

Development of the Corporate Credit Information Database and Credit Guarantee System

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Executive Summary

This study builds on the preceding “**Development of Database on Corporate Credit Information**” in 2007/2008, which underscored (1) the reality that SMEs throughout East Asia face the difficulty in accessing finance from the market, and (2) the importance of having a credit information database to reduce the information asymmetry problems and ease financing access of SMEs, in particular. New participating research institutions from Malaysia, Philippines and Thailand contribute to the research and making recommendations.

The SME Industry, Credit Information Infrastructure and Credit Guarantee Schemes in ASEAN

Information asymmetry still exists and the type of infrastructure that could appropriately address this problem varies widely, in terms of existence and state of development, across the ASEAN region. SMEs play a pivotal role in the industry structure of ASEAN nations (in terms of contribution to output growth, value-creation and employment) and yet their growing demand for credit is not entirely matched by the existing credit infrastructure and credit products of banks and other lending institutions. A credit information system is an indispensable infrastructure for credit market development. The provision of credit information helps lenders understand better the risk profile of their borrower-clients, enables them to expand their credit services, and reduce the financing problems for SMEs. Recent availability of new technologies such as credit scoring has facilitated the ability of banks to service SMEs better. ASEAN countries have established credit registries/bureau, but some of them do not possess credit bureau specified for SMEs.

Credit guarantee schemes (CGS) have the objective of absorbing part of the loss resulting from default of a bank loan. It reduces the risk of the lender, serves to improve the supply of credit and facilitates the smooth operation of the loan market. CGS can be compared and contrasted according to: definition, types of CGS (direct or indirect, individual or portfolio model, funded or unfunded, open or targeted, ex-ante or ex-post schemes and ownership), country-differences in establishing the rationale for CGS operations, criticisms and issues (motivation, sustainability,

funding, additionality, scheme design, moral hazard, scheme operations and practices, eligibility, enabling environment and success factors).

Insights from Japan's Credit Information Infrastructure and SME Financing Models

The CRD Association, which manages the Credit Risk Database (CRD), was established as an organization to collect the information regarding SMEs and construct the credit information database to improve the environment for fund-raising of SMEs. It is associated with credit guarantee corporations, which operate regionally. There is the need on the part of credit guarantee corporations to make an appropriate and objective evaluation of the creditworthiness of their customers, using the database of customers of all credit guarantee corporations in Japan. So, there is an incentive for credit guarantee corporations to provide the credit information of their customers to the CRD database. The Japanese experience with credit information infrastructure, particularly for SMEs, indicate that for this kind of infrastructure to support the internal rating based approach of banks, it will need to provide additional services to evaluate the credit risk of pooled data while paying attention to the issue of data protection, specifically anonymity.

Under the Basel II framework financial institutions are required to adopt either the standardized approach or the internal rating based approach in their risk management. Only a limited number of financial institutions such as mega banks and a few regional banks have adopted the internal rating based approach, mainly because this approach requires a large number of human resources and time to estimate the amount of credit risk according to the method stipulated by the internal rating based approach. Other smaller financial institutions have basically adopted the standardized approach. However, they receive the guidance from the authorities that they should conduct the strict internal ratings for SME in credit evaluation and internal management. Along with this kind of guidance, an increasing number of smaller financial institutions have adopted scoring models. This creates the demand for large-volume credit information database, like the CRD.

A large-volume credit information database can be created by the public sector as well. In fact, some central banks in Asia do manage such database. They will not find much difficulty in collecting a large volume of data from financial institutions and usually function as the credit bureau, responding to enquiries about the credit information of an individual borrower. However, if they want to support financial institutions in adopting the internal rating based approach and developing new methods for SME financing they will need to provide additional services to

evaluate the credit risk of the pooled data, while paying due attention to the data protection like anonymity.

Furthermore, progress in the credit evaluation methods together with the information and computer technology has made it possible for financial institutions to develop the credit score lending and collateralized debt obligation (CDO) schemes for financing of SMEs, particularly of small and micro enterprises. The key technology is how to estimate the average credit risk of a portfolio (pooled debt), not the credit risk of the individual borrower. If a large volume of credit information can be collected, the credit score lending and CDO schemes will become more readily available for small and micro enterprises. As in the case of Tokyo Metropolitan Government, CDOs with the guarantee of the public sector are the potent investment to facilitate SME financing by way of bundling many small-lot loans extended to SMEs. CDOs, if well managed, are effective tools for intermediating savings and investment on a regional basis. Establishing a large volume credit information database and having a common understanding of such database will promote the cross-border SME financing.

Policy Recommendations on Credit Information Infrastructure and Guarantee Schemes

Financial infrastructures are important for facilitating SME financing. Infrastructures such as legal systems, accounting and audit standards, and document standardization should be improved. Transparency and disclosure should be further promoted. Efforts to improve financial infrastructures at home will make positive effects on SME financing. If efforts are coordinated regionally, these effects will certainly be larger.

In the context of establishing a template for a regional information sharing mechanism, efforts must first be concentrated on the getting off the ground the establishment (and development) of reliable and robust credit information systems in all ASEAN10+3 economies. The typical requisites of a credit information infrastructure, as best practices for each country are: (1) The legal and regulatory frameworks for credit reporting; (2) The technology platform that would support such regional information sharing mechanism; (3) The providers and users of data; (4) The kind and quality of data to be collected and distributed; (5) The support for an advocacy program for credit reporting discipline, outreach and education; (6) Institutional arrangements that would govern the collection and use of credit information across borders; and (7) Policy guidelines for the use of regional credit information to benchmark how financial institutions rate in terms of credit reach to formal industries, with special interest to SMEs.

Credit guarantees schemes (CGS) have played an important role in Asian economies. The CGS experience of ASEAN countries demonstrates the importance of guarantors having sufficient capitalization and prudent risk management practices since guarantees are vulnerable to concentration risk. On the SME front, the following need to be part of SME discipline to prepare them for their entrance in capital market activities --- continuous disclosure of information on company's financial and operational profiles, aligning company procedures and outcomes with best business practices; establishing track record and related footprint in business transactions; tapping the support of broking community; obtaining knowledge as to the requirements and costs of listing, underwriting and funding; possessing and upholding sound principles and business ethics surrounding company management, governance, integrity, accountability, transparency, credibility to reliable information, and discretion for directors and management.

Policy Recommendations for Establishing the CRD-type SME Credit Information Database

The specific policy recommendations for establishing the CRD-type SME credit information database may include as follows:

- (1) SMEs have to be given incentives to disclose their truth data to the database. In Japan, there is an incentive for credit guarantee corporations to provide the credit information of their customers to the CRD database. Since ASEAN countries have different financial and SME lending systems, the organizations to collect SME data in each country must be carefully selected to ensure such incentives.
- (2) An organization of the SME database should ensure the confidentiality and trustworthiness in its database. This institution, which may be a government agency, a government-affiliated institution or an independent organization of banks should not be compromised to divulge or disclose information in its SME database to tax-collecting agencies or other related agencies. At the same time, its profitability and self-financing capacity must be ensured.
- (3) Once the organization to collect SME data is set up, the government must spend for the initial costs of its establishment to help get its operations off the ground. The costs must be minimized. At the same time, it must have its own revenue source. In Japan, the CRD collect fees from financial institutions by selling data and by providing the computation services of default risks. Consultation service of data analysis with various banks is another source of income from the CRD.

(4) The SME database should be a repository of both financial and non-financial SME data. In Japan, the data collected by CRD includes sales, operating profits, ordinary profits, investment in plant and equipment, investment in P&E (excluding investment in software), increase in inventories, ratio of operating profits to sales, ratio of ordinary profits to sales, ratio of net worth, liquid assets, inventories, fixed assets, deferred assets, total assets, liquid liabilities, fixed liabilities, net assets, interest expense and personnel expenses. For ASEAN countries which are just in the process of establishing an SME-dedicated information agency, they should study what kinds of data are appropriate to be collected in order to analyze well the SME business profile.

(5) Statistical analysis is required to compute the default risk ratio of SMEs. The database institution can then provide statistical analysis to its member banks.

Recommendations on Further Studies for Establishing Good Information Database for SMEs

Further studies need to be made on the following items:

1. To expand the coverage of the country study on credit information database, which in this report is limited to Malaysia, Philippines and Thailand, to other several countries in ASEAN and others;
2. To establish an action plan for the ASEAN plus three region to set up the CRD-type credit information database. In particular, to scrutinize the data to be collected in each country for credit risk models to be appropriately developed;
3. To seek the possibility and consider the systems for SME loans to be bundled, securitized and together with a regional credit guarantee mechanism to be made more attractive to investors. Collateralized debt obligation (CDO) schemes for financing of SMEs and other methods of securitization will become feasible. SMEs can start to issue CPs and corporate bonds as a group. A regional credit information sharing system will contribute to the enhancement of the Asian bond market by allowing SMEs to issue SME bonds and enhancing capital flows among Asian countries.