been examined by explaining the main worldwide principles and comparing different types of schemes ranging from public guarantee schemes in which credit guarantee schemes are based mainly on the government budget to international schemes that are supported financially by multilateral government and NGO initiatives. Moreover, corporate guarantee schemes are under the control of private sector and governed by a company boss, while mutual guarantee schemes are founded by the main actors, potential borrowers, even the states promote them mostly. The main impact of the credit guarantee funds is on small and medium sized enterprises

3 Spencer, Neville. "Banks Too Important To Leave In Hands of Greedy Capitalists." *Green Left Weekly* 1208 (2019: 7.

4 https://www.counterpunch.org/2013/03/01/socialize-costs-privatize-profits/, accessed on 01.03.2019.

in all types of guarantee schemes. This is not coincidence; SMEs are target group for supporting in the way of taking money from the banks and it is because they are seen as leading enterprises in terms of employment, labor force and economic growth especially in developing countries. There are four main reasons why SMEs have such importance. One of them is the change in organization of business which necessitates easier adaptation and crises. Other is the change in production process that prefers sufficient quantity and high variety instead of what the Fordist production process brought. Third motive is the requirements of free market economy in which do not have a place for monopolies or oligopolies. The final reason is transition from economies of scale which is based on supply to economies of scope which takes consumer demands to forefront. It is aimed to prevent SMEs from lagging behind in the competition in market. Then, a variety of countries from Europe, Asia and America are compared as a model of guarantee schemes. First of all, in Western Europe, it is highlighted that there are some common points among the credit guarantee schemes of countries in terms of their outreaches, services, coverage and claims. However, there are some continental differences between the functioning of credit guarantee schemes. For example, there is an association for guarantee banks which is the major organization to control guarantees given without being sole one in Germany. On the other hand, Korean Credit Guarantee Fund (KODIT is only guarantee institution in Korea and completely a public financial institution which provides both insurance and consulting to the market.

When it comes to Turkey, Credit Guarantee Fund has a genuine model in respect to its shareholding structure including both public and private as well as financial sector. The Union of Chambers and Commodity Exchanges of Turkey (TOBB, Small and Medium Indu stry Development Organization (KOSGEB, private and public banks are ones of among the partners of KGF. In second part, it is evaluated in detail with the evolutionary perspective of the credit guarantee fund in Turkey by using data from BDDK and graphics. There is one other guarantee institution apart from KGF which is Center Association of Turkish Tradesmen and Artisans Credit and Bail Cooperatives (TESKOMB date to 1950s which supports mainly crafts and artisans to facilitate their access to financial sources. However, KGF has a unique form and

differentiates itself from these two in terms of its process, budget and the share of governmental institutions inside its partnership. Basically, it is a joint-stock company but it has got some special features. KGF is exempt from taxes and fees because its activities are evaluated as for the public weal. KGF shares the credit risks of banks and strengthens the collateral structure. The expecting results with this incentive from the viewpoint of state are increase in taxes leading with the probability of corporate growth via the credits taken, and increase in employment. State encourages private staffing when it fails to create jobs for its citizens. Guarantees provided by KGF are separated into two main groups according to the source of budget which are equity or treasury-backed. The share of the allocated fund from Treasury is increasing year by year; after 2008 economic crises it became 1 billion Turkish Liras in 2019 to cope with the negative impact of crises. In 2015, it was duplicated and in 2017 it raised to 25 billion Turkish Liras. Moreover the guarantee limit from Treasury enhanced to 250 billion Turkish Liras from 20 billion Turkish Liras between 2016 and 2017.[5] For the guarantees given by the support of Treasury, there is no additional financial intelligence process run by the Fund apart from lender banks whereas the creditworthiness is investigated if the source is its own equity. The guarantees are calculated on the principal capital which the interests and commissions are not included and the guarantee extent can be between 85 percent and 100 percent according to source of budget. For example, full coverage is only possible for Treasury-based ones and export merchants. Potential borrower enterprises can apply to KGF via the lender banks and financing companies and they can use more than one credits with KGF guarantee on condition that it should not exceed its total limit from both same bank or different. Firms which do not get well and have difficulty in repayment can also use KGF guarantee for restructuring credits and maturity renewed credits if the banks propose them to KGF. Fund cares about the lender bank's opinion and proposal primarily for the evaluation of the borrower. KGF guarantee gives two

5 Kredi Garanti Fonu Information Center. http://www.kgf.com.tr/index.php/en/ information-center/faqs, accessed on 9.6.2019.

main opportunities to banks. First, banks have a chance to increase their capital adequacy ratios[6] by lowering risk weighted assets. Secondly, banks can make more profits when they bind a credit to KGF collateral in case of delay of this loan's repayment by means of making lower specific provisions for doubtful receivables.[7]

The last part of this study embraces the asymmetrical information in financial sector and its application on credit guarantee institutions, specifically on KGF by using Akerlof's terms bringing Akerlof the Nobel Prize in 2001. The theory briefly argues that the market would not function well when the potential buyers cannot confirm the offered product. It is main reason is that sellers always know more than the buyers about a product that causes seller can vend a bad product by marketing it just like a good one. Sellers of bad product would be persuaded for average price when the sellers of good one would demand more because they know that the real worth of their products is higher. Therefore, the adverse selection is occurred and the bad ones are mostly preferred by buyers which leads the less qualified goods hold the market. This partly resembles Gresham's Law[8]. However, in this case, in contrast to the other, both sellers and buyers have an ability to differentiate good and bad ones other than asymmetrical information.

In financial system, banks need collaterals to tackle with asymmetrical information problem.[9] Lender banks do not have knowledge of the customers

6 Capital adequacy ratio is an international criterion which is the ratio of equity and risk weighted credit exposure. There are some restrictions to the risks taken by banks to prevent the crisis and providing banking system to run well. BDDK requires minimum ratio of 12 percent in practice.

7 Banks should make sure they have the money required to cover both existent and possible losses in their credit receivables. To prove their ability for loss coverage, they are liable to hold in reserves to use them in case of non-performing loans. The percentage of these provisions increase in parallel with the non-payment risk.

8 In circulation, if there are two kinds of money and there are differences between their commodity values when their nominal values are same, people store valuable metal money and use the less precious ones in market. So, "bad money drives out good" and money whose commodity value is higher is pulled out of the market. The principle is referred by Gresham who is the financier in 16. century England.

9 Steijvers, Tensie, Wim Voordeckers, and Koen Vanhoof. "Collateral, Relationship Lending and Family Firms." Small Business Economics 34.3 (2010: 243-259.

as much as customers themselves. Therefore, banks try to find other kind of things to secure the credit risk. However, when credit guarantee fund undertakes the risk by providing collateral, the asymmetrical information problem will be between the debtor and KGF, and banks and KGF. First asymmetrical information relation is same with the former example based on the bank clients' information. Second one is more complicated relation. It is based on the idea that, in a branch of a bank, the customer representative has more chance to find and collect information about his or her customers than the credit guarantee fund representative. It is because representatives are generally in close dialog with their clients whose offices mostly around the branch and they can gather market intelligence about customers easier. This gives the banks and customer representatives the opportunity to cheat the fund that trusts the information getting from banks, about the customers. By collateralizing, banks might abdicate risk of untrusted debtors especially they find the collateral for restructuring credits. This asymmetrical information would also throw off the balance of financial market and prevent KGF from reaching its goals because of adverse selection. Moral hazard is the other problem occurring after financial transaction. It is the risk that borrower may engage in any undesirable and risky activity beyond the lender's knowledge which would reduce the likelihood of repayment of the loan.[10]

Starting with examining credit guarantee institutions, this work carries out its analysis with theoretical framework by using time based and country based data, most of them specific to Turkey. BDDK and KGF's own sources are mainly used in order to make clear the changes on the given guarantee ratios, non-performing loans and the budget allocated to measure the efficiency of KGF. The literature on asymmetrical information problem was surveyed to make clear the difficulties in financial sector. Despite Adam Smith's indivisible hand, Akerlof's adverse selection and moral hazard theories show the market's irregular functioning. These theories get used to explain how credit guarantee fund would be tricked and why it would not be successful to attain its main aims. As a result, collected data and literature reviewed indicate the socialization of the losses because financial sector fails.

10 Yiğitbaş, Şehnaz Bakır. "Banka Kredilerinde Ters Seçim ve Ahlaki Tehlike Etkisi." (2015.

2

The Emergence of the Credit Guarantee Schemes

Credit guarantee programs date back to the 19th century. The first guarantee schemes were founded in Belgium and France in 1840s.[1] Guarantee programs supported by the government have an important role in the restructuring of the economy in Europe after the World War II, particularly in Germany and Holland.[2] In addition, the ways in order to reduce the credit default risk addressed in Basel II Accord, contributed to the global expansion of credit guarantee institutions.[3]

Credit Guarantee Funds work as collateral giving institutions and their initial aim is to support small and medium enterprises which are not seen as appropriate borrowers by the banks due to low corporate credit rating or lack of collateral. These funds take the credit risk via providing joint guaranty to firms when they apply for credit. The guarantee program pays to the lender

1 Tunahan, Hakan, and Ahmet Selçuk Dizkırıcı. "Evaluating the Credit Guarantee Fund (KGF of Turkey as a Partial Guarantee Program in the Light of International Practices." International Journal of Business and Social Science 3.10 (2012.

2 Deelen, Linda, and Klaas Molenaar. "Guarantee Funds for Small Enterprises A Manual for Guarantee Fund Managers." (2004.

3 Cardone Riportella, Clara, Antonio Trujillo Ponce, and Maria José Casasola. "Credit Risk Mitigation and SMEs Bank Financing In Basel II: The Case of the Loan Guarantee Associations." (2008.

the amount of risk taken during the crediting process in case of default of debtor.

§ 2.1 The Process of Credit Giving and the Role of Credit Guarantee Funds

The terms of credit refer to a mix of three factors involving the period of credit, cash discount, and the type of credit instrument used. First, the credit period is the time frame between sales and payment, and this varies among different industries and the types of goods sold. Where setting a credit period, a lender must consider the probability that the customer may not pay at due the date, the size of the account in order to allow a smaller account for a shorter credit period and vice versa.[4] Regarding to this risk, degree of the durability of collateral presented as security also matters when deciding the maturity. Secondly, a cash discount is often allowed as part of the terms of credit, and the reason for offering the rebate is to speed-up the collection of receivables. Banks often find that they cannot receive payments timely from their borrowers. A study shows that if the loan maturity is 30 days, the money come on average 45 days after the invoice date.[5] Lastly, credit sales instrument is usually the invoice. A seller issues an invoice to customer to sign as a proof that the goods have been received.

Credit information analysis and scoring are various sources of information for deciding on the credibility of a prospective customer which affects the loans given to the customer.[6] The information that is often used to assess the credibility of customers includes the financial statements of the prospec-

4 Dunn Jr, J. Thomas. "Loan Modifications: Turbulent Times-Troublesome Topics." NC Banking Inst. 13 (2009: 197

5 https://www.accountingcoach.com/accounts-receivable-and-bad-debts -expense/explanation/2, accessed on 02.06.2019

6 Jibrin, Musa Success, M. S. K. Ifurueze, and Success Blessing Ejura. "The Impact of Effective Management of Credit Sales on Profitability and Liquidity of Food and Beverage Industries in Nigeria." Global Journal of Management And Business Research(2013.

tive customer. This allows the seller to perform a rate analysis. The other information required for credit reports of commercial customers is the customer's payment history, the size of the customer's valuable assets, at least three commercial credit references, all details of all managers, partners, or owners.[7] According to this information collected, either granting or refusing the loan is chosen. Jibrin describes the main criteria for assessing credit risk based on the "5Cs" of credit, which are character, capacity, capital, collateral, and condition. [8]

Character expresses the willingness of the customer to fulfill his/her credit obligations. Capacity indicates the ability of the customer to pay his/her debts through non-current cash flows. Capital is measured by the general financial ratio analysis and special attention is given to the risk ratios such as debt/ assets ratios, current ratio, and interest earned ratio.[9] This demonstrates the adequacy of the customer's capital. Moreover, collateral represents the assets pledged for the loan offered by the customers. Its quality and amount would help the customer assessed as qualified for credit and help give the customer a higher amount of credit. The last part of 5C, the condition refers to the economic and other national conditions that may affect the customer's payment capacity. Adverse economic conditions can influence the customer's ability or willingness to pay the debt at the time.[10]

§ 2.2 The Principles of Credit Guarantee Schemes

Credit Guarantee Schemes in the world have got 16 main principles and they are determined by World Bank as below:

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7 Adebayo, E. A., et al. "Analysis of The Role of Creativity and Innovation in Entrepreneurship." Theme: "Entrepreneurship and the Knowledge Economy" (2017: 388.

8 Jibrin, Musa Success, M. S. K. Ifurueze, and Success Blessing Ejura. "The Impact of Effective Management of Credit Sales on Profitability and Liquidity of Food and Beverage Industries in Nigeria." Global Journal of Management And Business Research(2013.

9 Okpala, Kenneth Enoch, Chinsunum Osanebi, and Ademola Irinyemi. "The Impact Of Credit Management Strategies On Liquidity and Profitability." Journal of Behavioural Studies 1.1 (2019.

10 Ofoegbu, Grace N., and Vincent A. Onodugo. "Liquidity Management and Profit Performance of Pharmaceutical Manufacturing Firms Listed in Nigeria Stock Exchange." (2016.

1 The CGS should be established as an independent legal entity on the basis of a sound and clearly defined legal and regulatory framework to support the effective implementation of the CGS's operations and the achievement of its policy objectives.
2 The CGS should have adequate funding to achieve its policy objectives, and the sources of funding, including any reliance on explicit and implicit subsidies, should be transparent and publicly disclosed.
3 The legal and regulatory framework should promote mixed ownership of the CGS, ensuring equitable treatment of minority shareholders.
4 The CGS should be independently and effectively supervised on the basis of risk-proportionate regulation scaled by the products and services offered.
5 The CGS should have a clearly defined mandate supported by strategies and operational goals consistent with policy objectives.
6 The CGS should have a sound corporate governance structure with an independent and competent board of directors appointed according to clearly defined criteria.
7 The CGS should have a sound internal control framework to safeguard the integrity and efficiency of its governance and operations.
8 The CGS should have an effective and comprehensive enterprise risk management framework that identifies, assesses, and manages the risks related to CGS operations.
9 The CGS should adopt clearly defined and transparent eligibility and qualification criteria for SMEs, lenders, and credit instruments.
10 The CGS's guarantee delivery approach should appropriately reflect a trade-off between outreach, additionality, and financial sustainability, taking into account the level of financial sector development of the country.
11 The guarantees issued by the CGS should be partial, thus providing the right incentives for SME borrowers and lenders, and should be designed to ensure compliance with the relevant prudential requirements for lenders, in particular with capital requirements for credit risk.
12 The CGS should adopt a transparent and consistent risk-based pricing policy to ensure that the guarantee program is financially sustainable and attractive for both SMEs and lenders.

13 The claim management process should be efficient, clearly documented, and transparent, providing incentives for loan loss recovery, and should align with the home country's legal and regulatory framework.

14 The CGS should be subject to rigorous financial reporting requirements and should have its financial statements audited externally.

15 The CGS should periodically and publicly disclose nonfinancial information related to its operations.

16 The performance of the CGS—in particular its outreach, additionality, and financial sustainability—should be systematically and periodically evaluated, and the findings from the evaluation publicly disclosed.[11]

§ 2.3 Credit Guarantee Funds in Other Countries

The credit guarantee funds, whose examples date back to 1948, have been on the rise after the dissolution of the USSR in 1991 in order to encourage the unemployed entrepreneurs to establish their own businesses and create new jobs for the others who were vacated with the wave of privatization and new capitalism.[12]

Credit guarantee systems are the structures that undertake the risk imposed to the banks by paying all or a certain percentage of the loans used by the enterprises. These systems often assume a certain percentage of credit risk and share the risk with financial institutions. It is established in order to provide enterprises access to loans. These enterprises have a profitable project and / or growth potential but do not have sufficient loan collateral or have no financial background to prove their credit worthiness. The credit guarantee system in the world market differs according to the world economic, social and legal structures. Particularly in large and developed countries, there are more than one credit guarantee structure and these structures have many regional

11 The World Bank and First Initiative (2015, Principles for Public Credit Guarantee Schemes for SMEs. Washington, DC: World Bank. p.10-11

12 Zerenler, Muammer, and Süleyman Bayındır. "KOBİ Kredileri Ve Kefalet Destekleri Kredi Garanti Fonu AŞ Örneği." (2011.

organizations or branches. While most credit guarantee systems target all sectors, there are also those that focus on specific sectors or business groups.

These schemes provide an opportunity for banks to share their credit risks with the state-funded schemes. Therefore, if the debtor defaults, the scheme takes the repayment responsibility of a prespecified percentage of the principal risk that is determined on the credit agreement.[13] Such public interference programs vary all around the world based on their pricing; risk evaluation and risk management exercises; on the role of government; on the criteria for lending; eligibility for borrowing; on the surety proportion; on the dissemination of losses between the lender and the guarantor considering probability of default; and on the sectorial and geographical impediments that are generally interested.[14]

In Credit Guarantee Schemes, the guarantor should accept sufficient amount of risk in order to persuade banks for their participation in the scheme. In this scope, when some countries accept 100 percent coverage such as Japan, the others do not lean towards fully extent guarantee. A 2008 World Bank survey that found 40 percent out of 76 schemes in 46 developed and developing countries offers full coverage.[15] However, this may lead to a higher moral hazard in parallel with higher risk taken. It makes not only the strategic default option of borrowers more, but also incentives of banks lower for the proper assessing and monitoring of risk. [16]

According to OECD 2019 report, new SME loans positively changed in 13 out of 24 countries, including which had undergone a decline in the previous year, countries like Canada, Chile, Colombia, Denmark, Greece, Luxembourg and the Russian Federation. In 10 countries, new SME lending seems negative in 2017, often in continuation with negative progress undergone in 2016, like in Australia, Brazil, Portugal and the US. In Kazakhstan, Latvia and Malaysia,

13 Beck, Thorsten, Leora F. Klapper, and Juan Carlos Mendoza. The Typology of Partial Credit Guarantee Funds Around the World. The World Bank, 2008.

14 İbid.

15 World Bank, 2008.

16 Report of the 11th Meeting of the Comesa Monetary and Exchange Rates Policies, 2013.

new SME loan growth becomes negative in 2017, after strong growth in the previous year (see figure 2.1. [17]

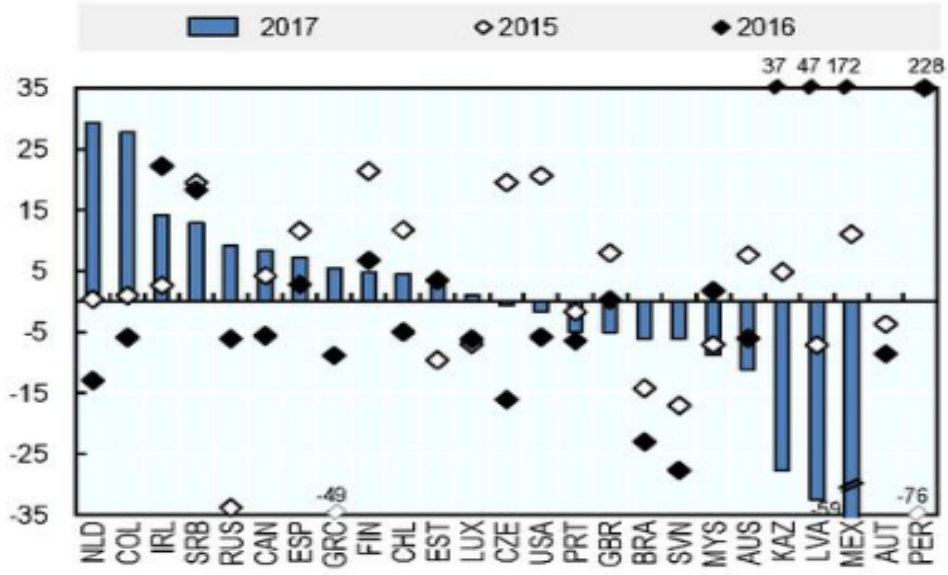


Figure 2.1 Growth in New SME Lending. OECD, Financing SMEs and Entrepreneurs 2019

The collateral requirements for SMEs in the world tend to be higher according to the investigation of OECD (see figure 2.2. Out of the 17 countries that provided 2016 and 2017 data, 7 countries have undergone a decline in collateral requirements. In Canada, Greece, Hungary, Ireland and Poland guarantee requirement decreased substantially. However, it can be seen that Serbia, UK and Netherlands have the strongest increase in collateral requirements.

17 OECD, "Financing SMEs and Entrepreneurs 2019: An OECD Scoreboard", OECD Publishing, Paris (2019. https://doi.org/10.1787 /fin_sme_ent-2019-en.

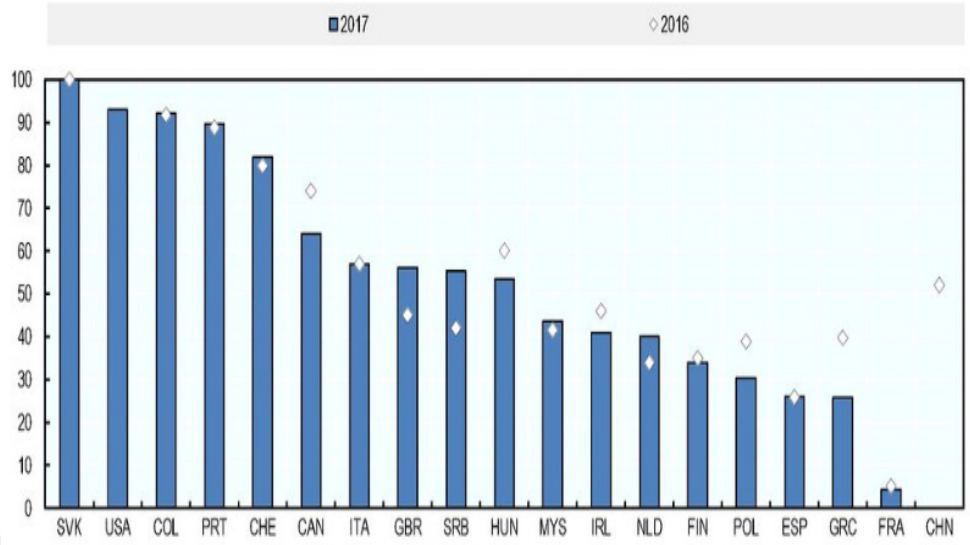


Figure 2.2 Share of SME Bank Loans Requiring Collateral. OECD, Financing SMEs and Entrepreneurs 2019.

2.3.1 *Types of the Guarantee Schemes*

As Green underlined that there are four major types of guarantee funds in the World. These are public guarantee schemes, corporate funds, international schemes and mutual guarantee associations[18] as explained below:

2.3.1.1 Public Guarantee Schemes

Public policy is the foundation of Public Guarantee Schemes. They usually include state subsidies, especially in the first place. In general sense, a private organization or an administrative unit of the government manage such schemes. One of the most significant advantages of this scheme is the government budget that is the source of payment for the guarantee in case of loan default. This provides a higher credibility to the scheme within the banking sector.

18 Green, Anke. "Credit Guarantee Schemes for Small Enterprises: An Effective Instrument to Promote Private Sector-Led Growth?" SME Technical Working Paper No. 10, UNIDO, Vienna, Austria. (2003.

2.3.1.2 Corporate Guarantee Scheme

Schemes that are most commonly financed and managed by the organizations from private sector like chambers and banks are called Corporate Guarantee Schemes which make it possible to be managed by experienced and eligible corporate leaders, and usually take advantage of the direct involvement of the banking sector.

2.3.1.3 International Schemes

These are the schemes that depend to the initiatives of bilateral or multilateral government or Non-Governmental Organizations, like European Investment Fund (EIF, International Labor Organization (ILO and the United Nations Industrial Development Organization (UNIDO . In general, a guarantee fund for technical aid is incorporated with firms by means of international schemes.

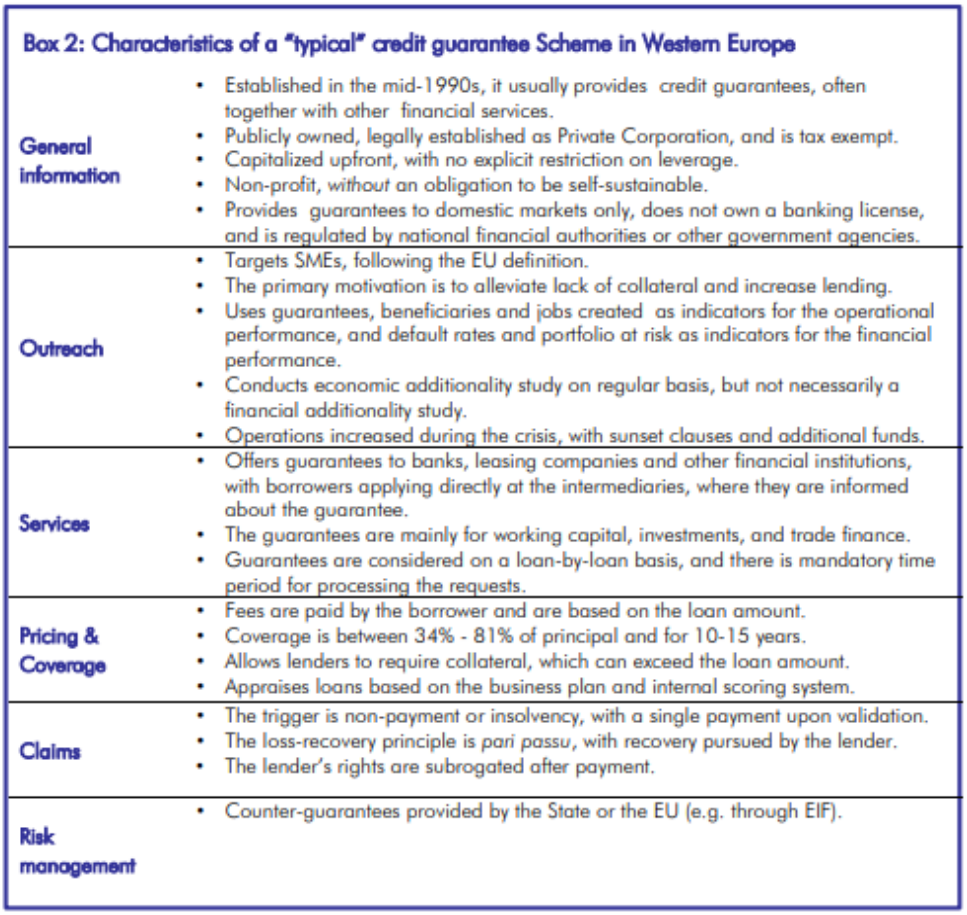
2.3.1.4 Mutual Guarantee Schemes

Mutual guarantee schemes are also referred to mutual guarantee associations, societies or funds. Such private and independent organizations are set up and directed by borrowers who have limited access to bank sources. In most cases, such organizations are supported by some forms of government even if they also benefit from some facilities such as membership fees, etc. Mutual guarantee schemes take advantage of the active inclusion and experience of their members.

The experiment of 76 guarantee schemes that was done by World Bank in 2008 reveals that mutual guarantee funds are likely to run in high-income countries, whereas public guarantee funds have been in place mostly in middle and low-income countries.[19] On the other hand, the report also illustrated that public schemes are, averagely, newer than mutual funds and they are likely to operate in emerging markets with a high degree of possibility. Moreover, mutual guarantee schemes are disposed to be more sustainable in terms of finance thanks to the ownership and participation of their members.

19 OECD, "Facilitating Access to Finance: Discussion Paper on Credit Guarantee Schemes", OECD Publishing, Paris (2010.

In Western Europe, there are some common characteristics of credit guarantee schemes which are shown in figure 2.3. Then, some selected countries are specifically examined in terms of their credit guarantee schemes both from Europe and Asia as well as America.



Box 2: Characteristics of a "typical" credit guarantee Scheme in Western Europe

General information	• Established in the mid-1990s, it usually provides credit guarantees, often together with other financial services. • Publicly owned, legally established as Private Corporation, and is tax exempt. • Capitalized upfront, with no explicit restriction on leverage. • Non-profit, *without* an obligation to be self-sustainable. • Provides guarantees to domestic markets only, does not own a banking license, and is regulated by national financial authorities or other government agencies.
Outreach	• Targets SMEs, following the EU definition. • The primary motivation is to alleviate lack of collateral and increase lending. • Uses guarantees, beneficiaries and jobs created as indicators for the operational performance, and default rates and portfolio at risk as indicators for the financial performance. • Conducts economic additionality study on regular basis, but not necessarily a financial additionality study. • Operations increased during the crisis, with sunset clauses and additional funds.
Services	• Offers guarantees to banks, leasing companies and other financial institutions, with borrowers applying directly at the intermediaries, where they are informed about the guarantee. • The guarantees are mainly for working capital, investments, and trade finance. • Guarantees are considered on a loan-by-loan basis, and there is mandatory time period for processing the requests.
Pricing & Coverage	• Fees are paid by the borrower and are based on the loan amount. • Coverage is between 34% - 81% of principal and for 10-15 years. • Allows lenders to require collateral, which can exceed the loan amount. • Appraises loans based on the business plan and internal scoring system.
Claims	• The trigger is non-payment or insolvency, with a single payment upon validation. • The loss-recovery principle is *pari passu*, with recovery pursued by the lender. • The lender's rights are subrogated after payment.
Risk management	• Counter-guarantees provided by the State or the EU (e.g. through EIF).

Figure 2.3 The General Characteristics of the Credit Guarantee Scheme in Western Europe. EIF.

2.3.2 *Credit Guarantee Schemes in Germany*

The Association of German Guarantee Banks (VDB which is a member of the European Association of Guarantee Institutions (AECM has been a guaran-

tor for the loans and venture capital that SMEs will use from banks in Germany for 50 years.[20] It was first established in the Federal Republic of Germany after the World War II to recover post-war wounds. The aim was that no economic project would fail due to insufficient collateral. Since its beginning, its equity has been met by various trade associations, insurance companies, chambers of commerce, industry federation, banks union and other economic associations. For this reason, VDB is considered self-sufficient in the private sector. It is organized as a top institution of the Surety Banks existing in Germany.

In the 70s and 80s, credit guarantee companies were regrouped and a single guarantee bank was established for the federal state. These organizations have banking license. Areas of activity of each organization are in the federative state.[21] 39 percent of these organizations were guaranteed by the federal government and of 26 percent by the state administration. This fact helps to solve all the problems faced by SMEs and professionals in all sectors of the economy in the financial world. Not only new entrepreneurs but also existing companies are supported. This includes government-funded programs as well as traditional credit and loan financing.

Credit Guarantee Fund Inc. in Turkey have been used in practice in Germany. In Germany, the state participates in the risk of credit guarantee institutions at 65-80 percent by the method of reciprocal bail which means that the state provides a certain amount of guarantee which is granted via credit guarantee institution without putting cash money. Payment by the state will only be made if the banks recourse to the credit guarantee organization in case the borrower does not repay its debt. This situation arises when the bail debt becomes due. This system increases the confidence of credit guarantee organizations and increases the volume of business and provides collateral to more

20 KKTC Kredi Garanti Fonu official website, http://www.kgf.gov.ct.tr/node/23 accessed on 12.05.2019

21 Önkol, Gamze, and Guray Küçükocaoğlu. "Türkiye'deki Kredi Garanti Fonu AŞ'nin Kefalet Hacminin ve İşlerliğinin Arttırılabilmesi İçin Yapılabilecekler." 13. Uluslararası Muhasebe Konferansı. 2016.

SMEs. The longest maturity is 23 years for the guarantee when the average maturity is 10 years whereas maximum limit is 1.25 million Euros per company in 2018 according to Association of German guarantee banks' official website.[22] Just like in Turkey, credit guarantee funds are the organizations of SME Professional Organizations in Germany while they are supported by the state. 51 percent of the capital is established by professional institutions when 49 percent by banks, savings funds and insurance companies. In addition, the banks structured as guarantee banks have more privileged positions than deposit banks. For example, credit guarantee funds in Germany have been granted a full tax exemption and the state provides reciprocal guarantee up to 80 percent.

2.3.3 *Credit Guarantee Schemes in South Korea*

In South Korea, the foundations of the credit guarantee fund system were started with the establishment of a fund in 1961, and significant developments took place in the following years. KODIT (Korea Credit and KIBO (Kisul Bojiung are the main credit guarantee agencies in South Korea. The Korean Credit Guarantee Fund (KODIT is a public fi nancial institution which founded on 1 June 1976 with the Korean Credit Guarantee Fund Act and subject to the Ministry of Economy. The commission rate varies from 0.5 to 3 percent. The guarantee rate varies from 50 percent to 80 percent.

KIBO started its activities as a unit of KODIT in 1986, and in 1989 it became an independent institution. KIBO provides guarantees to SMEs operating in innovative and technology intensive sectors. These enterprises are mostly SMEs that have been operating for less than 5 years and are involved in sectors such as innovative and / or information technology, nanotechnology, biotechnology, space technology. KODIT provides:

- Credit Guarantee Service: General surety makes it easier for SMEs to receive funding from banks or other financial institutions.
- Payment Based Capital Investment: By investing directly in SMEs using surety, the funds provide the long term sustainability.

22 https://www.vdb-info.de/, accessed on 05.09.2019.

- Management Consulting: Within the scope of improving the competitiveness and increasing the productivity of SMEs, management consultancy and evaluation services are provided.
- Credit Insurance: The Company provides services to cover the losses of SMEs due to the risks of non-payment of commercial invoices or receivables and the impact of bankruptcy on the public.
- Infrastructure Credit Guarantee: Korea Infrastructure Credit Guarantee Fund was established in 1994. It makes it possible for contractor companies to directly benefit from bail. Guarantees of loans or debt securities are provided within the scope of the financing of private sector investors or private sector project firms in government planned infrastructure projects.

When the Korean economy has been growing expeditiously the fund has issued many credit guarantees. In the late 1990s, Korea underwent a serious economic depression. In this process, the fund did not give up distributing bails as a tactic to skip normalization process easily. Therefore, the default rate has become higher which has not been decreased much. Since the early 2000s, the economy has been developing and the fund abandoned the focus on credit portfolio. Instead of quantity, it is making effort to enhance the quality of the portfolio.[23]

2.3.4 *Credit Guarantee Schemes in China*

There is no centralized government agency in China that provides credit guarantees to SMEs. As a result, by the end of 2005, only 2.6 percent of SMEs in China were guaranteed. However, in China, there are approximately 3,000 local guarantee companies. The first professional bail organization was established in 1993. Since then, the credit guarantee sector has grown rapidly.

The number of guarantee companies was 203 in 2000 whereas it was 2,914 in 2005. These organizations operate at provincial or urban level. Two thirds of these are private and the rest are local administrations. SME, mortgage and export financing loans by bail agencies in China are provided with surety services. But the most important guarantees among these three are the guarantees

23 World Bank Partial Credit Guarantee Schemes Conference, 2008.

given to SME loans. Despite the rapid growth and proliferation of credit guarantee agencies, the majority of these companies are insufficient and they are in a difficult position because of the funds and losses they incur.

2.3.5 *Credit Guarantee Schemes in England*

Business, Enterprise and Regulatory Reform (BERR is the state department of the United Kingdom.[24] It was established on 28 June 2007 after the separation of the Department of Commerce and Industry. This unit continues to work on legislative arrangements in order to increase productivity in the British economy. BERR also aims to increase the domestic investments through the implementation and development of trade policy in order to improve the economic performance of the regions and it carries out common activities with DIUS (Department for Innovation, Universities and Skills which aims to make the UK one of the best centers of science, research and development, and innovation in the world. Through BERR, SMEs that play an important role in increasing productivity, strengthening competition and innovation, and increasing employment are supported. SMEs are seen as the basis of the British economy. As in many countries, the Credit Surety System is used in the UK to provide solutions to the collateral problem of SMEs. For this aim, the SME Credit Guarantee Fund (SCGF was established in the UK in 1981 and has been shaped by changes in the economy and political priorities over the years. SCGF is an institution established by British government to provide the state guarantee granted to the lending firms, which do not have the assets to provide insurance, against the risk of default in order to implement the projects of SMEs. By SCGF, the financier is provided with 75 percent guarantee of the loan. The upper limit is £ 250,000 and the maturity is up to 10 years for the guarantee in British Credit Guarantee Fund System.

Small Firms Loan Guarantee Scheme (SFLGS is one of the 25 financier institutions among SCGF. SFLGS eliminates the collateral problem by providing government guarantees for the loans to be used. Banks involved in SFLGS

24 KKTC Kredi Garanti Fonu official website, http://www.kgf.gov.ct.tr/node/23 accessed on 12.05.2019.

and approved by BERR manage compliance criteria. The Bank receives 2 percent commission for bail, which is charged quarterly.

2.3.6 *Credit Guarantee Schemes in the U.S.A*

In 1953, the SBA (U.S. Small Business Administration was established as an independent agency to advise the federal government to support small-scale firms for the purpose of protecting their interests. SBA supports that the traditional credit market cannot address small-scale firms. Therefore, it offers bail for SMEs securities, debt financing and equity financing.

SBA does not directly lend to SMEs. Instead, it receives applications from the banks, development agencies and micro-credit institutions. Businesses apply to SBA's partners first for a loan. If the partners see a guarantee gap, the partners apply to SBA.

2.3.6.1 Guaranteed Credit Programs

CDC/504 CREDIT PROGRAM

CDC / 504 credit program is not short term based and concentrate on the economic development in long run. This program offers long term and fixed interest financing to grow and purchase the big real estates. Depending on project size, 50 percent of the project cost is guaranteed by the lender and 40 percent by the SBA. The remaining 10 percent is borne by the entity. Usually in this program purchase or modernization of securities; street improvements; public services, parking and environmental regulations; long-term purchases of machinery and equipment appear in.

MICRO CREDIT PROGRAM

This program is usually used in places like a nonprofit child development centers. It uses for operating capital needs or for asset purchases.

DISASTER RELIEF PROGRAMME

In this kind of program, loans are granted in the disaster-affected home to repair or replace the loss-bearing assets of their owners with low interest rate.

2.3.7 *Credit Guarantee Schemes in Canada*

The first credit guarantee scheme, Canadian Small Business Financing Program (CSBF, was founded by t he Small Business Loans Act (SBLA in Canada in 1961. Portfolio Management is the main basis of CSBF. Lenders have a leading role in the approval of entire process of credit and guarantee. Approximately 10,000 credits which value exceeding 1 billion CAD are given by this program every year. Thanks to this fund, any single enterprises can be subsidized up to 500,000 Canadian dollars.

A 2001 report by Riding and Haines indicated the proportion of loans in default based on age of loan in three countries which are Canada, England and the USA (figure 2.4.

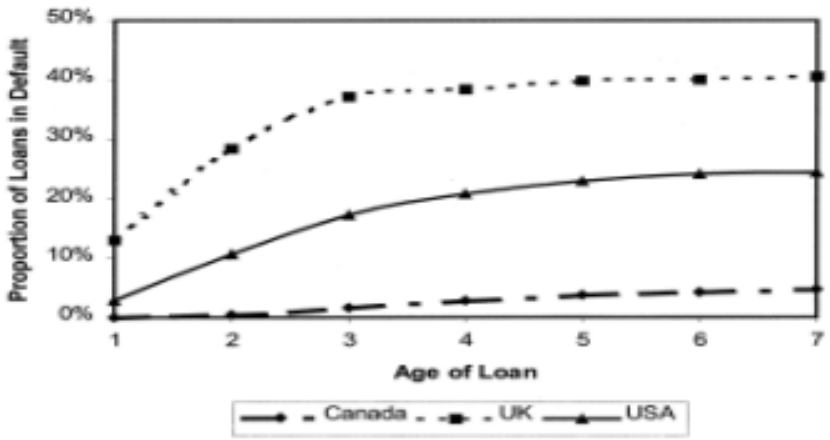


Figure 2.4 Loan Default Rates: Comparison of Canadian, English and American Credit Guarantee Programs. Riding and Haines.

2.3.8 *Credit Guarantee Schemes in Japan*

One of the credit support organizations in Japan which is Small and Medium Sized Entrepreneurship Firm (JASMEC was established with 1953 Credit

Guarantee Union Law to facilitate SMEs' access to loans from financial institutions.[25] JASMEC operates independently to support local SMEs in their region in accordance with the conditions of that region, and to increase the effectiveness of the guarantee system. One of the most important goals of these institutions is to ensure economic development and to help SMEs improve their business by increasing their credit worthiness. The operation of the credit guarantee system in Japan consists of two stages:

2.3.8.1 Credit Guarantee Institutions

They are non-profit governmental organizations and provide guarantee for loans to SMEs given by financial institutions. In addition, they also provide information for SMEs, management and consulting services. Each organization has an independent structure and works to meet the needs of the region. Credit guarantee institutions undertake 80 percent of the credit risk.

2.3.8.2 Contract-Guarantee Providing Institution

Japan Finance Corporation (JFC initiates counter-guarantee support to the bails provided by Credit Guarantee Agencies. After the guarantee is confirmed by the Credit Guarantee Institutions and the loan is granted by the banks, the loan is insured directly by JFC. If the credit guarantee institution makes a payment under this guaranty, it can demand from 70 percent to 90 percent of this amount from JASMEC. Thanks to this system, the ability to pay off the debts of Credit Guarantee Institutions is protected and credit worthiness is strengthened.

In Japan, the credit guarantee system is an institution that works with credit insurance. The credit is automatically insured by JASMEC when the credit guarantee institution approves the guarantee and the credit is granted by the financial institution. For this insurance, the credit guarantee agency pays an annual insurance fee to JASME. Charges vary from 0.5 percent to 2.2 percent of the guarantee according to the

25 Üstün, Nazlı. Kredi Garanti Fonu: Dünyadaki Örnekler ve KOBİ'lere Sağladığı Destekler. Research Report. Konya Chamber of Commerce, Konya, 2016.

business risks which are taken. In conclusion, SMEs can apply not only directly to the credit guarantee system but also through financial institutions in Japan.

§ 2.4 Role of the Credit Guarantee Institutions on SMEs

According to Honohan, financial system requires some guarantor institutions to tackle with market problems[26]. Asymmetrical information is a problem faced by lenders due to lack of their ability to have as much information as borrowers. Firstly, guarantors are getting better to handle asymmetrical information problem by means of their ability to get more information while lenders are not able to have information at same level with former. The mutual guarantee program, therefore gains importance owing to the ownership of businesses. The second factor focused on a specific geographic area, the fact that guarantee programs have a diversified portfolio. This situation make easier for guarantor to mitigate the risk posed on them while lenders are not able to. The last one, the crediting process is made easier for borrowers by the guarantee programs because same regulatory requirements are not binding for them. The fact that those guarantee programs remove all the barriers faced by SMEs regarding the crediting process encourages them to get more involved in banking system and creditors tend to decrease interest rate for SMEs owing to improving relations between them.[27] The research done proved this argument by showing that 50 percent of the banks in the developed countries and 56 percent in the developing countries rely on the guarantee programs and consider them as the most effective and reliable initiative of the government

26 Honohan, Patrick. "Risk Management and the Costs of the Banking Crisis." National Institute Economic Review 206.1 (2008: 15-24.

27 Posey, Raymond L., and Alan K. Reichert. "Terms of Lending for Small Business Lines of Credit: The Role of Loan Guarantees." The International Journal of Business and Finance Research 5.1 (2011: 91-102.

to enable SMEs to get more involved in financial system rather than other economic initiatives of government.[28] However, credit guarantee programs might encounter some risks arising from lack of funds dedicated to the programs in the developing countries since financial sustainability is not well assured because of high default rates, high guarantee rates and low guarantee fees.[29]

In the literature, enabling "additional" loans for the purpose of ensuring the guarantee granted to the lender in the scope of credit guarantee programs is named "Additionality" which is considered the most effective criteria in order to analyze the effectiveness of the credit guarantee programs on economy and SMEs. "Additionality" can be classified as two different notions which are "Financial Additionality" and "Economic Additionality".[30] However, these types of additionalities are very hard to be measured due to the fact that there are also other factors which should be considered to thoroughly analyze the effect of credit guarantee programs on economy and the development of SMEs. Financial additionality, or in other words incrementalism, is used to define the loans which would not have been actually possible to be granted to the borrowers in the absence of the guarantee. In the concept of financial additionality, credit guarantee programs make it possible for the SMEs to be granted loans thanks to the guarantee provided to the lenders.[31] FUNDES Fund, which operates across Central and Southern America, made possible 90 percent additionality in 1995 by providing its guarantee to the lenders. [32] More-

28 Beck, Thorsten, Asli Demirgüç-Kunt, and MS Martinez Peria. "Bank Financing for SMEs around the World: Drivers." Obstacles, Business Models, and Lending Practices, World Bank Policy Research Working Paper Series 4785 (2008.

29 Zecchini, Salvatore, and Marco Ventura. "The Impact of Public Guarantees on Credit to SMEs." Small Business Economics 32.2 (2009: 191-206.

30 Gurmessa, Negussie Efa, and Catherine Ndinda. "The Role of Loan Guarantees in Alleviating Credit Constraints: Lessons for Smallholder Farmers Cooperatives." International Journal of Business and Social Science 5.5 (2014.p.146

31 Ibid.p.146

32 Levitsky, Jacob. "Credit Guarantee Schemes for SMEs–An International Review." Small Enterprise Development 8.2 (1997: 4-17.

over, Berger et al. illustrated that 75 percent additionality was granted by guarantee programs.[33] It can be said that within the scope of economic additionality, the fact that additional loans are supposed to help SMEs grow their businesses and create new business facilities helps countries to grow their economies and leads to economic benefits such as creating new job opportunities, sustaining economic development, promoting trade and increasing tax revenues of countries. In order to measure the effect of credit guarantee programs on countries' economies, the study of Schmidt and van Elkan can be utilized. In their study, it can be seen that 3.2 billion Euros were added to Germany's GDP thanks to German credit guarantee institutions, and these institutions created 12.900 new job vacancies, helped more than 9 thousand unemployed people find jobs and boosted financial revenue of the government by 670 million Euros on an annual basis.[34] Korean Credit Guarantee Institution (KODIT which is considered as the most successful and impo rtant existing credit guarantee institutions because of the fact that 10 percent of the total credits granted to private sector was initiated under its guarantee which means 15 percent of the credits for SMEs and 9 percent of the South Korean GDP. In addition to these facts, KODIT had a positive effect on the employment rate of South Korea by creating 86.795 new employments. It boosted tax revenue of the government by 167 million USD initiating the production increase in 2003.[35] SMEs are the business groups which are affected by economic crisis the most since they have a limited ability to access to financial resources during economic crisis. In this matter, credit guarantee programs play an important role in enabling SMEs to access to financial resources when there are

33 Berger, Allen N., W. Scott Frame, and Nathan H. Miller. "Credit Scoring and the Availability, Price, and Risk of Small Business Credit." Journal of Money, Credit and Banking (2005: 191-222.

34 Schmidt, Axel G., and Marco van Elkan. "Macroeconomic Benefits of German Guarantee Banks, Quantification of the Macroeconomic Effects of the Activities of German Guarantee Banks Under the Framework Conditions of the Global Financial and Economic Crisis." (2010.

35 Gwak, Sung-Chul, and Korea Credit Guarantee Fund. "Supporting SME Financing Through Credit Guarantee." Korea Credit Guarantee Fund (Kodit. http://www. afdc. org. cn/upload/18/downloads/KCGF. pdf (December 20th, 2011.

limited financial resources in the financial system. European Mutual Guarantee Association (AECM having 34 member guarantee institutions from 18 countries including Turkey can be considered as an example of the credit guarantee institution playing an effective role during economic crisis. It helped SMEs by granting 11.2 billion Euros under its guarantee between the end of 2008 and the beginning of 2009 which consisted of one third of its total guarantee operations at that time. Owing to its operations during the crisis, 120.000 SMEs were able to benefit from financial resources and more than 800 thousands of employees kept their jobs.[36] The share of the guarantees in GDPs of some developed and developing countries can be seen in table 2.1 and figure 2.5. When Italy draws the attention in Europe, the ratio is significantly higher in Asian developing countries such as South Korea and Taiwan.

Table 2.1 The Share of the Guarantees Given by Guarantee Programs in GDP in 2009

Country	The Share of the Guarantees in GDP (%)	Country	The Share of the Guarantees in GDP (%)
Canada	0,1	Italy	1,4
USA	0,2	France	0,4
South Korea	5	Hungary	1,9
Malaysia	1	Netherlands	0,2
Taiwan	3,5	Romania	0,4
India	0,1	Turkey	0,1

SOURCE Tunahan and Dizkırıcı, 2012.

36 European Mutual Guarantee Association (AECM. "Position Regarding the European Commission's Green Paper on Innovation – From Challenges to Opportunities: Towards a Common Strategic Framework for EU Research and Innovation(2011.

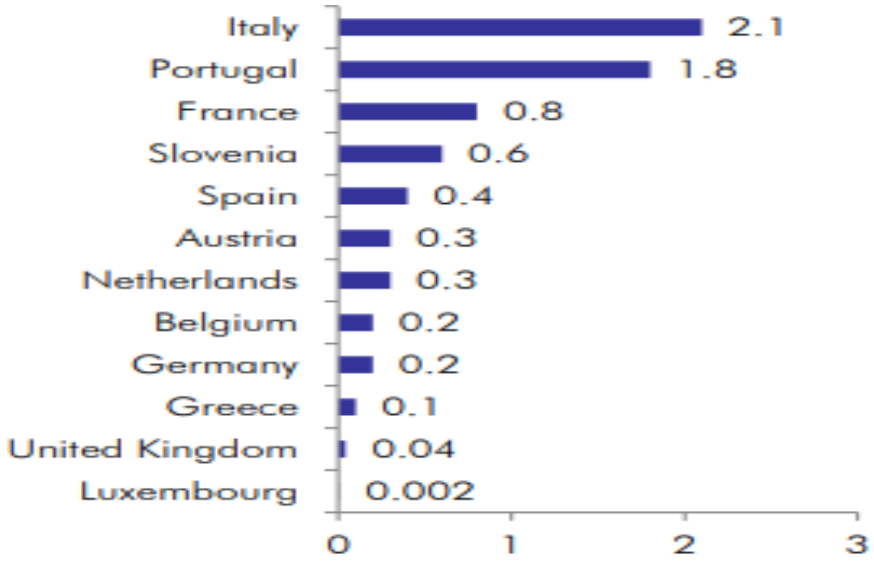


Figure 2.5 Outstanding Volumes of Credit Guarantees as a Percentage of GDP. EIF, 2017.

CGSs are an important pillar of financial intermediation in Western Europe. Credit guarantees are provided by national/local organizations and on a supranational level by the EIB Group, mainly through the EIF. Aggregate data on the activity of national/regional CGSs is collected by the AECM from their individual member organization. In the 18 countries covered by the EIB/EIF surveys, AECM has 21 member organizations in 12 countries. [37]

In 2015, the outstanding 2.03 million guarantee contracts in Western Europe represented a total value of EUR 68k. In terms of total amounts of guarantee activities, the core countries are Italy (33.6 thousand EUR, France (16.7 thousand EUR, Germany (5.6 thousand EUR and Spain (4.1 thousand EUR . Italy also accounts for half of the total number of outstanding guarantees (1.05 million EUR, followed by France (705. 000 EUR and Portu gal (89.000 EUR. Compared to the volume of economic activity, guarantees are the most important in Italy, Portugal and France. Figure 1 shows that in these countries, the guarantee coverage exceeds, or is close to 1 percent of the GDP. According

37 EIF. "Credit Guarantee Schemes for SME lending in Western Europe". EIF Research and Market Analysis:(2017: 42.

to the OECD , guarantees are most relevant "in those countries where a network of local or sectorial guarantee institutions is well-established".[38]

However, in the example of Turkey example, KGF guaranteed credits have been used for restructuring of risky, insolvent credits and the credits for which banks actually should start legal proceedings. With the guarantee institutions fed by the Treasury, implicitly by the taxes and public budget, the sunk credits have rendered liquid.[39]

I will explain why the increasing importance of small and medium size enterprises have gained importance in the world and in our country. First, SMEs are economic units that have started to attract attention after 1980s. With globalization, the basic structures of industrial society and the mixed economic structure were replaced by the market economy, the Fordist and Taylorist production was replaced by flexible production. In the globalization process, liberal philosophy became valid again that leads to the preference of the competitive free market economy in the world. As a result, the importance of SMEs has been increased instead of large-scale enterprises in new period. Market economy, in accordance with the logic of globalization, aims the lowest price and high quality of goods and services to produce. SMEs play an important role in the establishment and development of the market economy. Free market economy is an economy based on the phenomenon of competition and there must be no monopolies and oligopolies for competition. Therefore, an economy consisting of a large number of SMEs, as such, is an important element of the continuation of the functioning of the competitive market economy.

The second reason for the rise of SMEs is the changes in the organization of the business with globalization. Until the mid-1980s, while industrial societies needed to scale up to increase production, productivity and profitability, on the contrary, in post-industrial societies the scale had to be reduced to achieve the same goal. While large-scale enterprises dominated and succeeded

38 "SME and Entrepreneurship Financing: The Role of Credit Guarantee Schemes and Mutual Guarantee Societies in supporting finance for small and medium-sized enterprises". Final Report. CFE/SME(20121/FINAL. (2013

39 Aras, Güler, and Alövsat Müslümov. "Küreselleşme Sürecinde Türkiye Ekonomisinde KOBİ'lerin Yeri: Finansman, Ekonomik Sorunları ve Çözüm Önerileri." (2002.

in the economy prior to globalization, it was seen that small and medium-sized enterprises came into the agenda after this date, with the effect of changing conditions in the world. Small scale structure of small and medium sized enterprises has made it possible for them to easily adapt to transformation and to cope with crises more easily.

Third reason is that the Fordist – Taylorist process of production is now being replaced by a new process called flexible production. Flexible production is a strategy of anticipating future changes and adapting quickly to the new situation. In this process, there is no longer a need for large capital accumulation, large employment and large volume of physical investments in order to produce goods and services. Sufficient number and variety with lower costs for the demand in the market become more important than the former points. With a smaller capital, investment and workers, it is possible to produce quality, quantity, variety and price in accordance with market demands.

The other factor that makes SMEs brilliant is the role of SMEs in transition from economies of scale to economies of scope which is compatible with customer demands. Scale economies focus on decrease of costs with the increase of production when economies of scope prioritize the fall of expenditures with variety of products. The latter uses strategic advantage more than the former because it gives particular importance to demand when economies of scale prioritizes supply. As a result of the changing tendencies of consumers, the type of consumer demand has shifted from the standard goods and services towards private goods. Standard goods produced on the basis of mass production by large-scale economies have turned their direction towards individual-specific goods produced on the basis of flexible production by various economies. In other words, Fordist understanding of industrial societies to produce uniform, standard and mass goods is being replaced by small, high-tech, flexible enterprises based on a variety of economies. The mass production system of the scale economy has changed and it has been replaced by flexible production systems capable of producing very different products. The change has made SMEs the most appropriate type of business for the new economic structure. It is not expected that all the SMEs contribute to an economy at the same rate. Most of the SMEs in Turkey are traditional enterprises which

called as static SMEs. Only a smaller part of them is dynamic enterprises which are modern. The biggest difference between Turkish SMEs and SMEs in developed countries emerges especially in terms of investment, technology level, research and development, export and credit rates. There are financing, marketing and management problems of SMEs in Turkey.[40]

Until 1970s, SMEs generally operate on the basis of body strength and that they do not have qualified manpower, high technology and automation system. After 1970s, some SMEs were operating in the same sense, while one of them became highly advanced technology and qualified labor force. When the SMEs in Turkey are compared with the SMEs of the other countries, it is seen that there are very different points between them. The utmost difference of the SMEs in Turkey is the fact that they have a more traditional appearance. In Turkey, labor-intensive technologies are still preferred especially in micro-enterprises and back-tech machinery and equipment are also used intensively.

However, the type of enterprise that is primarily needed for economies is more aggressive, more ambitious, more innovative and technologically reconciled. Today, instead of traditional enterprises based on cheap labor and natural resources, enterprises based on knowledge and technology raise the countries to an advantageous position depending on the firms.

40 Civan, Mehmet, and Mehmet Tekinkuş. "Küçük ve Orta Boy İşletmelerin Avrupa Birliğine Uyum Süreci; Gaziantep Örneği." Erc/ODTÜ Uluslar arası Ekonomi Kongresi. VI. Bildiri Kitabı(2002.

3

The Credit Guarantee Scheme in Turkey

As can be seen in the previous chapter, credit guarantee schemes are advocated for many developed and developing countries through inducing unwilling lenders for loaning to customers of interest to governments and donors, such as agriculture, small farmers, women, microenterprises, and the poor.[1] İsmet Gergerli, CEO of Credit Guarantee Fund in Turkey, said that the state has to provide sufficient income for public services and provide the people with a generous means of subsistence, or rather, to be able to make their own livelihood. In this concept for Turkish economy and for the global economy small and medium sized businesses have great significance. When considered SMEs ratio in market in Turkey (99 percent of overall enterprises, 50 percent of added-value and 60 percent of overall export he argues that economic growth can be provided only if the power of SMEs is used properly on this way. He said that it is possible to capture the rapid change which the global system is experiencing only with the SMEs that are most prone to this change.[2]

According to 2019 OECD data, credit guarantee volumes increased in 16 out of 26 countries with some countries like China and Turkey experiencing a

1 Meyer, Richard L., and Geetha Nagarajan. "Evaluating Credit Guarantee Programs in Developing Countries." (1996.

2 Gergerli, İsmet. "Milletler KOBİ'leri Kadar Zengindir" 12.12.2016. https://www.dunya.com/kose-yazisi/milletler-kobileri-kadar-zengindir/341310, accessed on 13.03.2019.

strong expansion of these schemes in recent years. In Turkey, volumes were 40 times more in 2017 than in 2016. In other countries with more developed schemes, recent updates, for example with regard to eligibility criteria or the provision of complementary advisory services are more common. Figure 3.1 shows the outstanding volumes calculated as a percentage of GDP. Turkey has 7.6 percent, Japan has 4 percent and Korea has 3.8 percent where are the first 3 in the ranking (figure 3.1.

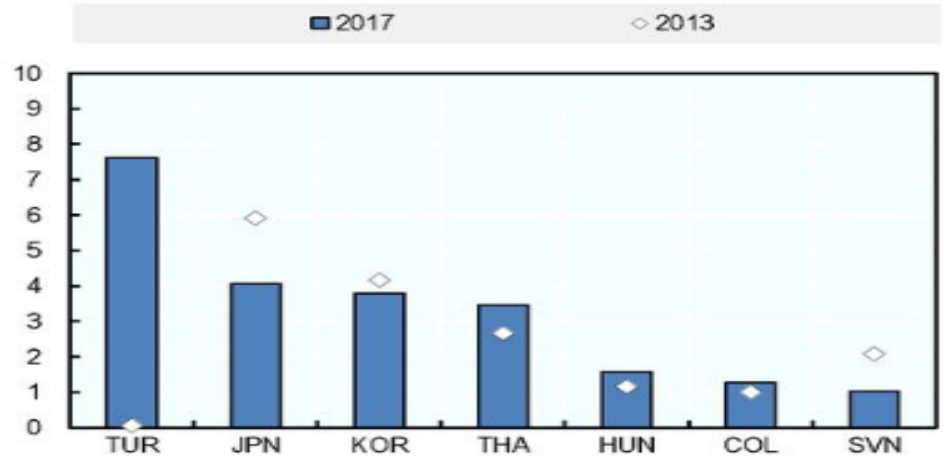


Figure 3.1 Share of Governmental Guarantees for Loans in GDP. OECD, Financing SMEs and Entrepreneurs,2019.

Based on this idea, Credit Guarantee Fund Management and Research Inc. was established in 1991 in the scope of "Project on Helping Establish a Credit Guarantee Fund for Small and Medium Sized Enterprises" within the framework of the technical cooperation agreement signed between Turkey and the Federal Republic of Germany in 1970 on the Small and Medium Business. Credit Guarantee Fund came into force in 14 July 1993 published in the official gazette.[3]

Because of the economic crisis in the Federal Republic of Germany which experienced with the Iraq crisis in 1991, Credit Guarantee Fund take a step with German support for the first source in order to encourage immigrant

3 Öndeş, Turan. "Kredi Garanti Fonu, İşleyişi ve Erzurum'daki Kimi Kobi'lerle Bu Konunun Bir Değerlendirmesi." Atatürk Üniversitesi İktisadi ve İdari Bilimler Dergisi 15.1-2 (2010.

Turkish people to return Turkey and reduce the number of potential immigrants who would migrate to Germany.[4] In this scope, the financing agreement was signed between the German Technical Cooperation Agency (GTZ and the Credit Guarantee Fund in December 1992 which is an evidential value for the preparation of the founding of KGF. Thus, giving collateral support and promoting entrepreneurs to create jobs were planned.[5]

Turkey has two loan guarantee programs created in order to encourage SMEs by going bail which are Center Association of Turkish Tradesmen and Artisans Credit and Bail Cooperatives (TESKOMB and The Credit Guarantee Fund Inc. (KGF. The most salient distinction between these structures is that KGF is established by public and professional organizations when TESKOMB is composed by businesses. The capital of the KGF in large part is funded by State Treasury while the artisans and tradesmen comprise all shareholding structure of the latter. Since TESKOMB is a mutual guarantee program working with full guarantee which takes on the entire risk of the credits, KGF is a non-mutual guarantee program that provides a partial guarantee.[6] KGF guarantee is generally 85 percent or 90 percent of the total amount of the credits. However, on KGF website, it is highlighted that credit guarantee activities are facilitated by only KGF in Turkey that helps SME and non-SME access to financial resources by grating guarantees to them[7]. Only Credit Guarantee Fund (KGF is analyzed in this chapter as the guarantee program in Turkey.

4 Kurnaz, Hikmet. "Kredi Garanti Fonu", https://www.istekobi.com.tr /kobi-bilgi-merkezi/sizin-icin arastirdik/kgf-genel-muduru-hikmet-kurnaz-s470.aspx ,accessed on 02.09.2019

5 Zerenler, Muammer, and Süleyman Bayındır. "KOBİ Kredileri Ve Kefalet Destekleri Kredi Garanti Fonu AŞ Örneği." (2011.

6 Tunahan, Hakan, and Ahmet Selçuk Dizkırıcı. "Evaluating the Credit Guarantee Fund (KGF of Turkey as a Partial Guarantee Program in the Light of International Practices." International Journal of Business and Social Science 3.10 (2012.

7 Kredi Garanti Fonu Information Center. http://www.kgf.com.tr/index. php/en/information-center/faqs, accessed on 9.6.2019.

§ 3.1 The Credit Guarantee Fund Inc.

Although there were several examples of credit guarantee programs seen in other countries, Federal Republic of Germany guided and shaped Joint credit guarantee system in Turkey for the purpose of putting a stop to immigration and getting the immigrants to go back to their home country owing to the impact of recession emerged in Western European countries in the aftermath of early 1970s' oil crisis. [8] Credit Guarantee Fund Incorporated Company was established in accordance with the decision of the Council of Ministers in 14 July 1993. It was promoted firstly by MEKSA (Foundation for the Promotion of Vocational Training and Small Industry, TOSYÖV (Foundation for Professionals and Executives of Turkish Medium Sized Businesses, TESK (Confederation of Turkish Tradesmen and Craftsmen. Then, KOSGEB (Small and Medium Enterprises Development Organization in 1995 and Türkiye Halk Bankası (Turkish Halk Bank Inc. in 1996 have also participated to its partnership structure.[9]

Then, many of Turkish banks also participated to its structure with equal shares (1.53 percent to increase its capital th rough banks as well. Now, 27 banks have got the partner status. The actual shares of the other institutions apart from the banks are shown in table 3.1:

Table 3.1 Shares of Institutions Among Credit Guarantee Fund

Partners	Share (%)
TOBB	29.16
KOSGEB	29.15
TESK	0.12
TOSYÖV	0.008
MEKSA	0.004

SOURCE Credit Guarantee Fund official website, https://www.kgf.com.tr/index.php/tr/

8 Ibid.

9 Tunahan, Hakan, and Ahmet Selçuk Dizkırıcı. "Evaluating the Credit Guarantee Fund (KGF of Turkey as a Partial Guarantee Program in the Light of Internatıonal Practıces." International Journal of Business and Social Science 3.10 (2012.

The main purpose of the establishment of The Credit Guarantee Fund (KGF was to help mainly small and medium-sized enterprises grow their business by granting them collateral and surety. Thus, through the bank loans in which SMEs use under the guarantee of KGF, they will be able to finance their investments, operations and projects. The more SMEs get involved in financial system thanks to KGF and it was expected to the more job opportunities created and the more tax revenue obtained, thus leading the country's economy to grow. KGF is working as a non-profit company with these motives. In parallel with these motives, on the European Guarantee Institutions' website the general goals of guarantee institutions are also listed as "Efficient operation of the credit market, SMEs' utilization of long term credits, strengthening of SME competitiveness, support innovation, a better income, support for innovation, a better income distribution and increase of employment."[10]

The guarantee from Credit Guarantee Fund can be provided via the Portfolio Guarantee System (PGS, where banks conduct credit evaluation or via the Portfolio Limit System, where the KGF does the evaluation internally. Banks are required to provide 80 percent of their KGF loans under the PGS system and 70 percent of these loans should be directed to SMEs. PLS is primarily used to grant commercial loans.[11]

In the year of 2007, the capital of KGF was boosted from 20 million Turkish Liras to 60 million in the aftermath of its transformation to "Credit Guarantee Fund Inc.". As mentioned earlier, KGF operates as a guarantor of SMEs in crediting process by mitigating banks' concerns arising from lack of collateral or assets of SMEs. Thus, the risk arising from granting loans to SMEs which have lack of collateral is shared between KGF and the banks. The guarantee ratio and its limit are changeable according to the source of the budget and type of the business. For the equity based SME guarantees, the guarantee is limited with 3 million Turkish Liras per enterprise while there is no option for non-SMEs from equity capital. On the other hand, if the budget is used from Treasury, SMEs can be pledged until 12 million Turkish Liras per company when non-SMEs have a chance to use maximum of 200 million Turkish

10 https://aecm.eu/kgf-credit-guarantee-fund/, accessed on 12.03.2019.

11 Global Securities Report. CGF Overview(2017.

Liras. The guaranteed percentage of the total credits cannot exceed 80 percent of the principal capital of the credit whereas it can be reach at 100 percent for exporter firms, in other words full coverage via Treasury. Depending on the need of businesses; KGF provides different types of guarantees. Apart from cash loans, KGF also provides guarantee for non-cash loans that SMEs need to cover the lack of collateral to finance their projects and operations. However, KGF does not provide guarantee for consumer loans, check-book loans and business credit cards. In order to satisfy the need of SMEs which need cash or non-cash loans in a foreign currency, guarantees in foreign-money are also given. Apart from the Treasury and its own equity, the budget for the guarantees is also supplied from the Turkish Section of Baku-Tbilisi-Ceyhan Pipeline Company (BTC Co. and European Investment Fund (EIF. KGF does not carry out a different fiscal investigation process for the guarantees based on Treasury. On the process, it investigates the bank guarantees bail requests in terms of value, and then examines the decision. On the other hand, for the bails based on its equity, the creditworthiness is investigated by the experts apart from the banks.

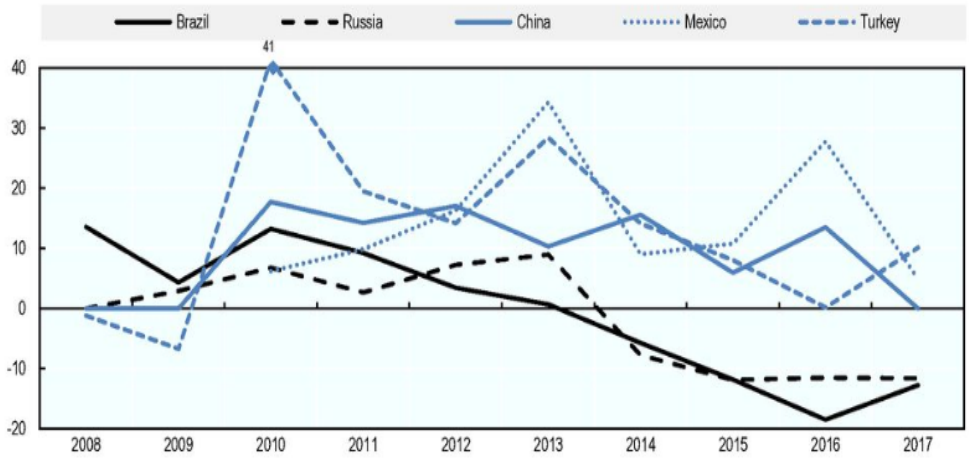


Figure 3.2 Growth Patterns in Stock of Outstanding SME Loans Based on Years. OECD, Financing SMEs and Entrepreneurs, 2019.

As can be seen in other examples around the world, guarantee institutions are supported by states because the services they ensure are seen as for the public good and the state try to make their image in the market better (see figure 3.2 .

Thus, KGF is excluded from some obligations such as stamp duty, corporate tax, and certain other fees and charges. Furthermore, in order to decrease the downsides of the 2008 global economic crisis on the SMEs, the amount of the funds given by the government is duplicated and reached to 2 billion Turkish Liras whereas the guarantee amount that KGF can provide was raised to 20 billion TL in 2015.[12] The resource amount from Treasury was improved to 25 billion Turkish Liras in 2017 and the guarantee amount was made 250 billion Turkish Liras which is more than ten times of the previous amount. The rapid increase in KGF loans between 2016 and 2017 can be seen in Figure 3.3.

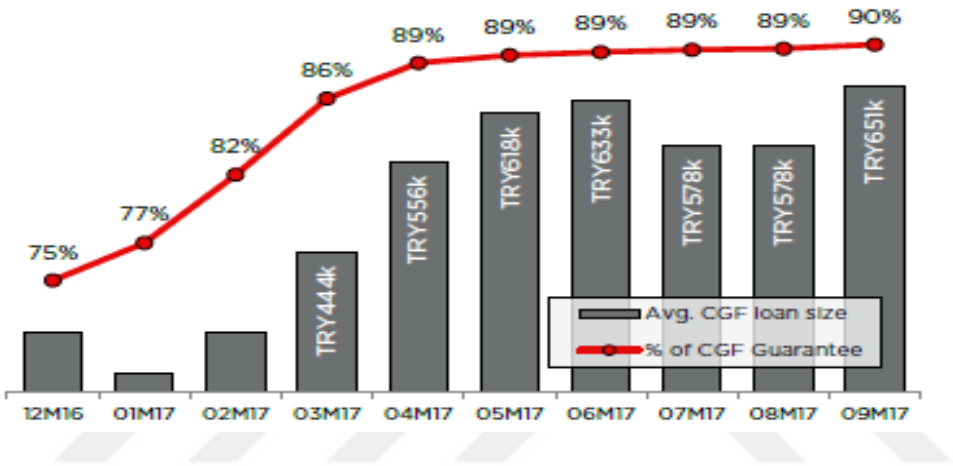


Figure 3.3 Average KGF Loans Size and Percentage of Guarantee. Global Securities Analysis, 2017.

SMEs are referred to small and medium sized enterprises engaging in any type of economic and commercial activities irrespective of their legal status. SME definitions vary from country to country, even in a variety in the country time to time. According to, the Law No. 5331 on the Additional Article to the Law on Organization and Duties of the Ministry of Industry and Trade dated to 12.04.2005 (published in Official Gazette on 16 April 2005 it is explained as principles of identification, qualification, classification and applications of small and medium-sized enterprises are determined by the Ministry and reg-

12 https://www.kgf .com.tr/index.php/tr/, accessed on 10.01.2019

ulations put into force by the Council of Ministers considering net sales proceeds, financial balance sheet amounts and number of employees. Small and medium-sized enterprises are called as SMEs. [13]

With the last update in June 2018, enterprises which have less than 250 employees all the year and less than 125 million Turkish Liras in annual net sales or assets are admitted as SMEs.[14] The threshold for the annual net sales or financial balance sheet number was 40 million TL until June 2018. Since that time, the limits for the definition of SMEs almost have tripled and issued on 24 June 2018 on official gazette. The shares of the SMEs in Turkish economy are shown in Figure3.4. Last data is seen for 2014 in TUIK.



Figure 3.4 SMEs Shares in Turkish Economy. TUİK, 2014.

Even though credit guarantee funds do not pertain to Turkey, its importance for Turkish economy appears in statesmen's discourse as well. Turkish old Prime Minister Binali Yıldırım stated: "When compared to worldwide KGFs, we moved up to the top by getting ahead of South Korea. Our credits with

13 Law No. 5331 on the Additional Article to the Law on Organization and Duties of the Ministry of Industry and Trade, 16.04.2005.

14 KGF Information Center, accessed on 01.02.2019

KGF are models for the World".[15] Moreover, Turkish President Recep Tayyip Erdoğan also said "In order to encourage our entrepreneurs, as of September, especially via KGF, we provided 220 billion TL credit support to 350k firms. As we always stated, we always stand by everyone producing, working, laboring, struggling, and we will continue to stand by" in his Turkish Academy Science prize-giving ceremony speech. [16]

The global financial crisis of 2008 had a very bad effect on the financial activities of SMEs, and therefore the need for financial support for SMEs broke out and economies went on a declining direction in many countries all around the world. In Turkey, KGF which had been passive for a long time was made active for the purpose of appeasing the bad effects of the global crisis on businesses. Turkish government supplied 1 billion Turkish Liras to KGF from Treasury aimed at satisfying the financial and collateral needs of SMEs which suffered from the global crisis due to lack of financial assets and collateral to facilitate their investments and operations. Financial resource of the Fund has been increased on Treasury and the description of SME is also changed to widen the scope of the guarantee schemes during this process. On my thesis, this topic will be evaluated in respect to the source of the Fund as a burden public carry on shoulders. My focus is on the socialization of the loss of the firms that they cannot pay back because willingly or not, public is all the guarantors of their credits implicitly. I concern with the contradiction that if the SMEs will use the credits for their investments and make profits, these profits will belong to its shareholders, on the other hand all the taxpayers will be responsible for their sunk credits.

15 "Dünya genelinde KGF'lerle kıyaslandığında Güney Kore'yi geçerek ilk sıraya yükseldik. KGF'li kredimiz dünyaya örnek."; http://www.hurriyet.com.tr /ekonomi/kgfli-kredimiz-dunyaya-ornek-40569213, accessed on 20 June 2019

16 "Girişimcilerimizin önünü açmak için özellikle Kredi Garanti Fonu aracılığıyla Eylül ayı itibarıyla 350 bin firmamıza 220 milyar lira kredi desteği sağladık. Her zaman ifade ettiğimiz gibi biz üreten, çalışan, emek veren, ter döken herkesin yanındayız, yanında olmayı sürdüreceğiz."; KGF 2017, Faaliyet Raporu.

§ 3.2 The Development of the Credit Guarantee Fund in Turkey

The actions have been taken to make KGF guarantee system more attractive. With the decision of Council of Ministers dated 10th March 2017, the source of KGF provided from the Public Treasury increased from 2 billion TL to 25 billion TL, the guarantee size expanded from 20 billion TL to 250 billion TL, the guarantee per SME increased from 3 million TL to 12 million TL. The guarantee ratios increased from 85 percent to 90 percent for SMEs, from 75 percent to 85 percent for non-SMEs, from 85 percent to 100 percent for exporters. In addition, the commissions received during the application for KGF guarantee decreased from 0.5-1.5 percent to 0.03 percent of a credit. Actually, Credit Guarantee Fund guarantee is suitable for the businesses which have creditworthiness but struggle with collateral problems.

In order to use credits with KGF guarantee; conditions such as the absence of overdue debt to the tax office and Social Security Institution of enterprises, and the absence of non-performing loans in the Turkey Central Bank records are required. Moreover, the validity of the official paper documenting about that there is no tax and insurance obligation was revalidated from 30 days to 90 days for the evaluation in guarantee process. With the cabinet degree dated 1st January 2018, it was decided that KGF guarantees would not be given to the illiquid loans as opposed to what happened in the past. Moreover, restructuring debt more than once and reapplication opportunity for the rejected credits by KGF are also possible. In this scope, 55 billion TL additional guarantee limit was formed of which 5 billion TL came from rejected credits in 2017. The distribution of this additional limit is shown in figure 3.5.

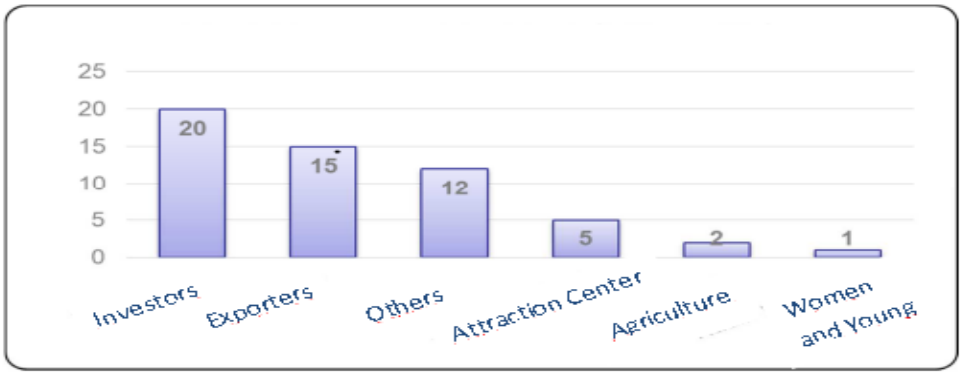


Figure 3.5 Distribution of Additional Guarantee Limit (Billion TL. BDDK, March 2018.

According to 01.01.2018 Cabinet Degree the guarantee ratios of Credit Guarantee Fund are:

- 85 percent for Investor SMEs, 80 percent for non-SMEs,
- 90 percent for the SMEs in the scope of Attraction Center Project, 85 percent for non-SMEs,
- 100 percent for SMEs and non-SMEs which are exporter or dealing with foreign exchange earning activities
- 85 percent for SMEs which are agricultural enterprises,
- 90 percent for women or young entrepreneurs,
- 80 percent for the other SMEs and 75 percent for the other non-SMEs.[17]

By the first quarter of 2018, total principal amount of the credits used with the KGF guarantee is 183 billion TL and these are given via 26 banks. Among this amount, 172,8 billion TL is cash credit while 10,2 billion TL is non-cash credits. On the basis of the customer, 210.297 different firms have benefited from KGF guaranteed credits with totally 358.406 credits given apart from the paid off ones and clear accounts.[18] Among these, 3.409 customers have totally 1.426 million TL non-performing loans. The concept of nonperforming loan (NPL refers to loans in default or close to default. A great risk is posed to banks in case of a nonperforming loan because the loan is most likely to be never paid

17 BDDK, March 2018, Annotation for the Development and Performance of KGF Credits.p.2

18 Ibid. p.3

in full. In the situation of no repayment done within 90 days or more, the credits are accepted as non-performing in general.

Table 3.2 Development of KGF Credits (March 2018

	Capital (Million TL)	Credit Amount	Number of Credits	Number of Customers
Cash KGF Credits	172.804	212.205	349.485	208.300
Performing Cash Credits	171.377	209.295	343.991	205.360
Non-Performing Cash Credits	1.426	2.910	5.494	3.409
Non-Cash KGF Credits	10.230	9.868	8.921	5.536
Cash+Non-Cash KGF Credits	183.034	222.073	358.406	210.297

SOURCE BDDK, March 2018, Annotation for the Development and Performance of KGF Credits.

The proportion of SME credits is higher than the non-SMEs among KGF – guaranteed loans. According to December 2017 statistics, rate of SMEs is 72.6 percent although it decreased to 68.6 percent in March 2018. Among SMEs incurring liability with KGF guarantee, exporters have just the share of 9.3 percent while this share rises up to the level of 38.8 percent among non-SMEs. The peak of KGF loan usage is the term of March-May 2017 with approximately 110 billion TL. After April 2017, the guarantee fund reached its limit so after this term gradually decrease has been observed. However, the loan usage began to increase again after 14th February 2018 as a result of a new KGF package with 50 billion TL amount.[19]

19 Ibid.p.3

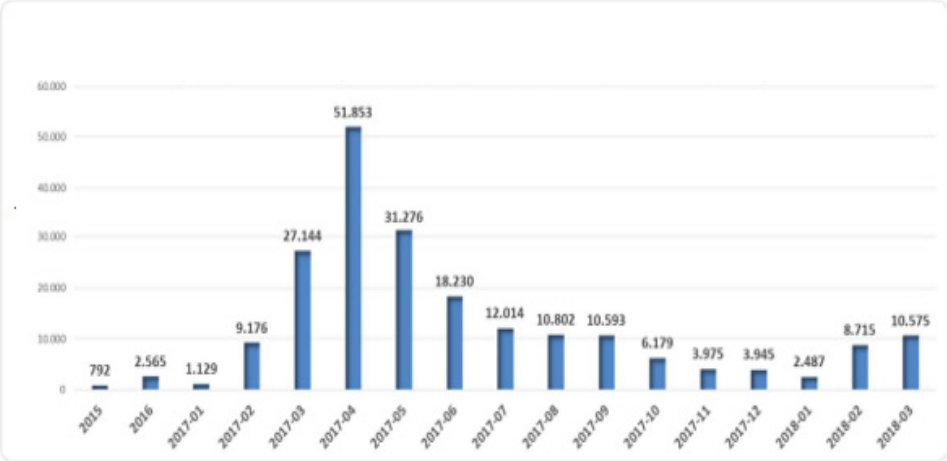


Figure 3.6 Periodical Changes in Supplied KGF Credits (Million TL. BDDK, March 2018, Annotation for the Development and Performance of KGF Credits.

Having lower interest rate than other commercial loans when there are no additional fees and commissions apart from mortgage and survey fees make KGF credits advantageous in terms of costs (figure 3.7.

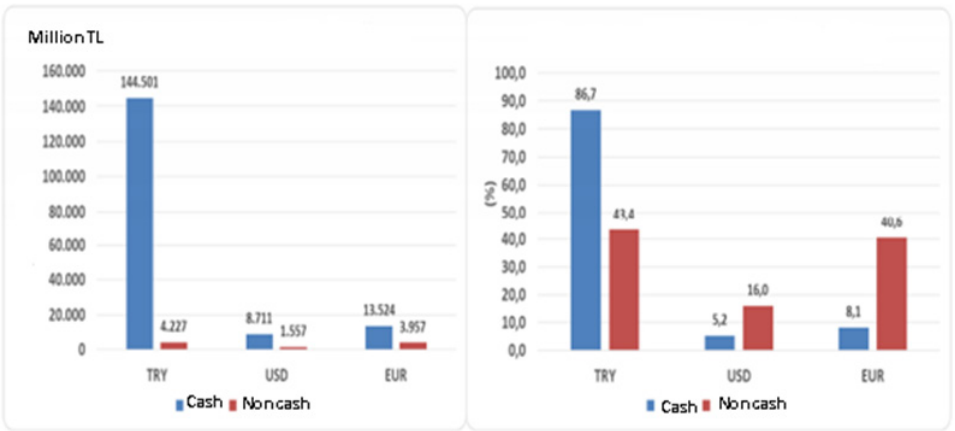


Figure 3.7 Approximate Interest Rate of KGF Credits(March 2018. BDDK, 2018.

Between the end of the year of 2017 and 25th May 2018, cash loans under KGF guarantee increased by 9.3 percent and reached up the level of 183.2 billion TL

when the nonperforming loans also increased to 1163 million TL. The important part of this increase resulted from a new package dated 11th May 2018 that included 35 billion TL working capital and export loans. The rate of cash KGF loans used as TL is 86.7 percent (144.5 billion TL, 8.1 percent as Euro and 5.2 percent as USD. Currency ratios converge in non-cash KGF loans. The rate of non-cash KGF loans used as TL is 43.4 percent (4.2 billion TL and 40.6 percent as Euro as shown in Figure 3.8. [20]

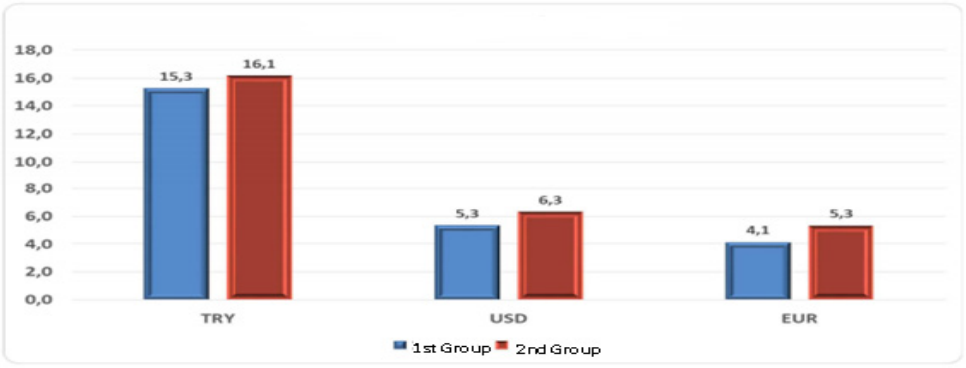


Figure 3.8 Distribution of Cash and Non Cash Credits Based on Currency. BDDK, March 2018

According to BDDK data of March 2018, average original term of KGF loans are 3,5 years when the remaining average term is 2,7 years. Considering relevant terms in commercial loans are respectively 3 and 2.1 years, it is seen that KGF credits are being used for longer terms and therefore they have an increasing effect on the terms of other credits in the sector. By March 2018, 33.5 percent of cash KGF credits were used by business sector, 33.4 percent were used by manufacturing sector and 12.4 percent were used by construction sector (figure 3.9. [21]

20 Ibid.p.4

21 Ibid.p.6

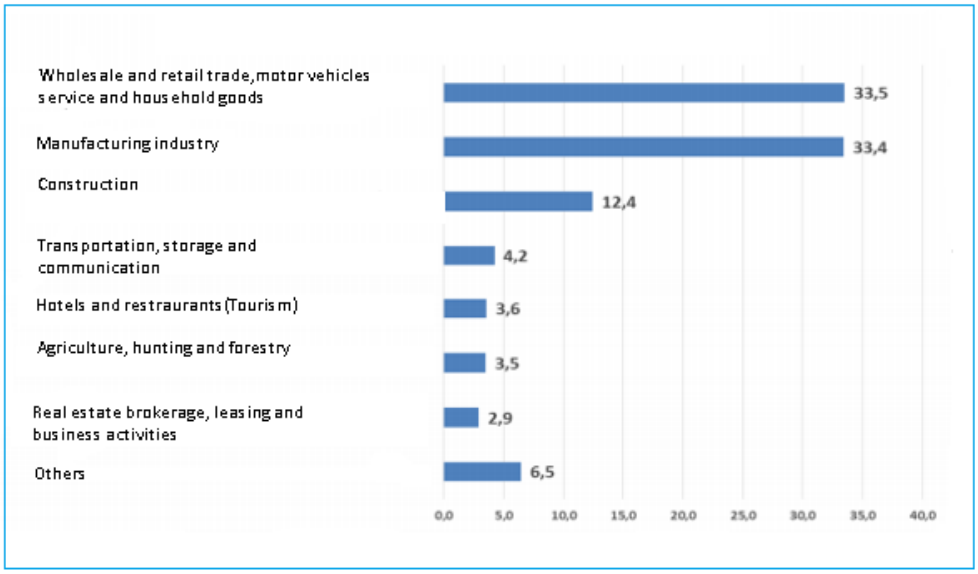


Figure 3.9 Cash KGF Credit Usage Based on Sectors. BDDK, 2018.

As shown in Figure 3.10, on city basis, the largest share for cash KGF credits belongs to İstanbul with 32.5 percent while the total share of 61 cities which have shares under 1 percent is around 17.4 percent. The other cities on rank are as follows: Ankara (9.2 percent, İzmir (6. 8 percent, Antalya (4.6 percent and Bursa (3.9 percent.

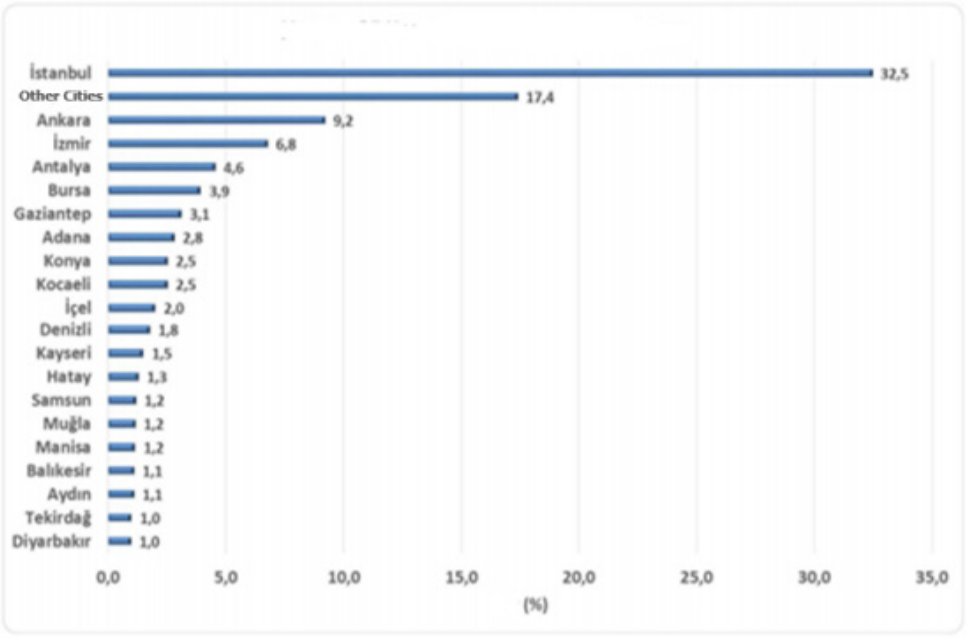


Figure 3.10 Distribution of Cash KGF Credits Based on Cities. BDDK, 2018.

By the end of September 2019, 714.890 enterprises are using KGF guaranteed credits. The total amount of the collateral volume is 342.800 million Turkish Liras when the loan volume is seen as 392.900 million Turkish Liras.[22] The proportion of the guarantees to the credits is about 87 percent.

86.5 percent of the debtors having used KGF credits are already existing bank customers who get KGF credits as extra credits as of March 2018. The 2.3 percent of customers are on the process of refinancing when 2.3 percent of them are restructuring their credits and both categories have difficulties in payment. On the other hand, the new customers consist of 8.9 percent of KGF credits (see figure 3.11.

22 Credit Guarantee Fund official website. https://www.kgf.com.tr/index.php/en/, accessed on 17.11.2019.

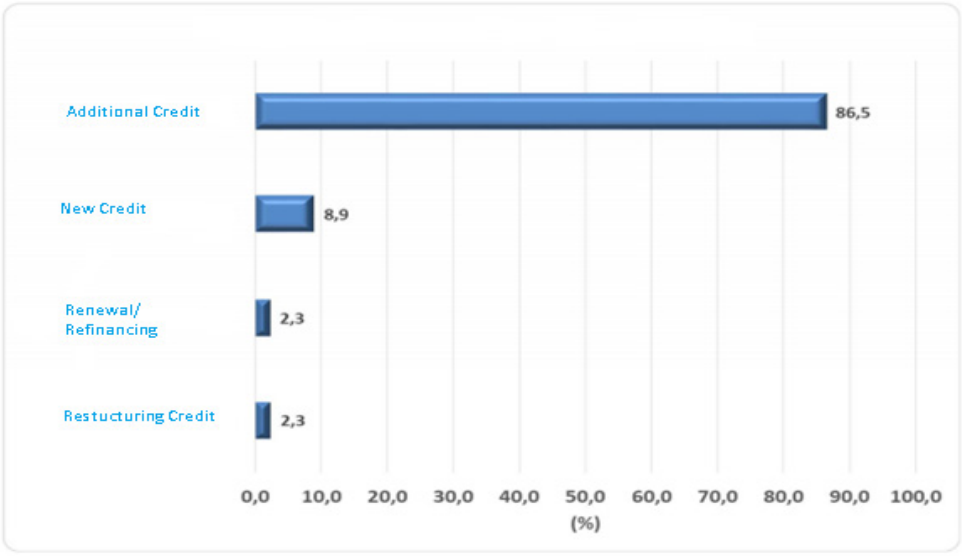


Figure 3.11 KGF Credits Based on Usage Purpose. BDDK,2018.

Except for personal loans, while 89.8 percent of overall sectorial loans are consisted of the first group[23] which is performing loan, this rate is higher at 93.9 percent in KGF loans. As for the loans under close monitoring named the second group which are accepted that there is a significant increase in loan risk, the ratio of overall loans is 7.4 percent while this ratio is lower at 5.3 percent in KGF credits. The quality of the KGF loans is higher than the sectorial average with the impact of portfolio which is not getting older just like seen in figure 3.12. [24]

23 Banks decide to the amount of money earmarked as special provisions according to the group of credit. There are five groups of credits which the first two address liquidity when the rest indicates non-performing loans. The amount of provisions making increases as the group number grows in parallel with increasing risk.

24 BDDK, March 2018, Annotation for the Development and Performance of KGF Credits.p.8

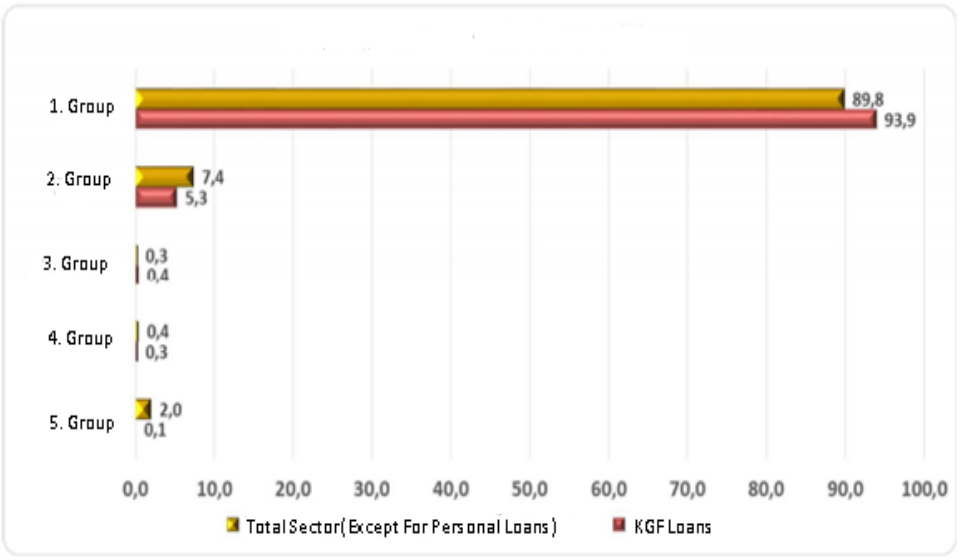


Figure 3.12 Group Distribution of Cash KGF Credits(%. BDDK, 2018.

As of March 2018, total cash risk of KGF customers is 603.4 billion TL. Customers who have used KGF credits are seen to have 26.7 percent of total credits in sector considering their other credits. Because of the implementation of TFRS 9 standard that came into effect in the beginning of 2018, loans under close monitoring (2nd Group have been increasing generally in the banking sector. In this scope, total share of 2nd group loans of KGF customers in total loans in the sector increased by 2.6 points and reached to 6 percent (36.4 billion TL. Mor e importantly, non-performing loans in KGF credits increased by 34.7 percent and reached to 5.6 billion TL.[25] In table 3.3, the sum of the amount of cash risks whose have a guarantee from KGF are shown both year and credit group based.

25 Ibid.p.8

Table 3.3 Total Cash Risk of KGF Customers

Credit Group	December 2017		March 2018		Difference	
	Amount (Million TL)	Share %	Amount (Million TL)	Share %	%	Share
1. Group	535.003	95,9	561.374	93	4,9	-2,9
2. Group	18.948	3,4	36.446	6	92,3	2,6
3. Group	1.661	0,3	1.800	0,3	8,4	0
4. Group	1.133	0,2	2.156	0,4	90,3	0,2
5. Group	1.347	0,2	1.622	0,3	20,4	0,1
TOTAL	558.092	100	603.398	100	8,1	

SOURCE BDDK, March 2018, Annotation for the Development and Performance of KGF Credits

It is being assessed that Treasury-guaranteed KGF credits are demanded by customers due to longer term and cost advantages and banks let these loans be used more intentionally due to capital sufficiency and repayment advantages in addition to high qualified guarantee owing to Treasury guarantee. The last data taken from weekly report on KGF website shows the huge rise on Treasury-guaranteed KGF credits in terms of both amount and quantity. It can be observed that compared to December 2017, the guarantee given by the Treasury in 2019(yellow bar almost duplicate d both numerically and in all (figure 3.13 .

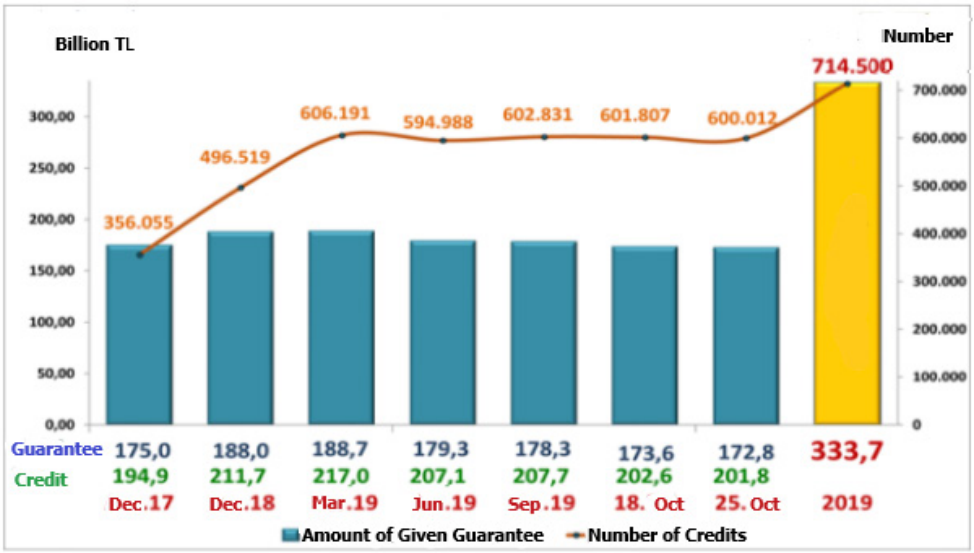


Figure 3.13 Development of Treasury Guaranteed KGF Bails. KGF,2019.

Loan Guarantee System which has been developed against the risk of loans which are not repaid at all is a tool protecting against unexpected changes, however it does not eliminate the risk totally. It aims to minimize the effect of losses on one bank owing to the risk distribution between banks, loan customers and the guarantee institution.

In Turkish law, direction of the regulations started with the Law on Chambers of Commerce and Industry (1924, but the movements for their economic support were somewhat delayed. Halk Bank, founded in 1933, despite of being a bank established for small and medium-sized industrial enterprises, legal changes made in 1950 to serve small trades associations and cooperatives.[26] Tradesmen Bail Cooperatives Act (Law No. 1163 and Tradesmen and Small Craftsmen Act (Law No. 507 bring about the regulations in favor of small businesses. Since the 1936 Labor Law, the Turkish lawmaker has adopted a pro-proactive approach to protecting small businesses from the financial and bureaucratic responsibilities imposed on them by business laws. Law No. 3008 which came into force in 1936 was not applied to workplaces with less than 10 employees, while other labor laws excluded members subject to the Tradesmen and Craftsmen Law. Both the Labor Laws No. 1475 and 4857 have linked the application of certain provisions to the size of the workplace and stated that certain obligations and responsibilities are not applied to workplaces with a number of employees less than 50 (sometimes 100. Financial and administrative burdens of enterprises are compulsory employment[27], establishment of workplace physician and health unit[28], employment of engineers or technical personnel assigned to occupational safety[29] breastfeeding room and nursery opening[30], permission board[31], occupational health related boards to establish[32] in general. However, these obligations are not applied to small businesses

26 Ekin, Nusret. Küçük İşyerleri ve Sosyal Koruma,İstanbul, İTO Yay. (1994

27 Turkish Labor Code no.4857, enforced in 2003. Act No:30

28 Ibid. Article 81.

29 Ibid. Article 82.

30 Ibid. Article 88.

31 Ibid. Article 60.

32 Ibid. Article 79-80.

which hire less than 50 employees but this can be counted as an incentive for small enterprises as well.

There are many different institution that support SMEs in the way of planned development as a state policy; which are state institutions (KOSGEB, Türkiye Halk Bankası, Eximbank, Sınai Yatırım ve Kalkınma Bankası, Türkiye Vakıflar Bankası, KOBİ A.Ş., Credit Guarantee Fund etc., professional organizations (TOBB, trading guarantee cooperatives, small industry cooperatives, private institutions (TOSYÖV, MEKSA and foreign supported institutions (World Bank, UNIDO, European Investment Bank etc.. In the next section, only KOSGEB (Small and Medium Industry Development Organization will be explained because it is the milestone of the financial support for SMEs in founding stage. There are two main differences between the Credit Guarantee Fund and KOSGEB. First, KOSGEB is founded in order to support the SMEs in the process of establishment while Credit Guarantee Fund supports the SMEs which have been already established in general. The second main difference between them is that KOSGEB gives the money to the firms directly however Credit Guarantee Fund just helps the firms to access money from bank.

§ 3.3 KOSGEB: The Other SME Supporting Institution

Small and Medium Industry Development Organization (KOSGEB is the main organization supporting SMEs within the scope of European Charter for Small Enterprises. It was the institution that either provided or coordinated the support to be given in the 10 main areas stipulated by the Charter.[33] Today, 780,000 businesses are registered in the database of KOSGEB to benefit from these supports and the number of them is increasing rapidly.[34]

According to the treaty between United Nations Industrial Development Organization (UNIDO and Turkey, KÜSGEM (Small Industry Developme nt

33 OECD. "Türkiye'deki Küçük ve Orta Ölçekli İşletmeler: Mevcut Durum ve Politikalar", (2018.

34 "KOSGEB'de Kayıtlı İşletme Sayısı 780.0002e Ulaştı". https://www.kosgeb.gov.tr/site/tr/genel/detay/4947/kosgebde-kayitli-isletme-sayisi-780-bine-ulasti, accessed on 01.05.2019.

Center was established in 1973 as a pilot project under the Ministry of Industry and Trade, which shaped KOSGEB then. In Gaziantep, it started to provide services to small industrial enterprises with common convenience workshops, and in the following years, it was evaluated that its activities were successful, and in 1983, with the International Agreement on the Development of Small Industry Extension Services, its activities were expanded under the name of KÜSGET (Small Industry Development Organization.

In parallel, SEGEM (Industrial Training and Development Center was established in accordance with the International Agreement on "Provision of Industrial Training Services which came into force in 1978 in order to meet the training needs of technical staff and managers working in small and medium sized enterprises. To make the services of these two organizations more comprehensive and widespread, Law No. 3624 (Law on the Establishment of Small and Medium Industry Development Administration came into force on April 20, 1990 in order to increase share and efficiency of SMEs in the Turkish economy, to promote their capacity to compete and to realize industrial integration in parallel with financial progress. Besides the financial support, the other services and programs which are the scope of the supports provided by KOSGEB for SMEs are listed below:[35]

- Entrepreneurship Support Program
- R & D and Innovation Support Program
- Industrial Application Support Program,
- SME Technological Product Investment Support Program,
- Strategic Product Support Program,
- Business Development Support Program,
- SME Development Support Program,
- Cooperation-Cooperation Support Program,
- International Incubation Center and Accelerator Support Program,
- Technological Product Promotion and Marketing Support Program,
- Developing Businesses Market SME Support Program,
- Credit Interest Support,

35 İnce, Metin. "KOSGEB Yeni Girişimci Desteğinin İşletme Faaliyet Süresine Etkisi." Itobiad: Journal of the Human & Social Science Researches 8.2 (2019.

- Laboratory Services

After founding their own businesses by completing Applied Entrepreneurship Training, entrepreneurs can apply for KOSGEB's grants up to 50.000 TL and financial support of up to 100.000 TL without any interest by preparing the KOSGEB business plan including the business idea and the road map related to the business (table 3.4.

Table 3.4 KOSGEB New Entrepreneur Support Upper Limits

Business Organization Support	Machinery, Equipment and Software Support in Organization Period	Operating Expenses Support	Fixed Investment Support
2.000,00TL (Grant)	18.000,00TL (Grant)	30.000,00TL (Grant) Lease and staff support	100.000,00TL (Reimbursement) Machinery, equipment and software support

SOURCE KOSGEB Entrepreneurship Support Program,2018

§ 3.4 COSME Project

KGF which mainly focused on equity guarantees based on its own capital and Treasury; get help from Baku Tbilisi Ceyhan Petrol Pipeline Turkey Branch (BTC Co. and European Investment Fund (EIF for grants and funds in its budget as well. Receiving grants and funds from institutions and organizations such as the Investment Fund (EIF requires different bail applications.

According to the announcement in 11th of April 2019 in KGF website, Competitiveness of Enterprises and SMEs (COSME Project is carried out by the European Union to make easier the access of SMEs to finance and to encourage the growth program (COSME covered 3 billion Turkish Lira of loans to be extended to SMEs in Turkey. In this context, the European Investment

Fund will provide grants to the KGF by a counter guarantee contract and the bond transactions will be made from the equity of the Credit Guarantee Fund. KGF will give bail to 80 percent of these loans. With the guarantee support to be provided, each SME will be able to use credit up to 1 million TL with a total of 60 months term, with a grace period of 12 months. SMEs will be able to apply to 16 banks in order to benefit from COSME Project which are Akbank, Alternatif Bank, Denizbank, Garanti Bank, Halkbank, ING Bank, İş Bank, QNB Financial Bank, Şekerbank, Turkey Economy Bank, Turkey Finans Participation Bank, Foundations Bank, Vakıf Participation Bank, Yapı Kredi Bank, Ziraat Bank and Ziraat Participation Bank.

The program consists of 'Access to Finance', 'Access to Markets', 'Framework Conditions for Business' and 'Entrepreneurship and Entrepreneur Culture' in order to increase the competitiveness of SMEs. Within the scope of the Access to Finance component, SMEs are expected to reach credit guarantees and venture capital, which provide flexible and easy access to credit guarantees. The program is coordinated by the Small and Medium Enterprises Development Organization (KOSGEB. KOSGEB Executive Committee held its meeting on 4 June 2013 and there, KOSGEB was authorized as the national coordinating organization for the COSME Program. COSME Program Participation Agreement, signed between Turkey and the European Commission in Brussels on 16 October 2014. The COSME Program was implemented with a budget of approximately 2.3 billion Euro for the years of 2014-2020.

COSME Program Credit Guarantee Support (Credit Guarantee Facility-LGF; Enterprise One EU Loan Financing Instrument is an initiative led by the European Investment Fund. Within the framework of; Single EU Loan Financing Tool; The Credit Guarantee Support (Loan Guarantee Facility-LGF under the COSME program and the InnovFin SME Guarantee Facility (InnovFin SME Guarantee Facility under the Horizon 2020 (H2020 program are managed by the European Investment Fund (EIF.

Through the Credit Guarantee Support, the European Investment Fund guarantees that financial intermediaries (eg, guarantee institutions, banks, leasing companies, etc. will be offered to support SMEs in providing more credit and leasing opportunities, including the securitization of SME credit finance portfolios. It will offer. By sharing the risk, COSME guarantees that

many SMEs who have difficulty in accessing the traditional banking system will have access to credit financing and will help financial intermediaries to increase the number of SMEs they will finance. Credit Guarantee Support is a continuation of SME Guarantee Facility (SMEG which was previously implemented by the European Investment Fund under the Competitiveness and Innovation Framework Program (CIP covering 2007 -2013.

Appropriate organizations are explained as below to be able to apply for grant to the Financial Intermediaries of the European Investment Fund under the COSME Credit Guarantee Support Call:[36]

- Finance or credit institutions and credit funds that are established in the member states of the European Union and COSME related countries within the framework of the relevant legislation
- Within the framework of the relevant legislation, guarantee institutions, credit or financing organization authorized to provide guarantees to SMEs operating in the European Union member states and COSME countries.

36 https://www.eif.org/, accessed on 15.05.2019

4

Privatizing Profits and Socializing Losses With Asymmetrical Information

The phrase of "privatizing profits, socializing losses" refers to the individual benefits of the enterprises gained thanks to the governmental aids are not reciprocal. If these aids bring about the downfall to the firms because of the ineffective use of money, the losses are hit with the shoulder of taxpayers, who are the real financier of the money given without taken their consents. One of the latest examples of privatization losses and socialization losses is the recovery of banks, insurers and auto manufacturers from the post-financial crisis. U.S. Treasury disbursed $700 billion from its Treasury budget under the 2008 Troubled Asset Relief Program (TARP on the purpose of rescuing these firms, many of which had carelessly associated with the crisis and they were sunk because of their investment to the mortgage-backed derivatives including huge risk.[1] Despite there are more than 800 thousand families who lost their houses because of the hypothec, the government preferred to support big firms financially which causes some unsuccessful employees received

1 Kenton, Will. "Privatizing Profits and Socializing Losses". https://www.investopedia.com/terms/p/privatizing-profits-and-socializing-losses.asp, accessed on 10 June 2019.

millions of dollars in bonuses.[2] This was seen as an example of the state support to wealthy people by taking from the ordinary citizens. Large companies, their managers and shareholders can utilize from government subsidies and be rescued to a large extent with the idea that if the big firms fall, this would discredit all the economy uncontrollably. However, the defenders of this idea do not question whether bailouts have a positive impact on middle and lower class citizens who are affected heavily from crises or they are more for the sake of businessmen.

Lemon socialism is also used as crony capitalism and it is a pejorative term for a type of the government intervention that causes government subsidies grant to weak or failing companies (lemons .[3] Consequently, the government, indirectly the taxpayer covers some or all of the buyer's losses. This type of payments made by the state may have the aim of preventing further systemic harms with increasing. For instance, the bailout by accepted the government which was at the state's agenda in USA after the 2008 financial crisis are described as lemon socialism by many.[4]

Dilorenzo and Walter state that the state intervention created by various forms and public institutions in the USA (since the late 1980s brought an end to economic growth, decisions have been taken by the central management rather than business owners and investors and as a result "less productivity" and "lower standard of living " show up.[5] However, recently the wave of state interventionism seen in the USA, Europe and most of the remaining developed countries is aimed at alleviating the pains. Especially in developing

2 Ibid.

3 "The Geithner Put", https://krugman.blogs. ntimes.com/2009/01/30 /the-geithner-put/, accessed on 20.07.2019.

4 Shaw, Randy. "The Return of Lemon Socialism". Beyond Chron 18.9.2008. http://beyondchron.org/the-return-of-lemon-socialism/, accessed on 19.7.2019; Will, George. "Bailouts on Wheels", 2008. http://www.washingtonpost. com/wp-dyn/content/article/2008/09/19/AR200809190318 3.html?noredirect=on , accessed on 19.07.2019.

5 Block, Walter, and Thomas J. DiLorenzo. "Is Voluntary Government Possible? A Critique of Constitutional Economics." Journal of Institutional and Theoretical Economics (JITE/Zeitsc hrift für die gesamte Staatswissenschaft (2000: 567-582.

countries and in countries with autocratic regimes, a heavy state hand involving reaction to the doctrine of free market economy is felt. In this development, international relations and the transfer of large-scale economic power influence to the central authority, and can continue to affect the global economy.[6]

117 state-owned or publicly owned companies in BRIC countries between 2004 and 2008 have taken place in Forbes Global 2000 among the world's largest companies list while a total of 239 Japanese, German, British and US firms dropped from this list during the period. Failure of companies in 2008-09, right after mortgage crisis, caused to increase in government bailout, in other words buying shares by government to rescue the firms. After crisis, capital injections in Western countries for restructuring and recovery activities are shown in the Figure 4.1. In other words, statism which can be seen as the antithesis of globalization in one aspect remains integrated into globalization on the other.

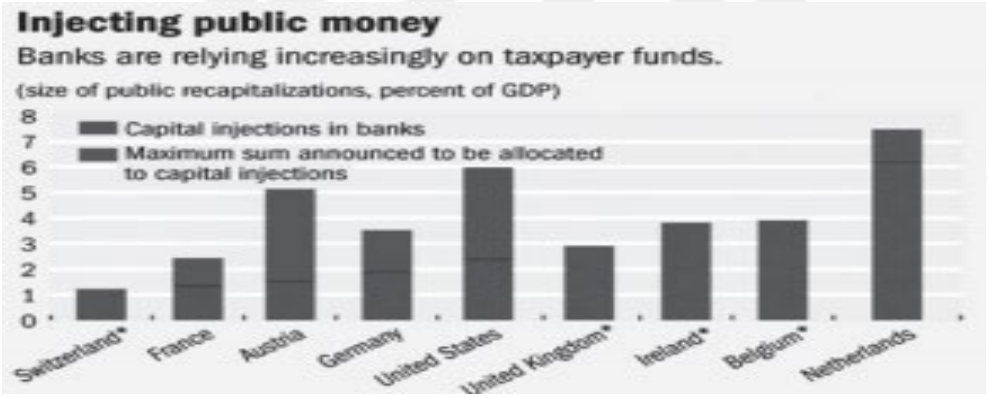


Figure 4.1 Public Money Injection Comparing Selected Countries. Jean Pisani-Ferry and Indhira Santos.

As seen in the figure 4.1, many countries have injected public money into the economic system for restructuring and recovering activities of private companies. In Turkey, recovering non-performing loans or watch-listed loans has been in place. However, restructurings and possible raises in non-performing loans/ watch-listed loans restrict the ability of the banks to trust. Mr. Hüseyin

6 Dedekoca, Ersin. "Devlet Yoluyla Kapitalizm." 21. Yüzyılda Sosyal Bilimler 1 (2012: 73-89.

Aydın who is the former Chairman of Banks Association of Turkey (TBB, shows that in 2018 restructured credits were 120 billion TL in 2018, and this corresponds with 6.4 percent of Turkish corporate loans.[7] Restructurings can be important and necessary in volatile economies; nevertheless delays in cash receipts limit banks' ability to give new loans. When the banking system fails to increase its resources, restructurings become a zero-sum game – restructuring one firm may make the other unable to take credit.[8]

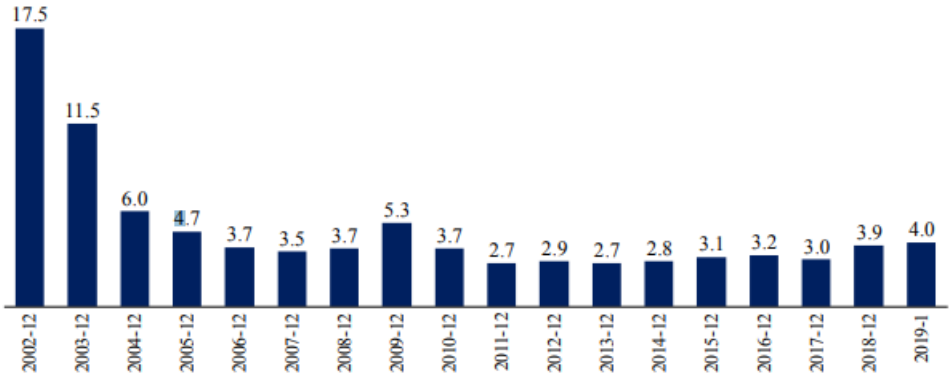


Figure 4.2 The Ratio of Non-Performing Loans in Turkey (2002-2019. BRSA, TEPAV visualization.

7 Munyar, Vahap. "Bankalar 120 Milyar TL Krediyi Yapılandırdı". http://www.hurriyet.com.tr/yazarlar/vahap-munyar/bankalar-120-milyar-tl-krediyi-yapilandirdi-41124361, accessed on 03.04.2019.

8 Dalgin, Burak, and Güven Sak. "Logbook of the Turkish Economy: Reassuring Flow of Credit to Return to Growth." (2019..p.6

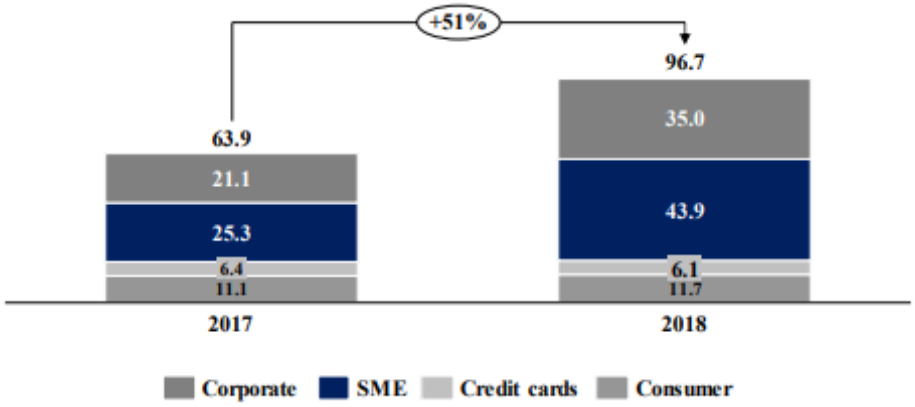


Figure 4.3 Non-Performing Loan Volume in Turkey, TL Billion, 2017-2018. PriceWaterhouseCoopers, TEPAV visualization

As we can see the conditions of Credit Guarantee Fund and NPL ratios in Turkey, it can be easily said that it is a classic example of crony capitalism/ lemon socialism. The Treasury is one of the source of non performing credits and accountable to the banks for unpaid credits. The approximate period for non-payment to demand credit from Credit Guarantee Fund is 90 days or three unpaid installment consecutively. Although its worldwide mission is explained as "achieve the twin goals of eliminating extreme poverty and promoting shared prosperity" in World Bank, in fact it is more helpful for firms to meet their immediate cash need.[9] As a result, if the firms are satisfied with this money and get its revenue more with the credit, this is good for its shareholders directly. There is no rule to hire more people with increasing revenue for the firm. Its direct impact may be just that the increasing revenue of a firm that can bring about more tax to the state and public may benefit from this. However, when we think about the extent of tax evasion in Turkey, we can easily foresee that the public benefit via tax would be significantly lower than the firm benefit from the credit or the loss of the Treasury in the case of the guaranteed but an uncollectible credit with high amount. The international rating firm S&P downgrades Turkey after KGF solution for the economy with

9 The World Bank and First Initiative(2015, Principles for Public Credit Guarantee Schemes for SMEs. Washington, DC: World Bank. p.2

the explanation of "The rating action also reflects our view of weakening in Turkey's fiscal position as a result of continued public and quasi-public stimulus to the economy".[10]

According to Haldane et al., socialized losses are twice as bad for society. Taxes may be raised in order to meet the losses which are the painful process for taxpayers just like in the aftermath of crisis in USA. Private investors would experience more of the upsides and less of the downsides of this situation. Because of the main supporter and of the CGF, high level of KGF supported loans expose the huge risk for State Treasury because of this paradox.[11]

The use of KGF guaranteed loans during the year is very attractive for the banks because of two reasons. First, the guarantee of the Treasury through KGF, second, these loans are not included in the Capital Adequacy Ratio. Credit Guarantee Fund loans that do not currently participate in capital adequacy ratio would create important negativities for the banks that fill their balance sheets with these loans in the coming period. The fact that a significant portion of these loans are used within the portfolio guarantee system and that the treasury will cover these loans up to a maximum NPL rate of 7 percent will push the banks that give these loans excessively, which would raise a significant risk of default. As the savings in our country are low and the equity is insufficient, the need for credit increases and deposits become insufficient. Foreign borrowing is inevitable to compensate for the difference between them. Decline in country ratings, economic and political risks increase the cost of borrowing from abroad.

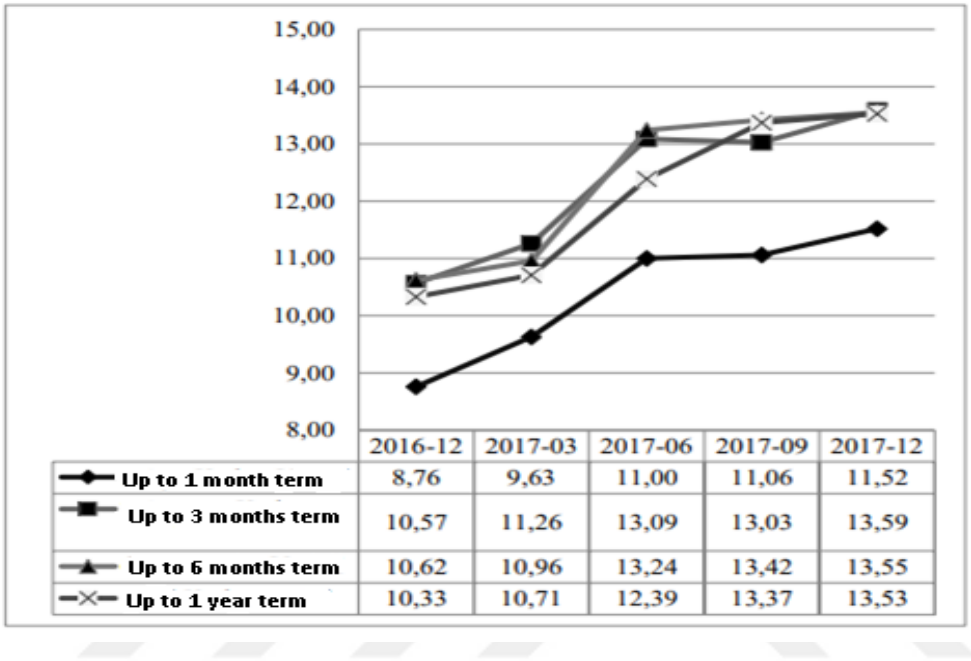
One important problem that awaits the banking sector and therefore SMEs is the ratio of deposits to loans. The fact that these loans are so attractive leads to an increase in the loan/deposit ratios in the sector, and even Turkey has a new record among the developing countries in this regard.[12] However, this

10 "Turkish Lira falls to new record low against dollar over inflation fears". Hürriyet Dailynews, 4 May 2018. http://www.hurriyetdailynews.com/turkish-lira-falls-to-new-record-low-against-dollar-over-inflation-fears-131347, accessed on 01.05.2019.

11 Alessandri, Piergiorgio, and Andrew G. Haldane. Banking on the State. London: Bank of England, 2009.

12 Moody's . "Banking System Outlook - Turkey, Downside Risks for Funding and Asset Quality Drive our Negative Outlook", 2018.

mismatch caused the need for additional liquidity and refinancing. In order for banks to provide this refinancing, they started a deposit race which causes that deposit interest rates started to increase on an absolute basis (figure 4.4. Because of all reasons mentioned above, Credit Guarantee Fund loans are open to be affected adversely by deposits and loan interest rates



	2016-12	2017-03	2017-06	2017-09	2017-12
Up to 1 month term	8,76	9,63	11,00	11,06	11,52
Up to 3 months term	10,57	11,26	13,09	13,03	13,59
Up to 6 months term	10,62	10,96	13,24	13,42	13,55
Up to 1 year term	10,33	10,71	12,39	13,37	13,53

Figure 4.4 Interest Rates on Deposits. TCMB, 2018.

§ 4.1 The Challenge to Adam Smith's Contradictory Idea

Adam Smith advocates the existence of selfish and self-esteem feelings of individuals which he explained as human nature but according to him, the social consequences of this selfishness are positive. He considers that the impacts of the individuals' actions are not just the interest of the individuals; others are also affected positively from these actions. Market is kept its balance in time itself and he denominated this as invisible hand. However, George Akerlof and Robert Shiller have objected the illusion of the perfection of free market resulted from the individual actions. They believe between two actors in market, sellers and buyers there is no equal chance to access to information about sold

product. Sellers systematically exploit the latter's ignorance through manipulation and deception. Markets are inherently filled with tricks and traps and they treat us as phool buyers who are being phished by the sellers.[13]

According to Kenneth J. Arrow, there should not be a lack of information for the market to function as required by neoclassical economics.[14] However, Adam Smith also found that the best borrowers withdrew from the market when businesses increased interest rates. In this case, if the lenders knew the risks fully, they could have solved the problem by installing an appropriate risk premium according to the borrower. The lemon market model developed by Akerlof[15] for the used car market in the USA is accepted as the beginning of the studies that increase the possibility of theoretical progress on financial issues. In this model, which is based on the principle that quality is associated with uncertainty, that is, asymmetric information, it is assumed that sellers know the quality of used cars they offer for sale, but buyers do not know. In this case, the buyers must make an estimate of the quality of the average car and determine the price she or he will pay accordingly. Those who want to sell at this price would be the only bad quality car "lemon" sellers, they would take over the market and good quality car dealers would be out of the market.[16]

13 Akerlof, George A., and Robert J. Shiller. Phishing For Phools: The Economics of Manipulation and Deception. Princeton University Press, 2015.

14 Kahveci, Hülya. Tüketicilerin Asimetrik Enformasyon ve Kurumsal İtibar Algısı: Seyahat Acentası Müşteri Üzerine Bir Araştırma. MS thesis. Balıkesir Üniversitesi Sosyal Bilimler Enstitüsü, 2015.

15 Akerlof, George A. "The Market For Lemons: Quality and The Market Mechanism. Quarterly." Journal Economics 84 (1970: 488-500.

16 Ökte, Kutluğhan Savaş. Finansal Piyasalarda Asimetrik Enformasyon Problemi: Temel Kavramlar Literatür ve Çözüm Önerileri, Uludağ Üniversitesi, IIBF Dergisi, 9. 1- 2.(2001; Tükel Ayça. "Asimetrik Enformasyon Işığında Halka Arzların Uzun Dönemli Performanslarının Değerlendirilmesi", İstanbul Üniversitesi İktisat Fakültesi Ekonometri ve İstatistik Dergisi, 12, p.102–121.

According to Akerlof, this information asymmetry gives the seller the incentive to sell goods that are lower than the average market quality.[17] For this reason, the average quality of goods on the market will decrease.

Akerlof assumes an automobile market model that includes four different types of cars, which are good and bad of the new car; good and bad of the old car, with new and old ones that are bad or good. In this context, the person receiving the car increases the knowledge of the car by using it after purchasing the new car. This stage can be described as the period in which asymmetric information developed. In this period, bad car owners will sell their cars as soon as possible and will try to reach a good one that has been exchanged for the same price; bad car prices will fall from increasing bad car supply, good cars will be excluded from the market.[18] Akerlof named the bad automobiles as lemons.

When buying a car, the probability of being a good car is q and the probability of being a lemon is 1-q. This can be applied to both new and old cars. Sometimes after acquiring the car, the car buyer will receive more information about the condition of the car and will determine a new possibility for the car to become a lemon. If this probability is assumed to be higher or lower than the initial probability q, an information asymmetry has developed between the owner and potential recipients. If potential buyers have not an ability to differentiate good cars and bad cars, potential sellers will determine an average price for both and they are persuaded to purchase from the buyer who is willing to sell his or her product at that price.[19]

Akerlof also says that the price of the new car should be higher than the price of the old car. It is because there is the possibility of buying a new car

17 Kahveci, Hülya. Tüketicilerin Asimetrik Enformasyon ve Kurumsal İtibar Algısı: Seyahat Acentası Müşteri Üzerine Bir Araştırma. MS thesis. Balıkesir Üniversitesi Sosyal Bilimler Enstitüsü, 2015.

18 Tükel Ayça. "Asimetrik Enformasyon Işığında Halka Arzların Uzun Dönemli Performanslarının Değerlendirilmesi", İstanbul Üniversitesi İktisat Fakültesi Ekonometri ve İstatistik Dergisi, 12, p.102–121 (2010.

19 Altunöz, Utku. Türk Bankacılık Sistemindeki Asimetrik Bilgi Probleminin Oyun Teorisi Çerçevesinde Analizi, Dicle Üniversitesi İktisadi ve İdari Bilimler Fakültesi Dergisi 5. 1-20.(2013.

with the possibility of q, which has the same price with the bad car. Therefore, an individual with a good and old car is locked in her/his position. Because the car which is better than the market average of the real valuation of the car cannot compete with the lower-priced ones and lose out from market. At the same time, the old car is unable to replace with a new car because it cannot get the price of a new car. According to Akerlof, this situation causes most of the cars traded are the "Lemons".[20] As in the case of Gresham Law, good goods are withdrawn from the market, such as bad money firing good money, while the remaining goods are of poor quality.[21] The case resembles Chine made productions nowadays. In time, customers have knowledge about the quality of second hand automobile market and they surrender to buying a second-hand automobile, because its market would be dominated by lemons. As a result, the first best-case-full competition market, which is dominated by complete information, is being distorted and the balance of the second hand automobile market is disrupted.[22] In this case, the process of bad cars starting to dominate the market is called as adverse selection.[23] This approach can divide the enterprises into two parts as goods and bads. This asymmetrical information approach can be applied to the enterprises. The enterprises that realize all profitability expectations of the shareholders and fulfill the interest and principal payments of the outsiders on time can be considered as good when vice versa is bad.[24] While business managers know that their businesses are in

20 Akerlof, George A. "The Market for Lemons: Quality and The Market Mechanism. Quarterly." Journal Economics 84 (1970: 488-500.

21 Fidan, M. M. Kobi Kredi Piyasasında Asimetrik Bilgi ve Ahlaki Tehlike: Laleli Örneği, Maliye Finans Yazıları, 25. 90.(2011.p. 44

22 Bekmez, Selahattin and Filiz Çalış. Oyun Teorisi Çerçevesinde Türk Bankacılık Sistemi ve Asimetrik Bilgi Problemi, Süleyman Demirel Üniversitesi, İktisadi ve İdari Bilimler Fakültesi Dergisi 2 (2011:79 -96; Altunöz, Utku. Türk Bankacılık Sistemindeki Asimetrik Bilgi Probleminin Oyun Teorisi Çerçevesinde Analizi, *Dicle Üniversitesi İktisadi ve İdari Bilimler Fakültesi Dergisi* 5. 1- 20.(2013.

23 Aksoy, Tolga and Işıl Şahin. Belirsizlik Altında Karar Alma: Geleneksel ve Modern Yaklaşımlar, Türkiye Ekonomi Kurumu Tartışma Metni Http://www.Tek.Org.Tr/Dosyalar/Kararalma_Sahin_Aksoy.Pdf, accessed in 01.09.2019.

24 Sarıkaya, Murat. Asimetrik Bilgi Çerçevesinde Müzayedeler, C.Ü, İ.İ.B.F Dergisi, 2002. 3: 2, p. 99–110.

a good or bad situation, there are two reasons why they can keep this information themselves. First, if the unsuccessful managers report their status or negative forecasts; this may be inconvenient for the business and for them. In such a case, capital will be withdrawn while successful staff will transfer to other businesses. Moreover, if unsuccessful enterprises do not disclose the unfavorable picture for the current situation and the future, there will be no serious punishment even in bankruptcy. When we comes to why the managers of successful enterprises do not provide information about the positive expectations of investors, managers try to create this image and explain the necessary information but it is not easy for them to convince investors. This is because unsuccessful enterprises also try the same way. Thus, it appears that the disclosure of a good estimate leads to the same costs and consequences for bad and good enterprises and in such a case it maintains the asymmetric information structure.[25]

The problem of bankruptcy for profit arises as another case that is encountered more in which companies rescued by the state while it is collapsing and the cost is borne by the society. In this process, asymmetrical information prevents the state being informed about the real financial situation and main intents of the firms. Bankruptcy may become more profitable when the government secures the commitment for debts. Insurance companies in USA are shown as the main example of this situation.[26]

Deposit insurance is one of the most relevant forms of such guarantee in USA. Bankruptcy for profit can be defined as looting due to clash between what can be acquired by the owners and what they can cause. Consequently, social losses can be brought on by bankruptcy for profit. Unfortunately, firms covered by government guarantees are not the only ones that face severely distorted incentives. Looting can spread symbiotically to other markets, bringing to life a whole economic underworld with perverse incentives. The looters in the sector covered by the government guarantees will make trades with unaffiliated firms outside this sector, causing them to produce in a way that helps

25 Cansız, Seda, and Güven Sayılgan. "Sermaye Yapisi Teorilerinin Reel Sektör Firmalari Özelinde Test Edilmesi." p.5.

26 Akerlof, George A., et al. "Looting: The Economic Underworld of Bankruptcy For Profit." Brookings Papers on Economic Activity. 1993.2 (1993: 1-73

maximize the looters' current extractions with no regard for future losses. Rather than looking for business partners who will honor their contracts, the looters look for partners who will sign contracts that appear to have high current value if fulfilled but that will not-and could not-be honored. First, limited liability gives the owners of a corporation the potential to exploit lenders. Second, if debt contracts let this happen, owners will intentionally drive a solvent firm bankrupt. Third, when the owners of a firm drive it bankrupt, they can cause great social harm, just as looters in a riot cause total losses that are far greater than the private gains they capture. This paper has shown how other people's money, typically deposits in financial institutions or insurance funds can profitably be looted, with the guarantor of the assets, typically the government and its taxpayers, left holding the bag.

George Akerlof and Paul Romer oppose the earlier view which argues the damage from deposit insurance and credit guarantees is brought by its shortening of the lower tail of the allocation of payoffs. Alternatively, they draw their attention to asymmetric payoffs. It is claimed by them that the social costs of looting exceed the governmental bailout costs. Akerlof and Romer contribute to discussion claiming that social losses are usually the private benefits when the benefits are earned by looting, they brings about social losses instead public wealth.[27]

The levels occurring respectively are adverse selection, moral hazard and bankruptcy for profit which asymmetrical information causes. When the adverse selection realizes before the act of selling, other two are the topics after vendition. Adverse selection is discussed for all types of buyers and sellers. It focuses on the impact of the manipulation by sellers on buyers and their convincing buyers in the point that the only difference between cheaper and expansive one is the price as explained in previous paragraphs. Adverse selection is the reason why the market does not function well and as expected. Moral hazard problem includes hidden actions from the one of the sides after signing a contract. [28] It rises generally in finance market and it refers to the debtor does

27 Ibid.p.16.

28 Grossman J.Sanford and Oliver D.Hart (1983, " An Analysis of The PrincipalAgent Problem", Econometrica, 51, 7-45. p.43.

not use money for lucrative investments, riskless projects as he or she promised in the process of credit application after taking money. Moral hazard abuses the trust in financial system and this causes that the system is not working well. Bankruptcy for profit is also based on a hidden action which Akerlof and Romer called looting.[29] They suggest that looting was part of the story behind the perverse commercial practices of the savings and loans. Lenders need to change their risk perception of SMEs to reduce credit constraints.[30]. Hereat there is a downward trend in average goods quality as well as market size. The automobile market is used to show and develop these ideas in his work thanks to the lucidity of the automobile market.

§ 4.2 The Asymmetrical Information between the Banks and KGF

The problems of adverse selection and moral hazard as a result of asymmetrical information may lead the sunken credits indeed to be selected by the Fund for giving guarantee and the costs will be higher for the society. If we think about the bank as the vendor and Credit Guarantee Fund as receiver, we can make believe the risk as a sold product. The bank sells the credit risk of a customer to the Credit Guarantee Fund as guaranteed by the Fund. Thus, banks assign the asymmetrical information problem between borrowers and them to the bailer. A customer representative has a chance to collect more information about the customer portfolio than the Fund officer in another city, Ankara. According to the international banking principle "Know Your Customer", the representative should be informed about his/her customer's main job, real income and the source of income, history of his/her occupation etc.[31] Moreover, as additional collateral besides KGF guarantee, the bank mostly

29 Akerlof, George A., et al. "Looting: The Economic Underworld of Bankruptcy For Profit." Brookings Papers on Economic Activity. 1993.2 (1993: 1-73.

30 Green, Anke. "Credit Guarantee Schemes for Small Enterprises: An Effective Instrument to Promote Private Sector-Led Growth?" SME Technical Working Paper No. 10, UNIDO, Vienna, Austria. (2003.

31 Gill, Martin, and Geoff Taylor. "Preventing Money Laundering or Obstructing Business? Financial Companies' Perspectives on 'Know Your Customer' Procedures." British Journal of Criminology 44.4 (2004: 582-594.

tends to demand pledge or another voucher from the customer in order not to be rejected by the Fund. However, the quality of these additional sureties and their risk proportion is known by the representative in the bank in general. Of course, customer is in the most advantageous situation in terms of the risk analysis and the probability of repayment but his or her representative is the second one who holds the knowledge among these sides. The pledge can be put on an estate which whether really valuable and easily vendible or not. The voucher can be a trustworthy and solvent or not. The officer in the Fund just can see the customer representative's comments on the KOBIT (Bail Approval Information Operating Technologies screen and evaluate according to this partial information because KGF does not run extra financial investigation process apart from the banks. Even, creditworthiness is also not evaluated for giving Treasury-based guarantees when it is analyzed if only for equity-based guarantees. This creates asymmetric information between banks (seller and the KGF (buyer, and conclude d with the adverse selection. Moreover, the customer representative prefers the credits of the customers in bad financial conditions and unreliable ones to guarantee under the state agency. Thus, the bank can protect its own interests; the customer representative can achieve his or her credit target. Even the credit would sink; the loss could be met in a high percentage, sometimes fully, thanks to the liquid collateral. It can be applied on especially restructuring and rescheduling of problematic and risky credits by KGF collateral. This leads to the public loss due to the fact that the collateral sourced by Treasury converts into actual money and it is used for the payment of defaulter to the banks. In compliance with the logic of collateral, banks are protected against default; instead state undertakes the responsibility of this risk. The other problem emerged after giving the guarantee for a credit is moral hazard. It is resulted from the situation that borrowers shift to riskier projects which would make difficult to repayment after borrowing.[32] This makes the possibility of collectability lesser and increases the payment of the debt to the bank by the guarantor. On the other hand, if the slight chance realizes and borrower enterprises make too high profits as a result of taking such

32 Stiglitz, Joseph E., and Andrew Weiss. "Credit Rationing in Markets with Imperfect Information." The American Economic Review 71.3 (1981: 393-410.

risk, they have the benefit for themselves. There is no return for the guarantor institution and the state implicitly as a result of this hidden action while it causes high monetary losses most likely vice versa.

The only checkpoint about the financial statement of a company used by the KGF is whether it has a non performing loan or not. However, most of the companies which declare concordatum recently, have not got a non performing loan but they suddenly fell. One part of them affected from sudden currency change then fell down. However, the other part used the concordatum rules for its benefit and selected this to return its profit and it is a salient example of bankruptcy for profit. To understand this, I will lastly mention about the terms to apply for concordatum and after its declaration what will be done.

4.2.1 *Concordatum Process*

Concordatum is explained in Turkey Bankruptcy and Enforcement Law(Article 206 as such an obligatory agreement between an honest debtor and a majority of its non-concessionary creditors and with the approval of the commercial court that the non-privileged creditors will waive a certain percentage of their receivables against the debtor or they give the debtor a certain amount of time to pay the debt and the debtor shall get rid of all of his/her debts by paying the portion (percentage of his debts accepted by the concordatum. [33] The lawmaker granted a borrower in such a situation an agreement with the majority of his creditors and allowed him to pay his debts within a time period recognized by his creditors.[34] In this case, a borrower, while agreeing with the majority of the creditors stipulated in the law, not only obtains a new period from them (the term concordatum, but a lso allows them to give up a percentage of their receivables (percentage concordatum. The ne cessary percentage in order for concordatum project to be accepted is that more than half of the creditors and receivables registered or one quarter of the creditors registered and two thirds of the receivables (BEL/302-3. This process is also deceivable because it creates the opportunity that malignant debtor become indebted on

33 Turkish Bankruptcy and Enforcement Law, enforced in 1932.

34 Uzay, Şaban. "İflasın Ertelenmesi Kurumunun Türkiye Uygulamasının Değerlendirilmesi" (2019.

purpose and delusively instead of the real debts in order to declare concordatum.

5

Conclusion

SMEs shining with globalization have been accepted as important building blocks of the society both economically and socially. Many incentives and support policies have been developed for SMEs in many countries, especially in developing countries. For developing countries, attracting the investments of big and corporate companies to hire is not so easy and there is no enough capital in order for people to encourage for founding corporate firms. Actually, as so in the other developing parts in the world, SMEs constitute more 99 percent of all the enterprises in Turkey. As the strategic economic policy, SMEs have been aimed to be more powerful and Credit Guarantee Fund Inc. is the one of the state action taken on this way.

Since 1991, the Fund was expected to provide guarantee for the loans given by the banks to promote lenders to give credit to SMEs. The guarantee program pays to the lender in case of default of debtor at the rate of risk undertaken during the crediting process. With the surety of KGF in excess of 250 billion TL, KGF became the biggest credit guarantee fund in the world.[1] When this policy is applied, this paper represents a black spot of this story. When transformations occur in sector, they are happening in such a way that financial risks are socialized while benefits are captured by the firms and businesses

1 Başkan, Serhat, and Vahit Ferhan Benli. "Kobi Finansman Sorunlarının Çözümünde Kredi Garanti Fonu Sistemi'nin Etkileri: İstanbul İli Portföy Analiz Örneği." (2019.

alone. The term may also address to the state that makes an effort to nationalize companies or industries which are the failing ones when it does not take over good companies.[2] Defenders of free market use the term to indicate how government regulation hurts business by focusing on the enterprises which are falling down but nationalized. This idea was earlier expressed as "Socialism for the rich and capitalism for the poor" [3] which was in use by the 1960s, though the notion of privatizing profits and socializing losses dates back to 1834 in the case that Andrew Jackson's closing of the Second Bank of the United States.[4] The risk of a private firm is guaranteed by the State Treasury, in other words by taxpayers, while all of the upsides belonged to the stockholders. It is a typical bailout' for financial institutions that is the transfer of wealth from ordinary working people to the rich. Bankruptcy for profit will occur if weak accounting, loose regulation, or low penalties for misuse give owners the willingness to pay themselves more than the value of their firms and then default on their debt obligations.[5]

The concern of this thesis can be explained in the light of the Akerlof's terms. As the same case, the seller of a particular product has more information about the quality of the product than the buyer. Asymmetric information means that one party is not as knowledgeable as the other in an economic relationship. In such opportunistic situations, markets may become unstable or the attractive features of the competitive market may disappear.[6] According to Akerlof's theory, unlike a competitive market in which there is full information and the customers can buy a product of good quality which they can maximize their own benefits, if there are sellers that have information which buyers do not have, they may tend to sell low-quality goods, often caused by asymmetric information. Such information asymmetry leads to quality loss in the products

2 Hahnel, Robin. "Economic Justice." Review of Radical Political Economics 37.2 (2005: 131-154.

3 Michael, Harrington. "The Other America: Poverty in the United States." New York: Touchstone (1962.

4 Krugman, Paul. "Banking on the Brink." The New York Times 23 (2009.

5 Akerlof, George A., et al. "Looting: The Economic Underworld of Bankruptcy For Profit." Brookings Papers on Economic Activity. 1993.2 (1993: 1-73.

6 Halaburda, Hanna, and Yaron Yehezkel. "NET Institute." (2011. p.4

and market insufficiency. This situation poses that adverse selection or wrong price choice in terms of the consumers and the producers that causes the danger of moral collapse. Even if a product is of high quality, it may remain outside the market in case it is not recognized by the buyers.

It is obvious that asymmetric information defined by Akerlof [7] can be observed between the credit guarantee funds and the banks about its customers. In case the sold product is the credit risk of a customer, the seller is the bank and the buyer is the KGF, the adverse selection is possible for the Fund. Banks using their information as an advantage would be eager to direct possible non performing credits lent by the customers not in a good financial condition to KGF. As a result, the credit guarantee fund obviously serves to the enterprises when putting the public budget into jeopardy considering the quite possibility of the repayment by the Fund.

7 Akerlof, George A. "The Market For Lemons: Quality and The Market Mechanism. Quarterly." Journal Economics 84 (1970: 488-500.

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