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Executive Summary
**Government Support Program to
Enhance Alternative
Finance Initiatives**

Ori Dvir

Research Supervisor: Prof. Orly Sade



About the Milken Innovation Center Fellows Program

The Milken Innovation Center Fellows Program accelerates Israel's economic growth through innovative, market-based solutions for long-term economic, social, and environmental challenges. Our goal is to accelerate Israel's transition from a Start-up Nation to a Global Nation with solutions that others can replicate.

The Program awards annual fellowships to outstanding Israeli graduate students. We train and deploy some of Israel's best and brightest young professionals to create pragmatic financing and economic policy solutions. Our applied research and Financial Innovations Labs® are a launching pad for transformative change, using innovative financing mechanisms, programs and policies to bridge social, regional, economic and productivity gaps within Israel and between Israel and the world.

In addition, Fellows craft their own projects during their internship aimed at barriers to job creation and capital formation in Israel. The Fellows' research, carried out under the guidance of an experienced academic and professional staff, support business and policy makers to shape economic reality in Israel. The program offers the ultimate training opportunity, combining real-life work experience with applied research.

Throughout the year, Fellows receive intensive training in economic and financial analysis, public policy and research methods. They acquire tools for communication and presentation, policy analysis, leadership and project management. The fellows participate in a weekly research training workshop where they work with senior economic and government professionals, business leaders, and top academic and financial practitioners from Israel and abroad. They also participate in an accredited MBA course, taught at the Hebrew University School of Business Administration by Prof. Glenn Yago.

Fellows Program alumni can be found in senior positions in the public and private sectors. Some serve in key positions in government ministries while others work at private-sector companies or go on to advanced graduates studies at leading universities in Israel, the United States and Great Britain.

The Fellows Program is a non-partisan. It is funded, in part, by the Milken Institute and other leading philanthropic organizations and individuals in the United States and Israel.

Small and medium-sized enterprises (SMEs) are consistently shown to be crucial for economic growth and job creation. However, SMEs worldwide still encounter difficulties in accessing credit. Shortage of credit can lead to overall reductions in investment in SMEs, and generally prevent them from thriving. In Israel, many reports have noted that the absence of competition in the banking sector and the lack of non-bank credit solutions as contributing to high funding costs and credit access for SMEs.

The purpose of this research is to examine how the Israeli government, via a targeted support program, can broaden the credit supply to SMEs and promote competition in financial services.

The research presents data regarding the SME credit market, as well as the conceptual constraints of policies exacerbating this problem. We see that SMEs pay approximately double the interest rate for credit relative to large and established businesses, even though their default rates are not significantly higher than that of large businesses. One of the reasons for this is that SMEs have few credit alternatives outside the banking system. Therefore, the absence of competition in the banking sector remains one of the central causes of the high funding costs and low access to credit for SMEs in Israel.

This research surveys the non-banking credit alternatives that can provide solutions for SMEs. The review focuses on two types of alternatives. The first is a traditional approach, such as loan funds for specific populations, factoring and the expansion credit card companies. The second alternative focuses on new credit channels provided by companies that use technologies such as crowdfunding or peer to peer (P2P) loans. These platforms usually raise capital from the public in order to provide credit and implement algorithms to determine the risk of the borrower and the interest rate. An analysis of the existing innovative non-banking credit platforms in Israel today reveals that the credit that they provide is still insignificant. What is more, the volume of transactions and the growth rates of those platforms in Israel are still low relative to many other developed countries. However, the advantage of these platforms is that they can offer efficient and effective credit solutions at a smaller scale, which means that SMEs can benefit from their expansion.

As a result of these findings, the research then explores the creation of a government support program in the non-bank credit market, specifically targeted to encourage alternative finance platforms. The research also presents specific recommendations for how the government can participate in the support program. For this purpose, the research examines past government support programs from various sectors in Israel in order to identify best practices, as well as to analyze the major reasons for the success or failure of such programs. In addition, the research examines government support programs from a few countries around the world aimed at

promoting similar innovative credit platforms. The conclusions of the section suggest that there are several possible types of support that can broaden the credit supply of those platforms in Israel:

- Government guarantee – a government guarantee is designed to reduce the risk to the investors in a given project; as it pertains to credit platforms, the goal is to make investment in those platforms as more attractive. The guarantee can be structured the first layer of debt for these platforms (such that the country absorbs the first losses up to certain amount) or as the second layer (such that the guarantee will be put into action only if the failure of credit exceeds a certain percentage). In addition, an advantage of limited guarantees is that the government can offer separate guarantees either for every loan, or for the whole portfolio.
- Budgetary support - The government can transfer a lump sum to those platforms or provide additional support to every loan that they provided (for example, the state adds 10% to every loan). The platforms can use this government support to reduce risk (for example, in case of loss, the state's share will be greater) or to have more sources for the provision of loans. It should be noted that, this program anticipates that most of the state expenditures are expected to be returned when the loan will be repaid. Therefore, the government risk exposure will be limited.
- Guarantees given to institutional investors investing in these platforms - State guarantee would reduce the risk of these investments and therefore encourage the institutional investors to invest in those platforms.
- Public campaign – a public campaign would serve to create more awareness of the solutions that these platforms suggest to businesses and investors
- Regulation that forces the sharing of credit information between banks and the non-bank credit platforms.

The support program should lead to improve access to credit at lower costs, increase credit supply, expand non-banking credit market, and develop an eco-system in the area of credit solutions. We expect that that the implementation of this program can support small businesses in Israel and enhance economic growth and job creation.



The Jerusalem Institute for Israel Studies
Milken Innovation Center
20 Radak St. Jerusalem 9218604
Office: 02-5630175 (Ext. 34)
www.jiis.org.il
www.milkeninnovationcenter.org