

The Application of a Loan Guarantee Mechanism for Small and Medium Sized Rural Agricultural Businesses in Mongolia to Access Credit from Commercial Banks



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1. Objectives

Mercy Corps Mongolia established a Loan Guarantee Mechanism (LGM) in 2004 as part of its Rural Agribusiness Support Program. Rural agribusinesses experience difficulties accessing credit due to their lack of collateral. The LGM assists them to obtain commercial loans through provision of additional cash collateral.

- The main objectives of the LGM are as follows:
1. To assist the rural businesses to access finance for the expansion and/or diversification of business activities.
 2. To strengthen the linkages between businesses and financial institutions.
 3. To promote the competition between financial institutions working in rural areas, and to encourage the banks to create favorable loan products for rural businesses.

2. Introduction

Geographic Area:
 Arhangai, Bayanhongor, Govi-Altai, Govi-Sumber, Dornogovi, Dundgovi, Umnugovi, Uvurhangai, Suhbaatar, Hovd, Zavhan

Cooperating Commercial Banks:
 Xac Bank, Khan Bank, Zoos Bank and Monqol Post Bank



Figure 1. Location of aimags (provinces) where the LGM is implemented.

3. Loan Guarantee Methodology

1. Rural Businesses develop a business plan with technical assistance from independent BDS providers. The plan allows the Business, Banks and Mercy Corps to identify the opportunities, risks involved and financial investment needs of the Business.
2. Mercy Corps reviews the business plan and if the business plan is considered viable for implementation, a formal letter with approval of additional cash collateral will be submitted to the Bank selected by the business.
3. The Business presents its plan to the bank, who in turn underwrite the loan and make an offer to lend. The business negotiates the loan terms and conditions with the bank.
4. The bank conducts normal underwriting procedures, values the business's collateral, and then makes a formal loan offer.
5. If there is a shortfall in collateral required, Mercy Corps deposits an amount equal to the difference between the loan amount and value of the collateral provided by the business into an interest-bearing account at the bank's head office.
6. In the event of default, the bank first recovers the value of collateral from the business and then recovers the deficit, if any, from the Mercy Corps cash collateral account.



Figure 2. Business Plan development by a rural business with assistance from local consultant.



Figure 3. Xac Bank underwrites loan to the herder business.

4. Results

- To date as a result of LGM implementation, 462 rural agribusinesses have accessed commercial loans worth US\$ 1.3 million; MC has provided US\$ 741,410 as additional cash collateral.
- The repayment rate is 94.9% with 1.66% of loan collateral at risk by the end of 2006 (over 1 month late repayments).



Figure 4-5. Rural clients who accessed loan with assistance from Mercy Corps.

- The LGM has encouraged banks to lend to rural businesses, decrease their reliance on collateral, decrease their interest rates as risk is reduced and lengthen tenure. As a direct result the two main rural banks lowered their annual interest rates from 42% to 18-24% for rural businesses, and increased the average loan tenure from 8 to 15 months and decreased their reliance on Mercy Corps collateral from 84% (first quarter of 2004) to 29.00% (last quarter of 2006).

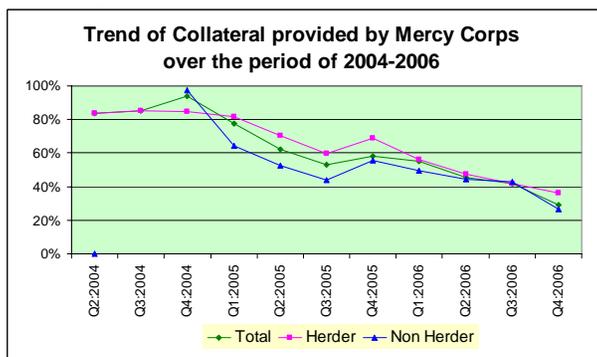


Figure 6. Trend of Collateral provided by Mercy Corps over the period.

- Many MC supported businesses (43.75%) have received loans for the first time. Prior to the LGM program approximately 10% of rural businesses had access to commercial financing on a regular basis.
- Banks stated that they would lend to most of the MC clients again without support from MC. IN a recent survey conducted by MC, Khan Bank indicated a willingness to lend to more than half of the MC clients without additional cash collateral from MC.



Figure 7-8. Rural life in Mongolia.

5. Plan for the future

- Mercy Corps Mongolia plans to institutionalize the LGM within a national institution which will be able to continue the provision of additional cash collateral for rural agribusinesses in Mongolia once donor (USDA) support ends.