Abstract

The aim of this research is to analyse how Spanish RGSs have developed and the problems they face resulting from an increase in bad debts in the current economic crisis: One of the most noteworthy conclusions is that in the face of current difficulties, the RGS have become all the more significant as they facilitate credit access for SMEs. However, these societies are also affected by the increase in bad debts and the need to keep required solvency ratios in the same way as other financial institutions. We analyse the role of re-warranty packages for covering the credit risk of RGSs and also the solvency of these societies and their level of activity over these years. It is clear that the latest mechanisms to be introduced have been important. Examples of these are: taking into account CERSA re-warranty when calculating the capital compliance ratio and the introduction of different autonomous re-financing models. These measures allow the RGSs to assume greater risk and reinforce their solvency.

Keywords: Financial Crisis, Reciprocal Guarantee Society, SME funding, Secured Loans, Warranty.

JEL codes: G01, G230.

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1. Introduction

During the course of 2012 financial tension in the euro zone has worsened, particularly in Greece, Spain and Italy. This situation has led to a toughening of conditions for funding for both the public and private sectors. The causes of this weakening are also related not only to the adverse international financial environment but also the state of public finance and the loss of credibility of the balance sheets of credit institutions (Bank of Spain, 2012a).

The problems faced by banks when accessing wholesale lending markets have led to a credit crunch which, when coupled with the increase in payment defaults, has raised the rate of bad debts to 11%. This is particularly evident in the building and real estate promotion sector, where the rate reached 26.4% at the end of 2012 although it is worth pointing out that it affects all parts of the lending portfolio, including home loans, where eviction orders are being carried out in the light of continued mortgage defaulting.

As far as SMEs are concerned, it is noteworthy that they struggle more to obtain bank loans than larger companies. This is all the more significant considering banks are their main source of funding. Not only that, the financial costs they experience tend to be higher. These problems have been exacerbated by the crisis which has been bludgeoning the Spanish and world economies since the end of 2008. The Reciprocal Guarantee Societies (RGS) are contributing to solving this problem since their function is to get the credit flowing to SMEs, through secured loans in similar conditions to large companies. In order to lower the costs of the guarantees on loans which SMEs must pay to the RGS the latter re-warranty of a percentage of the secured loans. However, the funding possibilities afforded by the RGS are, as yet, largely unknown to small Spanish companies. Consequently, there is a need to study them in greater depth and contribute to the awareness of their activities in the Spanish business world.

This study has as its main objective to analyse how the sector of RGSs in Spain is evolving in light of the crisis, and the problems caused by the increase in bad debts. In that sense, the RGS may be considered a solution to the problem of gaining access to bank loans which SMEs are experiencing and, as such, help Spain overcome the crisis. For that reason, in the second section we check the loan limitations in the financial system, the difficulties faced by SMEs when accessing bank loans and the increase in bad debts. In the third section we analyse the role of re-warranty packages in the coverage of credit risk in RGS and their contribution to the sector’s solvency. We also examine the role and development of the Autonomous Communities, which have supported the Guarantee Systems by holding capital of the RGSs and by contributing to the Technical Provisions Fund. Afterwards we analyse the development of the sector and the Spanish Re-warranty Company, S.A. (CERSA), which offers re-warranty packages to the RGS. Finally, we have included a section of conclusions and considerations about steps which could be taken to improve the credit situation of Spanish SMEs, for example, how the Q quality ratio can be calculated,
or how penalties and re-warranty fees are applied, in a similar way to the procedure in the banking sector.

2. Credit limitations and bad debt

At the end of 2008, the financial crisis caused a significant contraction and limitation of bank loans, which was particularly felt by non-financial companies. The indicators of bank funding for companies were less dynamic for several reasons: a less favourable outlook for growth, the levels of borrowing which had been reached and which triggered a gradual modulation of the demand for loans by private agents, the predicted weakening of economic activity and the hardening of borrowing conditions by financial intermediaries.

The effects of the crisis have intensified over time, thus worsening the conditions for loans and harming the confidence of institutions. The slight recovery, which the Spanish economy had experienced around the middle of 2010, was gradually weakened as the sovereign debt crisis in the European Monetary Union heightened tension in the financial markets and more and more eurozone states were affected. This situation made it increasingly difficult for banks to obtain funding from wholesale lenders, which, in turn, meant fewer loans were being granted and there was an increase in the number of cases of bad debts in many EU countries.

2.1. The credit crunch and funding difficulties for SMEs

The evolution of credit in Europe was very different during the credit growth period. While Spain grew at a rate of up to 30% at its peak (2005-2006), thanks to the development of the construction industry, France and Italy had rather more modest rates (10%-15%) and the figure for Germany was only around 5%. However, when the cycle entered recession, the behaviour of the credit market was much more uniform, with a sharp fall in the each of the countries studied; Germany and Spain experienced the sharpest drops (-5%), whereas France and Italy fell to a lesser extent (-2%). This is due to the fact that the recuperation in the credit market happens after the recuperation in the economic activity. These negative variation rates continued until September 2010, when loans to businesses increased temporarily until the beginning of 2011 (Caixa Catalunya, 2012a).

If we study in greater detail how credit has evolved in Spain up to the present day, we will see that the plummeting of funding for non-financial companies continued its downward spiral during 2009 with a recovery in the second half of 2010 due, amongst other things, to the Keynesian policies for public spending on infrastructure which the government employed – known as “Plan E”. However, during the course of 2011, there were further dips which took the variation rates to the levels found at
the beginning of 2010. The interannual variation for July 2012 was -3.3% (Banco de España, 2012a).

These falls were a consequence of a drop in bank loans being granted by home banks; in July 2012, the variation rate reached -5.9%, which is a fall of 3.4 percentage points in relation to the figure for the same month in 2011 (-2.5%)

In the case of SMEs, the situation is all the more serious as a result of the almost absolute dependency on bank loans for their everyday activity – both for working capital and investment.

According to the “Survey of SME access to external funding” carried out by the Higher Council of the Chambers of Commerce, in the third quarter of 2012, 27.7% of SMEs applied for funding, this marked a clear downward trend which began in the first quarter of 2012 (47.8%). The average figure for the years 2010 and 2011 was 68.9%. Over the same period, the third quarter of 2012, of all SMEs which applied for loans, 69.3% were successful. However, the obstacles to funding have increased, 63.5% of companies did receive a loan but the conditions were much harsher, whereas 25.5% had their application rejected by the banking entity (Consejo Superior de Cámaras de Comercios, 2012).

According to this report, the main cause of this situation is insufficient securities. This is true for 65.7% of the cases (the average in 2011 was 46.7%).

In this sense, the number of companies unable to gain access to loans has increased in comparison to 2011, but also the funding conditions themselves have worsened:

- The volume of funding has fallen for 23.3% of SMEs.
- The cost of funding has risen – borrowing rates are higher for 81% of companies and commissions have increased for 71% of businesses.
- The demands for securities and guarantors have increased. Of the 85.3% of SMEs which have suffered an increase in the demand for securities and guarantees, in 53.3% of cases, personal property has been required as security.

As far as the source of funding of SMEs in 2012 is concerned, it is worth highlighting the fact that the number of businesses which belong to a RGS and have applied to the RGS for a security has fallen. To be precise, in the third quarter only 2.5% of SMEs have done so, as opposed to the 9.1% average reached in 2010 and 2011. This reflects a fall to the figures registered at the beginning of 2009 (Consejo Superior de Cámaras de Comercios, 2012).

As regards the funding programmes offered by the ICO (Instituto de Crédito Oficial), whose conditions are better than the rest of bank loans for SMEs and are comparable with those of the bigger companies, it is worth noting that of all businesses which sought external resources up to September 2012, 40.3% applied for a ICO loan. This figure is higher than the average for 2010 and 2011, which was 37.7%. It is worth noting too, that of all those businesses which applied for the ICO loan, 78.8% were successful in obtaining funding from the ICO (57.7% receiving the amount they applied for and 21.2%, a lower amount than what they applied for).
Finally, from the analysis carried out by Analistas Financieros Internacionales (CESGAR, AFI, 2012) on the system of reciprocal guarantees and its contribution to business activity, the following is noteworthy: the accumulative fall in loans in Spain from the end of 2008 until the middle of 2012 is 7.81%, the limited access to bank funding has been noted more severely in SMEs, with the number of loans of under 1 million euro being granted to companies falling by 60%, according to figures from August 2012 compared with the first quarter of 2009. Concerning bank funding, this has become more expensive for businesses over the last three years with an increase in differentials ranging from 1% to 4.6%.

The AFI concludes that the current loan situation in Spain (less abundant, more costly and with greater demands being placed on the borrower) will continue for the medium and long terms so current conditions should not be seen as temporary or extraordinary but rather as permanent.

2.2. The state of bad debts

Another symptom of the worrying situation which the Spanish economy is going through is the increase in cases of bad debts. This is closely linked not only to the international financial crisis, but also to the bursting of the Spanish real estate bubble and the rise in unemployment, which reached 26.2% in October 2012 (the highest for any of the EU countries).

Whilst the volume of loans has fallen gradually from 1,869 billion euros in 2008, to 1,699 billion euros in 2012, the rate of bad debts has risen steadily, from 0.92% in 2007 and 3.37% in 2008 up to 10.8% by the middle of 2012 (Banco de España, 2012c). The reason for this increase is the growth of doubtful assets and the negative variation rates for credit. Nonetheless, the rate of bad debts varies when comparing one sector to another. For non-financial companies the rate reached 16.8% in June of 2012. This rise has been especially conditioned by the position of building and real estate promotion firms, where the rate reached 27% (Banco de España, 2012d).

In these circumstances, it is necessary to adopt measures to support the funding of SMEs, for one basic reason – these are the companies which suffer bank loan limitations more acutely and, at the same time, they are the companies which are most effective in creating and sustaining employment. By way of an example, between 1996 and 2000, SMEs accounted for 80% of all new employment created in industry and services (Ministry of Economy, 2002).

3. Re-warranty in the coverage of bad debts in the RGS

With the objective of obtaining greater efficiency in credit markets and facilitating access to bank funding for SMEs using a mechanism of guarantees, Spain has articulated the system using Reciprocal Guarantee Societies. The RGS in Spain are
one of the most developed and well-regulated systems in Europe (AECM, 2004). The key to their success has been the co-operation between the member SMEs, Central Administration, and Autonomic Administrations. These societies came into being in 1978 but they have been the object of deep-seated reform since the Law 1/1994, which establishes the legal framework that governs the legal nature of reciprocal guarantee societies was passed. Since then, a series of regulations and instruments have been developed with a view to incorporating the RGS into the financial system and contributing to their solvency.

In the Spanish system, the RGS acts as guarantor of the SME before the financial entity, for the whole value of the loan, carries out a study and follow-up of the operation and receives a small fee from the business. With this guarantee, it covers the Bank or Savings Bank’s management of bad debts and defaults. The guarantee is, therefore, made effective immediately for the lending institution. This is especially important, given that most of the funding for SMEs comes from banks. In addition to this, with this backing from the RGS, better use can be made of the ICO credit loans, because, with it being a mediator, it is the financial institution itself which takes decisions and decides whether or not to grant loans to the companies which apply for them. Basically, by taking advantage of the RGS, a considerable number of the cases of rejected applications can be resolved.

The RGS exist as financial institutions and, as such, they are required to maintain their capital compliance ratio at the same level as other financial institutions. They are under the supervision of the Bank of Spain, 20% of the warranty that they provide is computed in the capital requirements calculation of credit companies and it frees them from the cost of provisions in secured risks for these societies. This allows the lender to apply lower interest rates and longer terms for the loans to SMEs which are guaranteed by the RGS.

The security which is given by the guarantee system generates two types of costs which are reflected in the results of the RGS which should be passed on to the companies in the form of the commission charged: administration costs and provisions to cover bad debts and bankruptcies. As a means of reducing the cost of guarantees for SMEs, in Spain, (as in other countries), public re-warranty systems have been created.

The purpose of re-warranty is for the system to take on a percentage of the operations guaranteed, freeing up the company benefits from re-warranty (Gómez, 1944), so that the risk is shared between the society or organism which offers the re-warranty package, and the guarantee society. Hence, the re-warranty covers the part which corresponds to provisions and defaults of the re-guaranteed portion.

Re-warranty carries out a fundamental function – that of lowering the cost of the guarantee to the SME, which in turn, lowers the cost of long-term funding. Generally it is the Public Administration that assumes the cost, through some state-owned organism or society. In the case of Japan, for example, the Japan Small and Medium

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(1) In some systems – for example, in Germany – the society guarantees only a percentage.
Enterprise Corporation (JASMEC) covers between 70% and 80% of the loans secured by the guarantor, with the funds coming wholly from public sources and included in the general budget of the state. In other systems, such as in Germany, the guarantee is granted to the SMEs by means of what are called Security Banks and the re-warranty package security is shared between the Federal Administration and the Regional Administrations – normally it is 65% of the secured loan but sometimes as much as 80%. The former usually covers 36% and the latter, 29% (Pombo and Herrero, 2001; Gómez, 1995; De la Fuente, 2007).

In Spain, the support given to offset bankruptcies and the bad debts of the RGS has been put in place using two mechanisms: the technical provisions fund and re-warranty. Public Administrations have backed both instruments, given that they serve to increase the solvency of the company and reduce the cost of the warranty, because the total costs caused by credit risk and SMEs default do not have to be passed on to the SMEs.

The technical provisions fund is governed by the Law 1/1994 and its goal is to offset the bankruptcies and provide the necessary provisions to cover the credit risk. It is financed by money from the RGS with money that comes directly from their income statement, and from other entities – normally Autonomous Communities. The part which does not go towards financing defaults becomes part of the equity of the company so it serves to strengthen the solvency of the enterprises.

The Central Administration supports the system through the Spanish Re-warranty Company, CERSA. This society absorbs part of the risk of the RGS, thus multiplying their possibility of action. It covers a percentage of defaults, general and specific provisions and thus frees up the RGS from the credit risk provisions in the re-guaranteed part. The re-warranty is automatic for financial operations until its expiration, and has a limit of 625,000 euros (except in certain sectors, which are called “special sectors”, given their particular nature), and the period of the guarantee is greater than 36 months. Coverage varies between 30% and 75% of the guaranteed loans by the RGS to SMEs. In addition, CERSA has 35% coverage from the European Investment Fund.

Re-warranty is free up to a certain level of the the Quality ratio, “Q”, which is defined as: the relation between the sum of the increase of specific net provisions and the increase in net defaults of the RGS, divided by the risk matured for the period. If the ratio is greater than 6%, an annual commission is created with a maximum of 50% of the annual commission of the guarantee of the re-guaranteed risk.

The State Administration co-operates with the system through CERSA, the major shareholder, 72.2% of the capital belongs to the State (Patrimonio del Estado), and 23.87% belongs to the Instituto de Crédito Oficial (ICO). In addition, it allocates a considerable quantity to its Technical Provisions Fund each year, an amount which comes from the General State Budget, generally through the Directorate General for Industry and SMEs (DGIPYME).

Generally speaking, the Autonomous Communities have supported the system of guarantees, by participating in the capital of the RGS and by giving money to the
Technical Provisions Fund. In addition, some of them have approved autonomic re-warranty packages which, alongside the CERSA, have covered part of the portfolio of guarantees of the RGS, normally up to 75% of the risk not covered by CERSA (De la Fuente y Priede, 2003; De la Fuente, 2007).

The Reciprocal Guarantee Society of the Autonomous Community of Valencia was the pioneer in introducing autonomic re-warranty (in 1994), through the Instituto Valenciano de Fianzas, which even covered default. It was revised in 2004 when a complementary coverage was introduced. This coverage complemented CERSA’s 75% coverage in joint operations and its 40% coverage for financial transactions which were not refinanced by the aforementioned society².

The Basque Government introduced autonomic re-warranty in 1999 directly through Consejería de Hacienda. An agreement was signed with ELKARGI and, in 2001, with OINARRI. This is in parallel to CERSA and it covers up to 75% of the transactions re-guaranteed by CERSA. In addition to this agreement another was created, called “complementary” for those operations which were not re-guaranteed by CERSA.

Interestingly, these RGS which have been backed by autonomic re-warranty have been the most active ones over the last years. When we analyse the support received from Autonomous Communities, it can be observed that this re-warranty has replaced the money given to the technical provisions fund, because they are mechanisms with similar functions. In research carried out by De la Fuente in 2005, both societies mentioned re-warranty as a key element for their growth.

In 2006, re-warranty from the Instituto Catalán de Finanzas came into being with AVALIS. This was very similar to the Basque Country and complemented the coverage of CERSA up to 75%. In the last two years, similar re-warranty systems have been set up: in the Balearic Islands with ISBA, in the Canary Islands with SOGAPYME and SOGARTE, in Cantabria with SOCARGA, in Aragón with AVALIS and in Madrid with AVALMADRID, although the latter is only for the portfolio of re-guaranteed which were established in 2011. Additionally, a partial autonomic re-warranty system has come into operation in Galicia with AFIGAL and SOGARPO.

In February of 2009, something happened which increased the RGSs’ ability to assume risk – the Executive Commission of Spain’s Central Bank agreed that the risks refinanced by CERSA should count 50% when calculating the capital compliance ratio of RGS. This measure came as a consequence of what was established by the Royal Decree 216/2008 which recognised that re-warranty, under certain conditions, is an instrument which reduces loan risk and which, therefore, should reduce the capital requirements for joint re-warranties with public organisms and entities. Later, the notice 5/2008 issued by the Bank of Spain established in its first rule, sec-

(2) This RGS was the first in terms of level of activity since the end of the 1990s. However, in the last 2 years it has suffered a significant downturn in its guarantee portfolio. Presently, it is undergoing a process of restructuring.
tion 4, ii) that re-warranty contracts agreed with re-warranty institutions, insurance companies or public bodies, which reduce the credit risk of reciprocal guarantee societies, shall have the reduction factor set by the Central Bank of Spain and which may not be greater than 0.5. In the same way with CERSA, autonomic re-warranties have a reduction factor, in this case 0.45% or, in other words, the re-guaranteed risks compute at the 55% level when calculating the capital compliance ratio\(^3\).

These last measures completed the inclusion of the guarantee system within the group of financial institutions, since re-warranty was not considered until 2009. The immediate effect was to increase the multiplier effect of the money which the Public Administration gave to the RGS. Previously, each euro of public money which was contributed freed up 12.5 euro for guarantees, the capital compliance ratio being 8% of outstanding risk. The consequence was duplication, as both the RGS and CERSA computed the re-warranty signed by CERSA when calculating their respective capital compliance ratios. At present, if the average coverage of an RGS is, for example 50%, in operations re-guaranteed by CERSA, it would mean that for every 100m euro re-guaranteed, 75m would count towards the capital compliance ratio. In other words, the capital requirements would be 6m instead of 8m. The multiplier would be 16.6 euro instead of 12.5 euro in guarantees for each euro contributed by the Adminstration. It is, therefore, a much more effective tool to support SME financing than, say, direct subsidies and, in addition, no negative side effects are caused because the system does not relieve the debtor of their duty to pay back the loan. (De la Fuente et al., 2010).

4. Activity and bad debts in the sector and in CERSA

The RGS are a funding instrument for SMEs and, therefore, they are of particular importance in the current climate of crisis in that they facilitate the flow of credit to these companies. Having said that, to be able to carry out this function, the solvency of these companies has to be strengthened and measures, such as re-warranty, must be taken by both the CERSA and the Autonomous Communities in order to combat the current high levels of bad debts. In today’s climate, this support is all the more necessary.

In this section we will be studying how the activities in the sector and in CERSA have evolved, paying particular attention to the data related to solvency and bad debts. Prior to that, we will detail the measures which have been taken at a national level – essentially CERSA and ICO – to improve the access to funding for SMEs and self-employed people through the RGS. It would be beyond the resources of this study to analyse all products and specific lines which each individual RGS has introduced; however, the research team does feel that it could be the subject of later research.

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\(^3\) This came out during interviews carried out with CESGAR and with the Treasury of the Basque Government, both for this research and for the one in 2010.
4.1. Measures against the crisis

The Central Administration is involved in the guarantee system through the DGIPYME and the ICO. Both contribute to the capital of CERSA; in addition, the DGIPYME also makes contributions to the technical provisions fund each year. A series of measures has been put in place by both of these institutions to help ease the effects of the crisis in the RGS sector and, generally speaking, to facilitate funding for SMEs through these societies.

The fundamental needs of SME’s in recent years have been to obtain liquidity and to refinance liabilities, because financial institutions have restricted access to loans for businesses and in some cases even freeze their loan activity altogether. With a view to resolving this situation CERSA has increased the coverage of the financial transactions for working capital from 30% to 50% of the re-warranty package. In 2010, the DGIPYME made a one-off and exceptional contribution to the technical provisions fund in addition to its annual one of 8.7m euro.

At the end of 2010, the ICO-RGS line was signed – it is an intermediary agreement whereby the ICO supplies the Banks with funding so that they can lend money to companies with the guarantee of the RGS. The loan proceeds may be either used for investment purposes or for working capital. CERSA re-guaranteed 50% but with the ultimate backing of the ICO so that it is not the CERSA but rather the ICO which assumes the risk and any default does not affect the quality ratio, Q. This is the essential advantage for the RGS over other typical credit lines in which for any investment operation they may have a higher CERSA coverage of up to 75%.

In the interviews with CERSA and CESGAR, they said that this credit line was not used much in 2011 as it could be considered inconvenient and complicated because of the middle party who had to assess the operation beforehand. A total of 78 operations were agreed, amounting to almost 10 million euros.

In 2011, the Program of Guarantees for Entrepreneurs was also created by CERSA, with a contribution of 15m euros to the technical provisions fund, 75% coverage and with defaults not affecting the Q ratio. That year 1208 operations were signed (which amounted to a risk for the CERSA of 29,441,894 euros). This translates into more than 39 million euros of guarantees for SMEs by RGS’.

4.2. Evolution of the activity

At present there are 23 RGS in operation; most of them cover several sectors and operate in their respective Autonomous Communities, although some have extended their activities to other regions. Three RGS are sectorial carrying out their activity at a national level. In 2010 a new institution came into being – Aval Castilla-La Mancha. There are 110,273 associate companies, (82% have fewer than 50 employees and 50% have fewer than 10) (CESGAR, 2011). According to the estimates of CESGAR, investment amounts to 32,000 million euros and 820,000 jobs are linked
to the companies which are currently benefitting from the guarantees. There are 781 limited partners⁴.

As regards the guarantees themselves, it is worth noting that they totalled 24,800 million euros in 2011, and 1,282 were from that year. There was a considerable decline in 2010 (-28.9%) and 2011 (-27.4%), reaching levels below those recorded in 2005 (1,809 million €) and 2004 (1,495 million €) – naturally, this was a consequence of the economic crisis.

It is important to mention the downturn in 2008, possibly as a consequence of the beginning of the crisis which froze the flow of loans to companies for several weeks. This situation, however, changed into impressive growth figures in 2009 (12.4%), as a result of the increase in financial guarantees for investment (Central Bank of Spain, 2010), although the fact that that year saw the launch of specific liability-re-warranty products was also a factor. These measures really helped ease the problems faced by SMEs when seeking loans through the RGS. In that sense, it is important to mention the 585 million euro increase in outstanding risk in 2009, taking the total to 6,524 million euros. According to the information released by CESGAR, a considerable portion of this increase is for working capital operations. These were particularly necessary at that stage and went from being 4% of outstanding risk in 2008 to 13% in 2009 – this figure was 14.7% in 2010.

As can be seen from table 1, the outstanding guarantees totalled 6,524 million € in 2009, practically doubled over 2004 (3,307 million €). In 2010 there was stagnation and in 2011 the figures fell as an obvious result of the current crisis. It would be interesting for future studies to analyse whether or not the demand for RGS loans by SMEs has fallen, if credit conditions have become tougher or if it is the financial institutions themselves which make it more difficult to agree more operations.

(4) They participate in the equity of the society to support SME funding through RGS but they do not have the right to solicit guarantees from the latter. This category is mostly composed of Autonomous Communities, Business Associations and Chambers of Commerce.
The levels of coverage of CESGAR have remained between 30% and 35% of risk of the sector; the percentage of re-warranty for financial transactions will, naturally, be higher, given that the figures published by CESGAR include technical guarantees which are not re-guaranteed by CERSA.

4.3. Evolution of bad debts

The crisis has brought about a considerable increase in loan defaults and obviously this situation is similar for RGS. In this section we have studied the development of the rates of bad debts and solvency, both in the sector and CERSA. The latter is especially relevant, both in budgeting for the necessary provisions for credit risk and to facilitate the growth of guarantees in the mid- and long-terms, thus generating economic recovery through the secured loans to SMEs.

The equity, which include capital and the part of the technical provisiones fund which does not need to be used for its purpose, have developed in line with outstanding risk, which has meant the solvency ratio has remained reasonably steady – since 2006 it has been between 10.5 and 10.8 (table 2). As for bad debts, they increased considerably from 2008 on, reaching 20.95% in 2011.

In table 2 it can be seen that it will probably be necessary to increase the technical provisions funds to cover bad debts and the necessary provisions for the defaults of guaranteed companies. Having said that and judging by the information released by the Bank of Spain, the combined capital of the sector meet 166.8% of the minimum required (Banco de España, 2012c). It may also be important to take steps towards the launch of autonomic re-warranty, as some Autonomous Communities have already done, given that these (in the same way as CERSA) free up part of the refinanced guarantees from the calculation of assets.

Table 2. Bad Debts and Solvency ratios (RGS and CERSA)

<table>
<thead>
<tr>
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<th>2006</th>
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<td><strong>Bad Debts ratio</strong></td>
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<tr>
<td>RGS</td>
<td>6</td>
<td>6,5</td>
<td>11,4</td>
<td>13,48</td>
<td>15,4</td>
<td>20,95</td>
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<tr>
<td>CERSA</td>
<td>7,2</td>
<td>7,4</td>
<td>10,7</td>
<td>12,5</td>
<td>15</td>
<td>18,7</td>
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<tr>
<td><strong>Solvency ratio</strong></td>
<td></td>
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<tr>
<td>RGS</td>
<td>11</td>
<td>10,7</td>
<td>10,5</td>
<td>10,4</td>
<td>10,8</td>
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<tr>
<td>CERSA</td>
<td>8,6</td>
<td>9,2</td>
<td>10,2</td>
<td>8,3</td>
<td>9,8</td>
<td>11,7</td>
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*Source: Formulated by the authors based on the information from CESGAR, CERSA and Bank of Spain.*

Also we can see how the ratio of bad debts and assets of CERSA has developed. The re-warranty provided by CERSA really does serve a fundamental purpose in the
sector by covering part of the guaranteed loans and so boosting the RGSs’ capacity to take on risk. However, this society is also obliged to have the necessary solvency ratio. In addition to capital it also has a technical provisions fund which is essentially financed by Central Government.

The solvency ratio reflects the commitment of the members in capitalising the company. After the crash of 2009 when it reached 8.3%, there was a recovery, reaching 11.7% in 2011 thanks to the increase in capital and the contributions made to the technical provisions fund in the previous period. In Table 2 we can also see the increase in bad debts giving a ratio of 18.7 in 2011.

It is necessary to mention an important event which happened in 2010. In CERSA’s re-warranty contract with the RGS, they considered the possibility of establishing a fee which would be applicable whenever the Q ratio exceeded a certain level – as is mentioned in the previous section. In the years 2010 and 2011, re-warranty fees were introduced, totalling 2,061,270 and 702,458 respectively (CERSA, 2011). Together they amount to 2,763,728 euros, which is not a terribly significant amount and only 5 RGS were affected. However, the authors feel it is necessary to make two comments about this issue, given that the Q ratio is conceived as a penalty for RGS’s risk management policy. Firstly, it would have been more appropriate to revise and update the Q ratio value for a crisis situation such as the current one. It does not seem logical to maintain the same levels for the years before and after 2008.

Secondly, it would be of use to consider whether or not the situation of these RGS is a consequence of bad credit risk management or if it stems from the general crisis faced by the Spanish economy as a whole.

Finally we have calculated the cost of defaults to the CERSA since the re-warranty model came into effect in 1995 – based on defaults net of recoveries. In 2005 the figure was 36.2 million euros, which was 1.7% of matured risk (1,927 million euro) between 1995 and 2005 (De la Fuente 2007). In 2011, after four years of crisis, the figure had increased but not as much as might have been expected given the circumstances – it now stands at 2.6%. There has been a transfer of defaults net of recoveries of 101 million euros with matured risk of 3,825 million euros.

5. Conclusions

The current international financial situation, the economic crisis and Spain’s soaring unemployment triggered a sizeable fall in credit from financial institutions and an increase in bad debts. This situation is all the more problematic for SMEs as they depend on bank loans to finance their activity. In recent years, the hurdles to funding have grown for these enterprises: the amount of loan capital available has

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(5) The data are from the CERSA report, 2011. The net transfer for defaults is 113 million, from which 12 million should be subtracted as they are from the Sociedad Mixta de Segundo Aval.
shrinked, interest rates are higher, more commissions have been established and guarantee requirements have increased. With this panorama, the role of the RGS is all the more relevant. It is also important to support instruments which help SME’s with the problems they face when they try to access funding. These companies have shown a considerable employment generation potential in previous crises, thus it is clear that RGS can help ease that problem. In addition to this, there is the multiplier effect which their activity produces and which other aids do not generate.

Having said that, as with the rest of financial institutions, they are suffering a high level of bad debts and, on top of that, they are obliged to keep the required levels of solvency and, of course, the requirements of the Central Bank of Spain. As for credit risk, re-warranty plays a key role in that it offsets part of the re-warranty portfolio of the RGS, and the costs of provisions and bankruptcies which come with it. This allows the SMEs to obtain guarantees at a lower cost. Measures have been taken to support this coverage mechanism. The most important of these is to authorise a reduction factor of 0.5% of risks re-guaranteed by CERSA, or a similar figure for re-warranty from the Autonomous Communities, for the calculation of the capital compliance ratio. This measure strengthens the solvency of the RGS and extends their capacity to take on a higher volume of risk. The multiplier effect of a 1-euro contribution in the RGS can increase guarantees from 12.5 to 16.6 euros.

There is also a tendency towards complementary autonomic re-warranty (complementary to CERSA), in several Autonomous Communities, for example in the Community of Valencia and the Basque Country since 1994 and 1999 respectively. Similarly, others have been launched in Catalonia, the Balearic Islands, the Canary Islands, Aragon, Madrid, Cantabria and, partially, in Galicia.

Upon analysing how the activity in the sector has evolved, we can observe an increase in 2009, triggered to a large extent by transactions of working capital, which were particularly necessary at the time – these jumped from 4% in 2008 to 14.7% in 2010. However, there was a sharp decline in 2010 and 2011.

Concerning solvency, it should be highlighted that great steps have been taken, both in the RGS and CERSA. In the RGS, the levels are in excess of 10% (10.8% in 2011), and in CERSA, following the considerable fall in 2008, when it reached 8.3%, the figure for 2011 was 11.7%. In addition, considerable contributions have been made both to capital and the technical provisions fund.

Bad debts in the RGS’ have risen from 6.5% in 2006 to 20.95% in 2011. Important factors in the calculation of the ratio for this year were the defaults for the period and the reduction in outstanding risk. In 2010 and 2011, re-warranty contracts incurred a penalty based on the Q ratio, with five RGS having to pay commissions of a total of 2,763,782 euros over the two years.

This leads naturally to a study of the calculations of the quality ratio, Q, since the same figure has been applied in recent years as in the boom years. The system should, perhaps, draw up mechanisms to tackle critical situations such as the present one in which the economy is in a financial crisis which has led to periods of recession. The level of bad debts in the banking sector has gone from 0.9% in 2007 to 7.6% in
2011 and, for the RGS, the figure has also risen considerably in the same period although proportionally it has not been as drastic from 6.5% to 20.95% – the sector is accustomed to higher levels of bad debts as a consequence of the social nature of its function. The understanding of the authors is that it would be necessary to implement mechanisms or funding to allow CERSA to increase in similar proportions to the Q ratio for situations such as the current one. Likewise, the authors feel that to justify the application of penalties and a fee for re-guarantying, it must be verified if the situation of each society is the consequence of a bad risk management policy or if it is the result of the general crisis which the economy, as a whole, is suffering – this is particularly the case in certain areas or sectors, for which measures should be sought to ease the situation in the same way as is being done with credit institutions.

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