



Sociaal Economische Raad
Social Economic Council

Development Bank Sint Maarten

On the feasibility to start a Development Bank
in Sint Maarten

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Information

The Social Economic Council Sint Maarten (“Sociaal Economische Raad”, referred to below as “SER”) is an independent advisory body to the government of Sint Maarten. The SER advises upon request by one or more Ministers (solicited) or on its own initiative (unsolicited) on all important social economic issues.

The SER was established by law (“Landsverordening Sociaal-Economische Raad GT no.19”) in 2010.

The SER consists of representatives of employees’ and employers’ organizations as well as independent experts. The objective of the SER is to achieve a broad concept of wealth in Sint Maarten by offering quality advice and reaching consensus on social economic issues.

For more information, please visit our website www.sersxm.org

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Advice

Advice Summary

The SER established that the Sint Maarten banking system has an excess of liquidity. This is an underused potential for credits. The Central Bank of Curacao and Sint Maarten follows a monetary policy that requires control of liquidity and uses the reserve requirement and certificates of deposit (CD's) to achieve this control. At the same time commercial banks operate with a lower risk appetite. Consumer and business loans have been decreasing the past five years, and commercial banks do not issue business loans without collateral. Capital itself is not the problem for Sint Maarten, but a lack of viable economic activities of businesses with access to credit and a lack of financial access by Micro, Small, Medium sized Enterprises (MSME's) is. Preferably, these economic activities should replace imports and increase exports (including tourism). Businesses borrow when they expect this will be profitable for them. A Development Bank, mainly providing credits, would not address this situation.

The collateral requirement is especially relevant for Micro and Small Enterprises (MSE's). The situation of lackluster economic growth, limited (growth in) domestic consumption and some years of increased non-performing loans form a revenue trap for MSE's as they often depend on domestic demand and not export. Small and Medium Sized Enterprises (SME's) in other Caribbean countries also experience this. Successful Development Banks that finance larger projects have a clearly defined mandate, high corporate governance standards, strong risk management capability, proper regulation and supervision and a strong management team. Unsuccessful Development Banks are characterized by poor lending decisions, high amount of non-performing loans, political influence, capture by interest groups and diffuse mandates. Given the characteristics of Sint Maarten, such as lack of compliance enforcement, limited human resources, interwoven interests in a small scale society and an unstable political climate since 10-10-10, political influence, capture by interest groups and diffuse mandates seem more likely to occur than not. This constitutes a risk for a self-sustainable Development Bank that finances larger projects. Moreover, the international consensus is that Development Banks should finance economic activities that are not financed by commercial banks. The SER has not found data to support that such is the case for larger companies in Sint Maarten.

Setting up fully-fledged corporate governance practices and risk management safeguards while serving excluded economic actors with small(er) loans would undermine the self-sustainability of a future Development Bank considerably, especially in a small scale economy. Other Development Banks targeting Micro, Small, Medium sized Enterprises (MSME's) need to compensate with more

profitable loans to larger companies because lending to MSME's carries higher risks. Only guidance, training and adapted lending processes for MSME's decrease those risks, but they also increase operational costs. The development of MSME's has as much to do with financial access as with guidance and training, and microenterprises need a different approach than SME's.

A credit institution that serves currently excluded borrowers would be an effective alternative for a Development Bank. The optimal development path for MSME's shows that Sint Maarten would benefit from a microcredit institution that brings financial access to (more) MSME's. The microcredit foundation Qredits is an example of such an institution. Qredits is already looking to expand to Aruba, Bonaire, Curaçao, Saba, Sint Maarten and Statia. The established SME policy framework by the Ministry of TEATT supports financing and guarantee schemes for (M)SME's from international sources. The policy framework also supports entrepreneurial training. The SER learned that Qredits delivers both. Next to serving microenterprises, Qredits – after some years – also started serving SME's in the Netherlands with larger credits. Furthermore, local learning on microenterprises and their contribution to the economy should be explored as part of any cooperation between Sint Maarten and an outside microcredit organisation.

The optimal development path for MSME's also shows that commercial banks should cater better for SME's than they currently do. Commercial banks require a different attitude and should adapt their lending processes to achieve this. Especially the requirements concerning collateral obstruct loans to SME's. Although these requirements are understandable and serve to decrease risks, other lending processes can also identify and decrease risks, and make lending to SME's profitable for commercial banks. Within the regulatory framework, commercial banks are free to conduct their business as they choose, but as long as they do not serve the need of SME's, especially in a situation of lackluster economic growth, SME's will not develop fully.

1. Introduction

This is a solicited advice at the request of the Parliament of Sint Maarten. The advice was received through the President of Parliament Mrs. Sarah Wescot-Williams, and was requested by Member of Parliament Mr. Christophe Emmanuel. The SER received the request on the 22nd of January, 2016. Member of Parliament Emmanuel gave an elaboration on the advice request to the Social Economic Council (SER) on February 25th, 2016. The SER approved the advice request on March 15th, 2016.

Mr. Emmanuel requests that the SER undertakes a study on the social and economic impact the establishment of a Development Bank will have on the Small and Medium Businesses, taken the stagnant economic growth for these businesses over the past years into consideration. More specifically, the following key areas should be included:

- Viability of a Development Bank
- Key functions/features of a Development Bank
- Existing gaps in the current financial architecture
- Sustainable development needs for Small and Medium Businesses

This advice elaborates on development banking, financial development and Micro, Small and Medium sized Enterprises (MSME's) in Sint Maarten. The aim of the advice is to give direction to the discussion on a possible Development Bank. Under what conditions will a Development Bank benefit the economy, especially concerning MSME's? As people have different ideas what a Development Bank should be and do, the SER first determines the wanted outcomes, and only then defines which instrument is most suited to achieve those outcomes. In other words, which instruments from the 'financial development' portfolio serve sustainable development in Sint Maarten? Is a Development Bank such an instrument?

Given the emphasis on Small and Medium sized businesses, the SER deemed it necessary to obtain research data on MSME's in Sint Maarten, and therefore sought cooperation with the COSME programme. The COSME programme¹, called after Boosting Caribbean OCT Small and Medium Sized Enterprises, is funded by the European Union and aims to develop MSME's in what the European Union calls 'Overseas Countries and Territories' (OCT's). The COSME study forms part of the programme, and entails a survey on micro and small enterprises (MSE's) in 12 Caribbean Islands, including Sint Maarten. The SER obtained the preliminary results of the survey concerning Sint Maarten on September 10th, 2016. The SER thanks the COSME researchers for their cooperation even though the results of the survey do

1 <http://www.cosmeprogramme.org/website/>

not lend themselves for quantitative conclusions given the small sample size that was obtained by COSME.

The advice request by government, dated June 22nd, 2016, concerning the “Draft National Ordinance containing measures regulating the establishment and acquisition of shares of the Development Bank of Sint Maarten” [“Concept landsverordening houdende regels met betrekking tot het oprichten van en het verwerven van aandelen in de ontwikkelingsbank van Sint Maarten”] takes an opposite approach. In this advice request, the government does not define any wanted outcomes other than generic ones nor any core principles and characteristics that should be considered when establishing a Development Bank. In other words, the draft ordinance states that a Development Bank will be established, and does not concern itself with specific considerations. Consequently, the SER advised against the ordinance in its current form². This advice also serves as a framework for the solicited advice from the Prime Minister and Minister of Finance of June 22nd, 2016, concerning a Development Bank with the objective to contribute to sustainable development of Sint Maarten.

1.1. Outline of the advice

The first chapter is the introduction.

The second chapter deals with the financial development, development banking, current monetary policies and credit & savings in an economy.

The third chapter deals with the demand for credit by businesses and private loans in Sint Maarten.

The fourth chapter deals with MSME's in Sint Maarten, especially regarding their access to finances.

The fifth chapter comes to a conclusion and advises government.

2. On the benefits and risks of financial development

This advice is about which instruments from the financial development portfolio are most useful to serve sustainable development for Sint Maarten, especially concerning MSME's, and whether a Development Bank as one of those instruments fits this objective. Financial instruments from the financial development policy agenda must fit within Sint Maarten's economy and society in order to be effective to increase sustainable development in Sint Maarten.

Given the economic history of the Latin American and Caribbean region, the conventional financial development policy agenda has strong consensus on four basic endeavors: solid macroeconomic policies, letting financial markets breathe (enhance market discipline and eliminate state interference), prudential regulation and supervision and broadening access to financial services³. Especially the latter two are relevant for the discussion on a Development Bank.

The global financial crisis of 2008/2009 forced a reassessment of the four basic endeavors. The favored macroeconomic policy of a low interest rate aimed at low inflation (one instrument, one goal) failed to deliver sustainable development. Market discipline between financial institutions failed to produce an optimum outcome, but instead contributed to the financial crisis of 2008/2009. The governance of the financial sector, executed by Central Banks and other regulators, proved that the soundness of the separate financial institutions did not guarantee a solid system. The broadening of access to financial services, in this case to too many American households becoming homeowners, actually threatened the sustainability of the financial system and contributed to the global financial crisis⁴.

Even though Sint Maarten is a Small Island Development State (SIDS), and these experiences are far removed from the imprint that the financial sector of Sint Maarten could ever make, the lessons learned from financial development are important to the financial sector in Sint Maarten for its local consequences if a future Development Bank would become a substantive financial service provider.

In essence, financial markets experience two types of friction while developing: agency and collective frictions. Agency frictions are frictions between supplier and clients of financial products related to their interest and information position on financial

3 World Bank, 2012, page 2, 3

4 World Bank, 2012, page 3, 4

products. Collective frictions are frictions on a collective level that Central Banks and other supervisors settle with constraints for financial services. Internal (financial institution) and external (Central Bank) oversight manage these frictions. Both frictions tend to ease, or are tested, through innovations and competition. When innovations and competition thrive, more actors are included and more financial products enter the market. Together they distribute benefits that grow the financial sector and the economy, and this reinforces more financial services. When financial institutions are left without sufficient internal and external oversight because easing of frictions is seen as a success at first, they can generate risks. In other words, what originally was seen as benefits now turns into risks, and sometimes quite destructive, consequences follow when too much risk is accumulated in a financial institution or in the financial sector. These consequences are felt by more actors and have larger consequences for the economy than before the easing of the frictions because financial markets expanded through innovation and competition. This is, very simplified, how financial sectors grow, create distortions, and then burst⁵. Financial development can generate financial instability. Given the small scale of the financial sector in Sint Maarten, and depending on the size of a future Development Bank and its connection to the financial sector and economy, these considerations may become important. The lesson for Sint Maarten is that a Development Bank must always operate objectively concerning risks. Internal and external oversight are instruments to avoid too much risk. The challenge is to determine when that point is reached. Easing of frictions is not necessarily a negative outcome, but too much easing could be because it generates too much risk.

2.1. On Development Banks

Given the unfamiliarity of Sint Maarten with Development Banks, the survey of the World Bank on 90 Development Banks in 61 low and middle income countries serves to give a description of the characteristics of Development Banks. The survey excludes multilateral, regional and sub-regional Development Banks⁶.

Development Banks have different **shareholders**. They are typically fully owned, administered and controlled by governments (75%). The private sector owns half or less of the shares of 21% of the Development Banks, and owns more than half of the shares of 5% of the Development Banks⁷.

The **funding** of Development Banks varies widely, but generally different funding

5 World Bank, 2012A, page 3-5

6 World Bank, 2012A, page 4-12

7 World Bank, 2012A, page 4-12

mechanisms are activated: taking savings from the general public (46%), borrowing from other financial institutions (89%), raising money in domestic/international capital markets (89%), using own equity, and receiving budget transfers from the government (40%)⁸.

Governments guarantee the debts of 64% of the Development Banks, and this allows them to borrow at relatively lower costs. The latter is considered an effective way of funding when these lower costs are transferred to final borrowers under the condition that Development Banks do not venture into the markets of commercial banks. The latter is generally considered an unfair competitive advantage towards commercial banks. Governments can also minimize their risk by banning Development Banks from the financial market and taking deposits from the general public, or mandating that they fund their operations only with own funds⁹.

Characteristics	Development Banks (total 90)
Fully owned, administered and controlled by governments	75%
Private sector owns less than 50 percent	21%
Private sector owns more than 50 percent	5%
Savings from the general public	41%
Borrowing from other financial institutions	89%
Raising money in domestic/international capital markets	89%
Receiving budget transfers from governments	40%
Governments guarantee the debts	64%
Assets under 1 billion USD	51%
Share of the market (in assets) under 5 percent	80%

Concerning taking **savings from the general public**, only retail Development Banks (direct lending to customers) have this mechanism in place, and this is usually supported by their mandate: increase savings¹⁰.

Development Banks are expected to be **profitable, self-sustainable and non-reliant on government contributions**, but 18% of the Development Banks indicated that they would not be self-sustainable if government transfers would cease. Development Banks that receive government transfers often do so with subsidized interest rate to particular borrowers. Depending on your political viewpoints, this is a controversial practice. Some view this as market distortions and undermining the profitability of Development Banks while others find this justifiable to promote specific economic development if these subsidies are transparent and only used for intended purposes¹¹. About half of the Development Banks provide credit at subsidized interest rates.

8 World Bank, 2012A, page 4-12

9 World Bank, 2012A, page 9, 10

10 World Bank, 2012A, page 10

11 World Bank, 2012A, page 11, 16

Concerning their **size**, most Development Banks (80% of the Development Banks hold assets of less than USD 1 billion) are regarded as relatively small, holding 3 percent or less of the assets of the banking systems in their countries, bearing in mind that most of these Development Banks operate in far larger economies than Sint Maarten. Development Banks typically, but not exclusively, hold larger shares of the total assets in small economies compared to economies of scale¹².

The **mandate** of Development Banks varies, ranging from broad to specific. Both options have advantages and disadvantages. Broad mandates provide flexibility to service financial needs according to governments in the economy, but tend to lose, if not properly managed, focus and effectiveness. Development Banks with broad mandates become more easily dependent on different ministries and interest groups to advance their own objectives when the Development Bank is pulled into the political arena. Development Banks with specific mandates mostly do not have this issue, and often gain specific knowledge of sectors enhancing their effectiveness, but they are limited to respond to different and evolving financial needs and have more difficulties spreading risks through diversification¹³.

Broad mandate	47%
Specific mandate:	53%
SME's	12%
Agriculture	13%
Export & Import	9%
Housing	6%
Infrastructure	4%
Other	9%

Development Banks serve **different types of clients**, but almost all serve SME's. Regardless of size and mandate, 92% of the Development Banks serve SME's. This is a logical outcome given that the key challenge of the financial sector in low and middle income countries is to serve SME's. Almost half of the Development Banks has other financial institutions as intermediaries between them and the final borrower. This means that the credit risk is partially absorbed by these intermediaries and operational costs for Development Banks are lower. However, interest rates for borrowers tend to be higher because the intermediaries pass on their costs plus other margins. When Development Banks lend directly to borrowers, interest rates are lower, but the operational costs of Development Banks and percentage of non-performing loans are higher.

12 World Bank, 2012A, page 6, 7

13 World Bank, 2012A, page 11, 12

Type of clients	Development Banks (total 90)
Other financial institutions	46%
Other state-owned enterprises	54%
Individual and households	55%
large private corporations	60%
SME's	92%

Concerning the **maximum loan term** of Development Banks, only 13% Development Banks offer long terms loans of 21 years or longer. Besides traditional loan products, 73% of Development Banks also provide credit guarantees thereby (partly) offsetting the risk for financial intermediaries, and thereby increasing credit. Many of them view credit guarantees a useful instrument to assist commercial banks to lend to the same sectors and clients the Development Bank serves. Other services of Development Banks are advisory services, factoring services, capacity building and all sorts of training programs either for clients or financial intermediaries¹⁴.

Concerning **non-performing loans (NPLs)**, Development Banks tend to perform less well than the banks of the financial systems they operate in. Development Banks are, supposedly, less able to assess the capability of borrowers to repay their loans and are less able to collect debt from loans. On average, this means that Development Banks have higher NPLs. About 40% of the Development Banks show higher NPL ratios than other banks in the same market. Development Banks lending through intermediaries (whole sale) perform considerably better than Development Banks lending directly to clients (retail). The ratios of non-performing loans tend to be stable over the years¹⁵.

Level of non-performing loans (2009)	Development Banks (total 90)
less than 5%	55%
5 %to 9%	10%
10% to 19%	16%
20% to 29%	5%
More than 30%	15%

Good corporate governance is critical to the success of Development Banks, and is also more challenging than in private financial organisations. First, the structure of ownership is often more complex, and shareholders have often legitimate conflicting interest. For example, the Ministry of Finance needs a solid Development Bank, but at the same time the Ministry of Labor wants large investments with a high risk in labor market policies of a specific sector. Second, when the mandate is broad and the institutional structure is weak, a Development Bank can be coerced into unfavorable

14 World Bank, 2012A, page 15-17

15 World Bank, 2012A, page 17, 18

lending to political pet projects, thereby increasing the risk of the portfolio and causing financial losses to the Development Bank. Third, when Development Banks are government owned, they are impossible to take over when they underperform, and therefore inefficiencies and weak performances could be tolerated¹⁶.

The boards of Development Banks consist on average of 8 board members, and most boards have a strong presence of government representatives, sometimes also civil servants. Independent board members are in the majority on the boards in 30% of the Development Banks. Board members often need to fulfill requirements. Firstly, they should have a minimum level of education (91%). Secondly, they require minimum technical qualifications in banking (87%). Thirdly, they can't have a history of bankruptcy (75%). In all of the Development Banks, governments retain the ultimate authority to appoint and remove board members¹⁷.

Development Banks, due to their mandate, should strive for **transparency**. Moreover, effective corporate governance depends on the accurate, relevant and timely information within the Development Bank, and externally towards government and the general public¹⁸.

Disclosed information	Development Banks (total 90)
Annual report	96%
Audited financial statements	93%
Off-balance sheet items	71%
Governance and risk management framework	63%
Regulatory capital and capital adequacy ratio	64%

A broad international consensus exists that Development Banks should have the same **regulatory and supervisory standards** as private financial institutions. Therefore, Development Banks should comply with the same solvency, liquidity, accounting, governance and transparency standards as those institutions, and regulators are expected to behave in the same manner towards both. About 75% of the Development Banks are supervised by the same regulators and 78% by the same standards, but about 25% are supervised by the ministries that provide them direction. The latter creates tensions between supervision and direction of the Development Bank. Moreover, ministries are generally not equipped to provide sufficient supervision. A professional external auditor audits almost all Development Banks¹⁹. Concerning internal

16 World Bank, 2012A, page 19, 20

17 World Bank, 2012A, page 20

18 World Bank, 2012A, page 21

19 World Bank, 2012A, page 22

transparency, 88% of the Development Banks have risk management units, but half of them report directly to the board of the bank.

Drawing from international experiences stemming from vastly different financial markets and economies, **the success of Development Banks**, becoming self-sustainable while serving their mandate, depends on the following institutional features:

- Clearly defined mandate
- High corporate governance standards
- Strong risk management capability
- Proper regulation and supervision
- Strong management team

In the past, several **Development Banks have failed** due to:

- poor lending decisions
- high amount of non-performing loans
- undue political influence
- capture by interest groups
- diffuse mandates.

On the bright side, Development Banks clearly are part of the financial inclusion agenda when they serve clients and sectors otherwise not served by private financial institutions²⁰. This is the main added value of Development Banks, especially for SME's as these are underserved by the financial sector in Latin America and the Caribbean.

2.2 On development banking

Development Banking is first and foremost about identifying, measuring and managing risks of financing specific economic activities²¹. In that sense, development banking is just like commercial banking with a specific mandated goal. In the case of market economies, this goal is often mandated because commercial banks do not serve the clients and the economic activities that a country wants to develop. Often commercial banks do not finance these specific economic activities because they are not profitable (enough) for them. In other words, development banking is almost by definition, but depending on specific financial market situations, more difficult to embark on under market conditions than commercial banking.

20 World Bank, 2012A, page 25

21 World Bank, 2012A, page 21

To ameliorate market conditions to finance specific economic activities that are less or non-profitable, governments get involved, often with the help of others, and start Development Banks. From the beginning, Development Banks are expected to serve high(er) risk clients and sectors not served by commercial banks. With the cooperation (debt guarantee) of governments to mitigate this higher risk, development banking comes under the influence of political pressures. This can create another risk from a financing perspective (unfavorable lending). Therefore, strong safeguards must be in place to mitigate the risks from political pressure and high(er) risk clients and sectors. Although Development Banks must be profitable and self-sustainable, they do not seek the maximization of value for shareholders, but instead are supposed to be guided by their mandate. The mechanism to bring two elements, profitability and mandate, together is called corporate governance.

Here lies the crux of the challenges of development banking: to bring profitability and mandate together through sufficient corporate governance. Without strong safeguards, such as corporate governance, development banking is prone to many of the challenges of state financial institutions. The most common challenges are weak performance, financial problems, diffuse mandates, unfair competition with the private sector and capture by interest groups²². These challenges interfere with profitability and mandate. When the World Bank executed a survey among Development Banks in 2012, their answers to the main problems they are facing preventing them from going forward fit with the above identified challenges of Development Banks. Four of the mentioned answers relate directly to profitability, mandate and corporate governance. This confirms that development banking is, just like commercial banking, mostly about risk management. It confirms that becoming self-sustainable is a challenge. It confirms that corporate governance and transparency is an issue. It confirms that undue political influence is a factor. In addition, in lower and middle income countries finding sufficient qualified personnel is often also a factor.

What are the most important challenges facing your institution going forward?	Development Banks (total 90)
Improve risk management capacity	71%
Become financially self-sustainable	59%
Improve corporate governance and transparency	50%
Acquire more flexibility to hire and retain qualified staff	40%
Reduce undue political interference	31%

2.3 On credit and savings in the economy

In a nutshell, from an economic perspective, credit is used as a mean of production to increase output on the supply side and is used to increase consumption on the

22 World Bank, 2012A, page 20

demand side. Without credit, less would be produced and consumed, and therefore the economy would grow less, but would also have less debt. Clearly, with credit alone little economic activity would be established. To increase output, credit needs to come together with other means of production such as skills, knowledge (labor), productivity, efficiency, marketing (management), demand of the product or service and many other. In essence, people and ideas are more important than credit itself. On the other hand, when the best ideas and most productive people are left without investment capability, little is achieved. Credit on the demand side increases consumption, but at the same time decreases future consumption when payments are made to pay the interest of loans, mortgages, etc.. However, economic growth based on credit extension to boost consumption without increasing output will inevitably backfire. Moreover, the increase in output is preferred to be sustainable, and the aggregate activities ideally need to fit with the larger (sustainable) direction a country wants to take.

2.4 Credit, savings and monetary policy in the Monetary Union

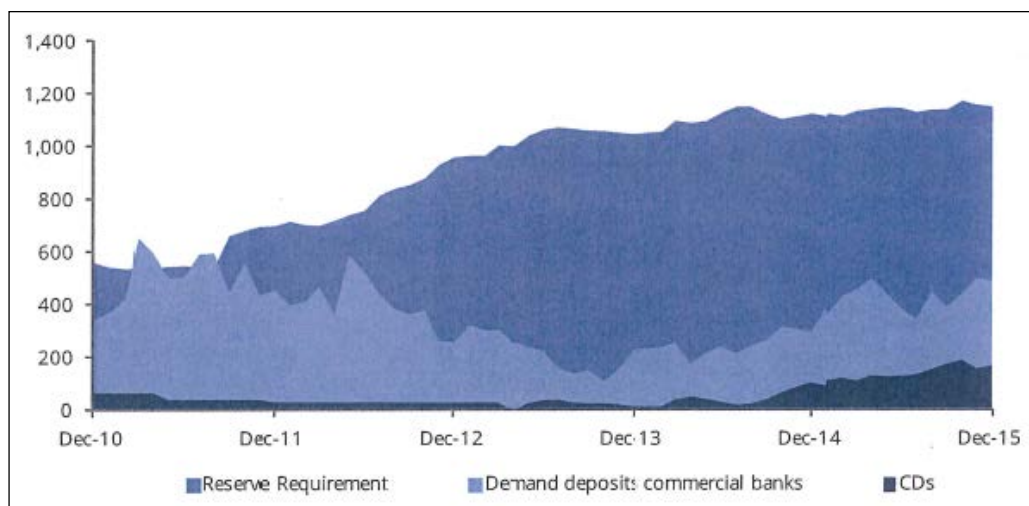
Monetary policy is only relevant if a future Development Bank would have sufficient influence on the liquidity of the banking system. The policies and decision-making process of the Central Bank determine when such is the case. The SER connects monetary policies and information on the banking system to this advice to increase awareness in Sint Maarten concerning both, and to paint a picture of the environment a future Development Bank would find itself in. The SER realizes that monetary policies only attempt to address the supply of credit, not demand for it. The website statistics and annual report of the Central Bank of Curaçao and Sint Maarten describes the state of the banking sector in relation to monetary policies and provides data on credit and savings of the banking system in Sint Maarten (and the Monetary Union).

An important characteristic of the current condition of the banking system is that it has an excess of liquidity. Since the debt relief arrangement connected to 10-10-10, the banking system of the Monetary Union is fueled by interest and principal payments by the Netherlands. Together with more than sufficient deposits; deposits account for about 87% of the liabilities of commercial banks, both are the primary cause of the excess of liquidity in the banking system²³. The excess of liquidity has not led to an excess, or even increase, in private loans in Sint Maarten over the last five years. Private loans issued in Curaçao have increased until 2013, and decreased after that²⁴.

23 Central Bank, 2016, page 66

24 Central Bank, <http://centralbank.cw/uploads/files/EKF-YEAR-2015-Q3.pdf>, page 9, 14

Over the last five years the Central Bank has actively used two policy instruments, the reserve requirement and the Certificates of Deposit (CD's), to counter this excess of liquidity in the banking sector. The third instrument, the official lending rate (pledging rate) the Central Bank charges to banks, has been stable since December 2008. First, the Central Bank has increased the reserve requirement to 18%. This means that commercial banks in the Monetary Union need to keep 18% of their domestic liabilities interest free at the Central Bank, not to be used for other transactions (average ANG 1,135 million in 2015). Second, the Central Bank has issued CD's to attract excess capital from the banks. CD's are investment alternatives for commercial banks and can also be used as collateral by the Central Bank. Again, the lack of government bonds since the debt relief program and current borrowing arrangement between countries Curaçao and Sint Maarten with the Netherlands are (mainly) responsible for the introduction of CD's by the Central Bank (the average of outstanding CD's is ANG 136 million in 2015). However, in 2015, despite these measures the amount of liquidity in the domestic money market was not curtailed because the demand deposits increased by approximately ANG 100 million²⁵. The below graph shows the effects of monetary policies on money market liquidity (in millions ANG)²⁶.



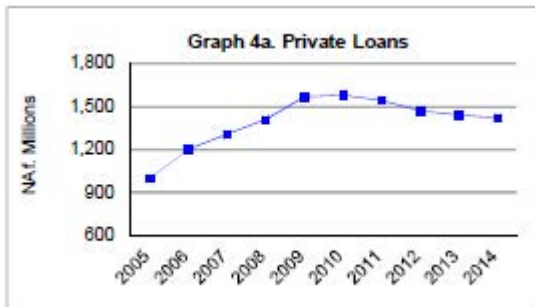
Both instruments, reserve requirements and CD's, restrict lending practices of the banking sector in the Monetary Union. The main consideration is that credit generally is used to finance imports, and that would influence the balance of payments of the Monetary Union, and ultimately the official reserves needed to keep the peg with the dollar. More importantly, with an excess on their account balances at the Central

25 Central Bank, 2016, page 62, 65, 66

26 Central Bank, 2016, 65

Bank, the banking sector of the Monetary Union has not lent more to businesses and private persons. The Central Bank used these monetary policies to decrease the excess liquidity.

Considering that the main objective of a future Development Bank would be to provide credit to businesses, it is important to consider the reasons behind an excess of liquidity and no increase in private loans in Sint Maarten (graph 4a: private loans are the total of mortgages, consumer and business loans). Perhaps credit itself is not the problem for Sint Maarten. Three factors contribute to explain this situation.



First, the demand for credit by businesses and private persons is lagging. This is related to the investment climate, macroeconomic expectations and sluggish economic growth. Here, credit is not the issue, but economic opportunities are. After all, businesses only borrow if they expect their output to grow so that obtaining credit becomes profitable.

Second, the conditions set by the commercial banks in Sint Maarten for credit reflect a lower risk appetite that restricts the supply of credit. The capital adequacy ratio is an indicator that the banking system in the Monetary Union is very cautious. This ratio expresses the ratio of the bank's capital to risk; how safe is your bank. The aggregate capital adequacy ratio for the Monetary Union is 13.9% (2015) while the Central Bank's standard is 10.5%, and the international standard is 8%²⁷. According to the IMF: "credit growth remains weak, despite ample liquidity, reflecting banks' lower risk appetite and subdued credit demand given uncertainties in the macroeconomic outlook"²⁸. Here, credit itself is not the issue, but a lower risk appetite of the commercial banks is.

Third, an explanation for cautious lending practices is the rate of non-performing loans (NPLs) to total gross loans in the Monetary Union. This rate increased between

27 Central Bank, 2016, page 81

28 IMF, 2016, page 5

2010 (8.6%) and 2013 (11.9%), and then decreased in 2014 (11.0%)²⁹. Here, the access to credit is not the issue, but the ability to pay off loans is.

The SER is aware that more indicators play a role in the banking system, but chooses to discuss those directly related to lending practices even though indicators also influence each other and together the Central Bank aims for monetary stability. All in all, the current monetary policies following established lending practices of the banking system in Sint Maarten suppress credit supply while a future Development Bank, based on economic considerations, and concerning its impact on the banking system also depending on its size, would aim to increase credit.

Concerns regarding the balance of payment would not be valid if funding for a future Development Bank or other credit institution would be attracted from abroad, but this would still bring more capital into an already overly liquid banking system. The conclusion is that those currently without access to credit and with viable economic ideas must be served better without substantially contributing to the already excess of liquidity in the Sint Maarten banking system and negatively influencing the balance of payment.

2.5 Chapter conclusion concerning a Development Bank

The financial development of Sint Maarten is not characterized by easing of tensions on agency and collective level. On the contrary, the banking system with an excess of liquidity has not increased private loans or sparked new financial products and operates with a low risk appetite. Apparently, innovation and competition don't drive the banking system of Sint Maarten (and the Monetary Union). The Central Bank is largely active with decreasing the excess of liquidity with monetary policy tools. The latter suppresses imports to be bought with (extra) credit to keep the balance of payment within international standards. This keeps the peg between guilder and dollar intact. The annual report of the Central Bank 2015 does not show signs of easing of collective frictions, but instead the Central Bank and commercial banks err firmly on the side of caution.

The institutional features of Development Banks differ. Independent of the economy they operate in, several characteristics of successful Development Banks are known. These are a clearly defined mandate, high corporate governance standards, strong risk management capability, proper regulation and supervision and a strong management team. These characteristics would increase the operational costs of a Development Bank, making a large lending portfolio necessary to cover these. The track record

29 Central Bank, <http://centralbank.cw/uploads/files/EKF-YEAR-2015-Q3.pdf>, page 4

of Sint Maarten in these areas is, despite a modern law on corporate governance, not promising. The characteristics of Development Banks that failed elsewhere are poor lending decisions, high amount of non-performing loans, undue political influence, capture by interest groups and diffuse mandates. Given the characteristics of Sint Maarten, such as lack of compliance enforcement, limited human resources, interwoven interests in a small scale society and an instable political climate since 10-10-10, the latter three (undue political influence, capture by interest groups and diffuse mandates) seem more likely to occur than not, and therefore constitute a risk for a self-sustainable Development Bank.

Current monetary policies and risk averse lending in a situation of depressed credit demand of those with access to the banking credits suppress private loans in Sint Maarten. A credit institution such as a Development Bank would provide credit to businesses and aim for economic objectives. If this (extra) credit would increase liquidity in the banking system, this would go against current established monetary policy. Clearly, increasing the liquidity of the banking system requires substantive capital from outside the banking system. More importantly, even despite the monetary policies, this situation shows that Sint Maarten does not have a lack of capital, quite the contrary, it lacks demand for credit from medium and larger businesses, combined with an low risk appetite of the banking system. Medium and larger businesses only borrow when they expect this will be profitable for them.

A credit institution that will serve currently excluded borrowers, most likely MSME's, with credit that will not substantially affect the liquidity of the banking system is therefore an effective option. Setting up fully-fledged corporate governance practices and other quality safeguards while serving currently excluded economic actors with small(er) loans would undermine the self-sustainability of a future Development Bank considerably. Furthermore, if financial institutions outside the Monetary Union would provide credit to currently excluded borrowers, again depending on the amount of credit, this would not negatively affect the balance of payment, and would bring more financial inclusion. The latter stimulates inclusive growth³⁰. At the same time, an outside financial institution most likely has already established corporate governance, and if such an outside financial institution fails, possible financial risks are carried elsewhere.

30 Draft baseline study of St. Maarten's development from a government perspective, page 54. Inclusive growth is one of the type of growth options for Sint Maarten

3. The demand for and supply of credit in Sint Maarten

The primary function of a future Development Bank would be to provide credit to businesses in Sint Maarten. This credit would fuel economic activities and generate economic growth. Independent of the type of economic activity, it would be beneficial to identify the demand for credit of businesses. This chapter serves to answer this question with the currently available data. The commercial banks of Sint Maarten do not keep a record of credit application that they did not approve³¹. Therefore, the SER turned to local surveys and interviews that (indirectly) measure the demand for credit by businesses and current lending practices, and then compare them to data of the Central Bank that measured the actual supply of credit.

3.1 The demand for credit by MSMSE's in Sint Maarten (COSME study)

The SER obtained the preliminary results of the COSME study concerning micro and small enterprises in Sint Maarten. However, the results of the study are disappointing from a quantitative viewpoint. Only 19 respondents of the original target group of 180 have filled out the survey. Moreover, of those 19 respondents some did not fill out the survey questions relevant for this SER advice. Despite the random sample drawing, the results do not allow for any kind of generalization regarding the demand of credit by MSME's in Sint Maarten. For example, 4 businesses are currently using some form of loan, and 8 businesses are not. Given the small sample size, this gives insufficient insight if this 'vague picture' reflects lending practices of micro and small enterprises in general.

3.2 The demand for credit by businesses

The department of statistics Sint Maarten executes the business cycle survey twice a year. The sample contains approximately 550 businesses³². The survey asks respondents about making investments, and poses a follow-up question if they experienced difficulties making their investment. Although this survey asks about businesses that managed to invest, with the exception of 2015, about a quarter of those respondents

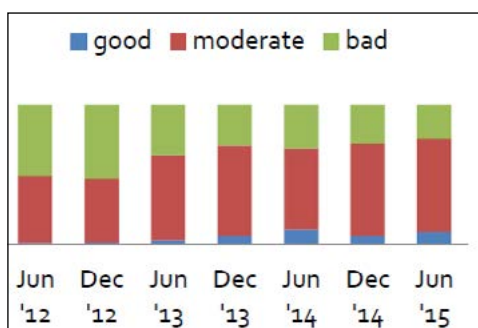
31 Interview Sint Maarten Bankers' Association

32 For a full explanation of the methodology, please go to <http://www.stat.gov.sx/>

indicate that the financing of their investment was difficult. The survey does not answer why this was difficult.

Business cycle survey	% made investments	% experienced finance difficulties making investments
2015	30%	10%
2014	33%	27%
2013	39%	25%
2012	28%	25%

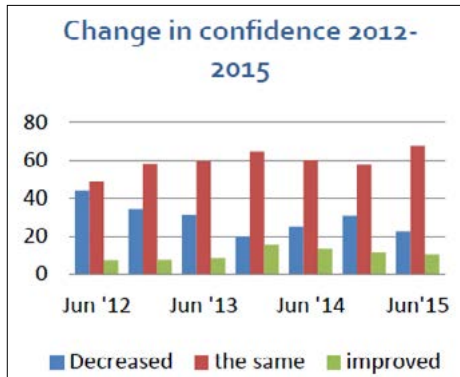
Another indicator for the demand for credit by businesses is the investment climate. The SER realizes that how businesses expect the coming years to develop does not equal their demand for credit nor their actual investments. In the absence of other local data, this indicator is the best alternative available at the moment. The graph shows that the investment climate has improved the last few years. The category ‘bad’ decreased and ‘moderate’ increased, and some optimism has appeared in 2014 and 2015³³.



The ‘change in confidence’ by businesses concerning their future confirms the data on investment climate. The general notion is that business’ confidence is needed before business develop an appetite for credit to invest. The last four years about 60% of the businesses have the same amount of confidence, whether it be high or low. The number of businesses with decreased confidence has dropped, and over the years some have become more optimistic³⁴. How do these data relate to the actual development of business loans by commercial banks?

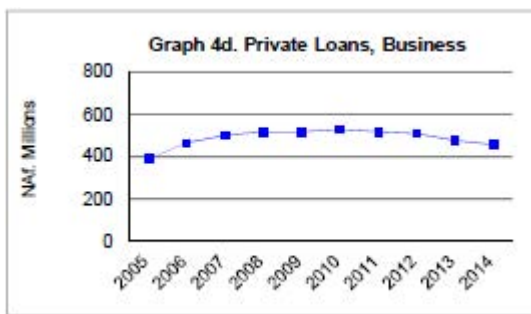
33 Department of Statistics, Business Cycle Survey 2015, http://www.stat.gov.sx/business_cycle_survey_first_results/2015/Business_Cycle_Survey_Flyer_Half_Year_2015.pdf

34 Department of Statistics, Business Cycle Survey 2015



3.3 The supply of credit by commercial banks in Sint Maarten

The Central Bank collects data on business loans separate for Sint Maarten. Especially loans to businesses are relevant concerning a Development Bank (graph 4d). Total amount of business loans is ANG 457 million in 2014. This graph shows that loans to businesses by commercial banks in Sint Maarten decreased each year between 2010 and 2015³⁵. Business loans increased from ANG 457 million (2014) to ANG 485 million (2015)³⁶. The data do not allow a break down to the size of businesses that obtained loans.



The Sint Maarten Bankers' Association contends that the commercial banks in Sint Maarten serve all businesses in Sint Maarten that fall within their credit policies. Commercial banks also service the financing needs of the private and public sector for larger projects in Sint Maarten, such as the Causeway, the airport (expansion) and the government building. Larger businesses, including the government owned companies, also have the option to attract credit on the international market. According to the Sint Maarten Bankers' Association, Sint Maarten has not sufficient large(r) development projects to fund a Development Bank. The institutional investors,

35 Central Bank, <http://www.centralbank.cw/uploads/files/EKF-YEAR-2015-Q3.pdf>, page 14

36 Central Bank, 2016, page 68

such as Social and Health Insurances (SZV) and APS [Algemeen Pensioenfonds Sint Maarten], already have difficulty finding investment opportunities. For the smaller businesses that do not have collateral to access credit, credit guarantee schemes are an efficient alternative. The Sint Maarten Bankers' Association acknowledges that especially collateral is a problem for smaller businesses to access credit. Another problem is that MSME's often do not have sound business plans³⁷. Business education, or guidance, should be an integral part for the development of MSME's in the Caribbean, but is not provided by commercial banks.

Other interviews confirm the notion of the Sint Maarten Bankers' Association concerning the lending practices of commercial banks and collateral: no collateral, no loan. For example, if the collateral would cover 80% of the loan request, the banks would, in general, approve 80% of the requested amount. If businesses do not already have collateral, they need to give personal guarantees to secure the loan. Furthermore, commercial banks do not venture into guidance of businesses. Even though some customers 'hop' between banks in the absence of a credit rating system, most businesses pay back their loans because they risk losing their collateral³⁸.

The Central Bank calculated the credit-to-GDP gap for the Monetary Union as -3.9% in 2015. This means that the credit ratio to GDP in 2015 is less than its long-term trend in the Monetary Union. This indicates that credit has not kept up with the GDP, and therefore the economy is falling behind its potential³⁹. The Central Bank does not calculate the credit-to-GDP gap separately for Sint Maarten.

The data show that business loans have decreased between 2010 and 2014, but increased in 2015. According to the 'change in confidence' by businesses and the investment climate, the demand for credit should have been increasing slowly but steadily since 2010. The data of the business cycle survey support the increase in business loans in 2015 because fewer businesses experienced difficulties obtaining loans in 2015. The demand for credit apparently took some years to materialize into an increase of business loans. The data on demand for credit does not explain by how much the supply of business loans could have increased to meet demand fully.

3.4 Chapter conclusion concerning a Development Bank

Chapter 2 already identified three factors influencing credits: sluggish demand for credit, a cautious banking system and monetary policies aiming to reduce the excess

37 Interview Sint Maarten Bankers' Association

38 Interview Corporate Manager CIBC First Caribbean International Bank

39 Central Bank, 2016, page 14, 15

of liquidity in the banking system (thereby reducing credit extension by commercial banks). Furthermore, current lending practices of commercial banks concerning MSME's clearly indicate that businesses without collateral, business or private, would not be able to secure a loan in Sint Maarten.

Given the conclusions of chapter 2, the SER will not focus on a Development Bank that services larger businesses and government owned companies with large loans. The SER has found no data indicating that commercial banks in Sint Maarten or the international financial market do not serve larger businesses. The data in chapter 2 do indicate that commercial banks are cautious issuing credit, but the data in chapter 3 indicate that this is foremost applicable to businesses without collateral, and these tend to be MSME's; not larger businesses. Moreover, the international consensus is that Development Banks should finance economic activities not financed by commercial banks. Even if the banking system in Sint Maarten has a lower risk appetite, a Development Bank should not be an instrument to improve competition in the banking sector, but should serve specific clients with a specific mandate. Alternatively, institutions such as the European Development Bank and the European Union (mostly European Development Fund) could provide loans for development projects when appropriate, and these loans come with a safeguard framework.

Within the regulatory framework, commercial banks are free to conduct their business as they choose. The SER adds that lowering their operational costs, and then issuing better priced credit to more local economic actors, especially currently excluded ones, would certainly benefit the economy of Sint Maarten. Commercial banks claim to be cautious to guard the savings of their clients. However, not serving potential borrowers who have viable business plans because the risks exceed the expected gains to cover operational costs suppresses economic growth. Moreover, commercial banks could create different lending processes that serve small and medium sized enterprises better. This change would make lending to SME's profitable for commercial banks. The above data brings attention to a conclusion already drawn by the SESNA programme in 2008⁴⁰. The evaluation states that *“the experience of commercial banks with small private businesses is [...] poor. Banks are known to be reluctant lenders to small entrepreneurs. Borrowers are almost invariably obliged to offer fixed collateral. Local banks lack experience with micro-business lending, with initially small but increasing loan amounts, with other than fixed collateral as the underlying security”*⁴¹.

40 See 4.3 for an elaboration on the SESNA programme

41 Ecorys, 2016, page 52

4. MSME's in the Caribbean and Sint Maarten

This chapter elaborates on MSME's and the development challenges they face, especially concerning financing.

4.1 MSME's in the Caribbean

The Caribbean Development Bank estimates that MSME's constitute between 70% and 85% of the number of enterprises in the Caribbean. They contribute between 60% and 70% of the GDP, and account for approximately half of the employment in the Caribbean. Clearly, MSME's are important for many reasons: reducing poverty, increasing employment, economic output and government revenues⁴². Next to economic considerations, micro and small businesses often form a cushion and give meaning to the productive life of many, and therefore SME's also have an invaluable social function for society that is often overlooked.

Although MSME's are praised in many speeches and political manifestos, clear and effective policies to stimulate the development of MSME's are often not in place. This sector is often overlooked and underserved despite its importance. The allocation of resources to improve productivity in MSME's through state and non-state actors over the past decade in the Caribbean has probably reached less than 10% of the MSME's. Some governments have supported programmes through Business Support organisations (BSO's), Development Banks and commercial banks⁴³.

Inadequate access of MSME's to financial resources is widely recognised. The Caribbean financial services sector, dominated by commercial banks, restricts the overall scope of MSME's to grow and expand because they are hesitant to lend to them. Commercial banks regard MSME's as high risk, they do not finance start-up enterprises, and they typically require payment of high interest rates and (more than) 100% collateral for loans. The latter is explained in some countries by Central Bank regulations demanding 'adequate cover' for loans⁴⁴.

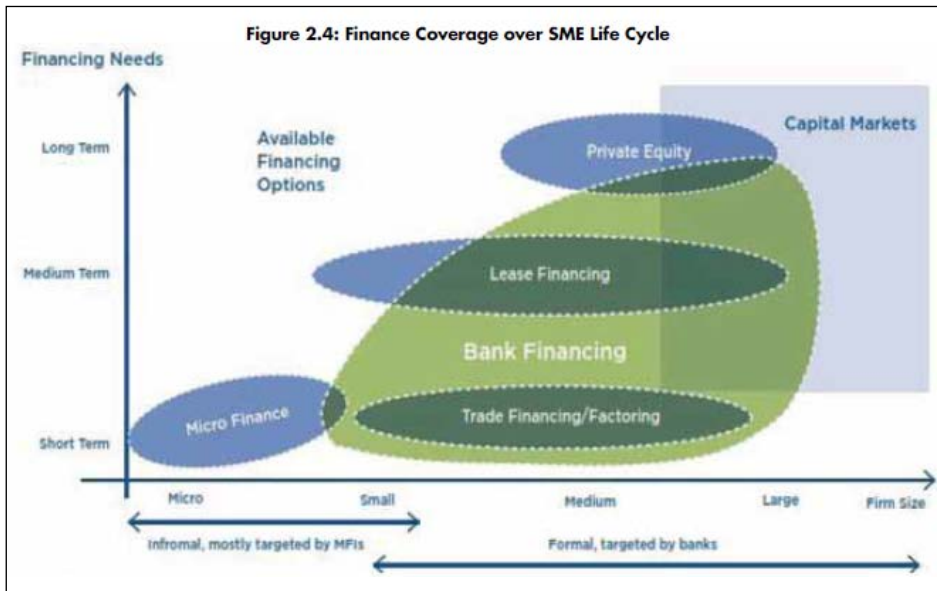
The optimal development path for MSME's has a three-tier approach. The first tier improves productivity and the quality of products and services of MSME's. The second

42 Caribbean Development Bank, 2016, page 29, 30

43 Caribbean Development Bank, 2016, page 29, 30

44 Caribbean Development Bank, 2016, page 29, 30

tier improves the efficiency and effectiveness of other organisations, including financial service providers and business support organisations (BSO's), supporting MSME's. The third tier formulates policies and legislation enabling the business environment for MSME's. Countries aiming to improve MSME's must develop all three tiers. The access to financial services is a second tier aspect, and is depicted in the above graph when fully developed⁴⁵.



The figure above illustrates that the access to finance for microenterprises is different from the access to finance for small and medium sized enterprises. **Microenterprises** also save money, prefer low cost and flexible loans, are risk averse, are largely unfamiliar with microcredit and have serious financial supply side constraints. These characteristics demand another financing approach than for SME's. Furthermore, microenterprises are creative accessing finance from different sources such as friends and family, suppliers and credit cards⁴⁶.

Even though the access to finance for Caribbean **SME's** is difficult to measure separately from larger businesses, the conclusion is that their access increases with economic growth. When compared to economic growth, the collateral component loses weight as a factor to explain the access to credit⁴⁷.

45 Caribbean Development Bank, 2016, page 31

46 Caribbean Development Bank, 2016, page 42, 43

47 Caribbean Development Bank, 2016, page 48

Also in other Caribbean countries, the banking system has an excess of liquidity, in other words a large unused capacity for lending, but private loans are not increasing. Several factors can explain this situation. First, credit demand by businesses deemed worthy of credit by the banking system is weak. This relates, in general, to lackluster economic growth. Second, non-performing loans have been rising, also connected to less growth than before the 2008/2009 economic crisis, and therefore commercial banks have raised their credit assessment standards⁴⁸.

The credit demand of SME's is underserved because often credit worthiness information is missing and they have limited capacity to meet credit criteria (asset quality, financial statements, collateral requirements, etc.), but their distance to financial access is still smaller than for microenterprises⁴⁹. These constraints on the credit supply to SME's, together with a situation of limited growth in consumption spending and limited exports by SME's, form a revenue trap for Caribbean SME's⁵⁰.

4.2 The SME policy framework for Sint Maarten

The SME policy framework for Sint Maarten recognised that SME's are indirectly responsible for economic growth and considers SME's a vital area of interest. Moreover, SME's are a large source of employment. The framework identifies three main areas: professionalisation of SME's, increasing access to financing and putting in place a supportive institutional infrastructure. The policy framework classifies businesses by their monthly revenue size. The government (and society) accommodates SME's in different ways. First, sole proprietors do not need a business license, but need only to register with the Chamber of Commerce⁵¹. Second, the Small Business Development Foundation (SBDF) was established to deliver business advisory services, training and information to SME's. Third, different NGO's aim to aid SME's with professional coaching and professional development⁵².

More than	But not more than	Enterprise Size
NAF. 0,--	NAF. 15.000,--	Micro
NAF. 15.000,--	NAF. 50.000,--	Small
NAF. 50.000,--	NAF. 75.000,--	Medium
NAF. 75.000,--	NAF. 100.000,--	
NAF. 100.000,--		Large

48 Caribbean Development Bank, 2016, page 46

49 Caribbean Development Bank, 2016, page 47

50 Caribbean Development Bank, 2016, page 47

51 For certain operational activities business licenses are needed.

52 Ministry of TEATT, 2014, page 3-5

The policy framework states that SME's face challenges in Sint Maarten. First, they (should) spend relatively more time on tax and legal compliance and administrative tasks related to compliance even though the skills to do so are often lacking. Second, SME's have little access and knowledge of the Business Support Organisations (BSO's). Notwithstanding their difficulties, SME's are engines of economic growth, alleviate poverty, a source of government revenues, source of job opportunities, drivers of competition and market efficiency and sources of innovations and new products. SME's account for 85% of the number of businesses, and they generate approximately 20% of Turnover tax revenues⁵³. The COSME study estimates that there are approximately 10,000 active MSME's in Sint Maarten⁵⁴.

Especially paragraph 5.4 of the policy framework is relevant for this advice. It acknowledges that access to finance is difficult for SME's. This is mainly due to collateral requirements, lack of commercial bank's confidence in SME's, lack of guarantee functions, high administration costs of small loans and lack of entrepreneurial skills. The policy statement concludes that the government will encourage local financial institutions to lend to SME's and pursue financing and guarantee schemes from international sources⁵⁵.

The SER concludes that a financial institution aimed at servicing (M)SME's fits within the framework of established policies. The SER further adds that many of the framework's policy statements still need to be executed or become meaningful for (M)SME's, but fully supports the notion that not only an access to credits is a challenge, but skills and knowledge are equally important for business persons to successfully start or operate a (M)SME's. Even though the framework deals with SME's, the SER adds that microenterprises also deserve the same attention and support.

4.3 OBNA and SESNA programme

The Ontwikkelingsbank van de Nederlandse Antillen (OBNA), founded in 1981, is a private-public Development Bank (NV) with a majority of public sector shareholders (51%). OBNA has an office and a representative in Sint Maarten, and has been financing economic activities with a special focus and attention to the agriculture, animal husbandry and fishery sector the last few years. However, the loan emphasis has been on tourism and services. Its lending portfolio is around 77 million guilders, of which 36% is invested in Sint Maarten. Country Sint Maarten holds approximately 7% in the share capital of OBNA. The investment portfolio and shares express an

53 Ministry of TEATT, 2014, page 6-8

54 Cosme, 2016, page 5

55 Ministry of TEATT, 2014, page 13

imbalance according to OBNA. Furthermore, OBNA is self-sustainable and usually makes a small profit, and the shareholders funnel that profit back to OBNA. When needed, OBNA attracts capital at low(er) costs because its institutional strength carries confidence in the financial sector. Drawing from local experience financing MSME's, OBNA concludes that financing MSME's is a high-risk activity that takes up a lot of time from the lender. Especially the collection of outstanding loans is difficult in Sint Maarten; clients need to be guided to pay back their loans⁵⁶. OBNA does not make their annual reports public, nor do they have a website to inform the public about their activities and objectives. After several requests, the SER obtained information from OBNA on their lending portfolio for the years 2000-2015. The OBNA disbursed approximately ANG 26 million for economic activities in Sint Maarten. The Tourism and Service sector received approximately ANG 13.5 million and 10.5 million respectively.

The OBNA representative in Sint Maarten informed the SER that OBNA took part in the SESNA program (Small Enterprise Stimulation Netherlands Antilles Programme). The SESNA programme aimed to increase financial access to small businesses in the Netherlands Antilles, including Sint Maarten. Its objective was to *'strengthen the contribution of the small business sector to economic growth and to structural employment generation and consolidation throughout the five Islands'*. The European Development Fund (EDF) funded the programme with € 5.5 million between 2002 and 2007, and the private sector and government made additional funds available. The local banking system dispersed the funds as loans to SME's (€ 3.25 million). The remaining funds were used for non-financial services (€ 1.75 million for Business Support Organisations and training and € 500,000 for technical assistance)⁵⁷. The amounts relate to the five islands of the former Netherlands Antilles (not only Sint Maarten).

During the programme it became clear that the financing sector was not ready to deal with credit to micro and small enterprises (MSE's). In Sint Maarten, 94% of the loan portfolio was at risk, and the programme estimated that for each guilder only about 26 cents was reimbursed⁵⁸. The programme evaluation names several factors influencing these and other results, but for this advice, it suffices to notice that financing MSE's is difficult and banking for MSE's needs different lending processes.

4.4 Korpodeko in Curaçao

The sustainable development corporation Curaçao, Korpodeko, aims to contribute to the economic development process through financing economic activities; a

56 Interview OBNA representative

57 Ecorys, 2016, page 9-15

58 Ecorys, 2016, page

general objective. Korpodeko is a foundation with a bank permit, not an NV, and was founded in 1985. The Netherland Antilles originally financed Korpodeko through a contribution of 5% of the income and wage tax. This funding mechanism stopped 26 years ago, and now Korpodeko is self-sustainable. Korpodeko finances large corporations, government projects, government owned companies and SME's. Korpodeko also buys shares and participates in other companies. Korpodeko does not operate with a guarantee from the government, nor does it engage in retail lending. Korpodeko acknowledges that Curaçao has sufficient financial institutions and therefore provides its services when commercial banks do not facilitate financing, often in addition to other loan parties. According to Korpodeko, Development Banks should only service those needs that are not serviced by other financial institutions. Furthermore, Korpodeko does not compete with low(er) interest rates and specialises in high-risk projects that their capital position allows for. Furthermore, the board of the foundation has a tripartite setup: representatives of country Curaçao, employers and employees⁵⁹.

SME's are about 75% of their clients, and this constitutes approximately 35% of their lending portfolio. The larger companies receive approximately 65% of their loans. Korpodeko uses the larger and far more profitable loans to be able to service the smaller ones because financing SME's is considered high risk and difficult. In order to be self-sustainable, Korpodeko needs to extend large loans.

Even in fully developed economies, about 66% of SME's fail in the first two years of their existence. In Curaçao, about 25% of the loans to SME's are successful in the sense that the business keeps being operational, and this percentage drops to 10% for microfinancing. The added value of Korpodeko concerning SME's is that they reserve approximately 30% of the loans for SME's for guidance and education, often obligatory components of a loan programme. According to Korpodeko, SME's financing is just as much about practical guidance and education as it is about credit. Moreover, Korpodeko aims to finance economic activities that increase exports and decrease imports because the Central Bank controls imports through regulating liquid assets in the banking system⁶⁰.

The director of Korpodeko emphasizes that the most important aspects of development banking are specific mandates and solid corporate governance. Without these two elements firmly in place, the chances for failure increase. The trust in a Development Bank by other financial institutions determines the cost of borrowed credits, and institutional strength determines for a large part trust. Furthermore,

59 Interview Korpodeko

60 Interview Korpodeko

the regulatory environment in the Monetary Union is strict, and therefore institutional investors shy away from projects that they otherwise could have financed⁶¹.

4.5 Small Business Development Foundation (SBDF)

The SBDF is a Business Support Organisation for MSME's in Sint Maarten. They provide skill and entrepreneur courses for clients to start and stay in business. These courses are, for example, administration, income tax filing, costs and pricing, sewing, marketing and financial management. Government currently finances part of the operations of SBDF, and the SBDF is looking for extra finances. The SBDF learned from many clients that they have difficulties securing loans from commercial banks, and the SBDF considers the demand for credit by MSME's far larger than the supply of loans to MSME's⁶².

4.6 Microfinance for Sint Maarten; the example of Qredits

Through the Ministry of TEATT, the SER learned that a microfinance organisation called Qredits recently opened offices in Bonaire. Qredits is a microcredit foundation that originally started in the Netherlands in 2009. In just a few years, Qredits developed into the largest alternative credit institution in the Netherlands with over 8,000 loans, 60 employees and 650 volunteers. Qredits funds its operation with borrowed public and private sector capital, but their operations really increased when the European Investment Fund and the European Investment Bank stepped in. The European Investment Bank made a €120 million loan available to Qredits, and the European Investment Fund guaranteed their loans for 50%. Consequently, Qredits has a large lending capability and is looking to expand. As a foundation, Qredits is not looking to maximise profits, but being profitable is necessary to continue operations. A board and corporate governance regulations supervise their operations⁶³.

The SER learned from the Director of Qredits that financing MSME's is not only about issuing credit, but Qredits offers a program how to become a successful entrepreneur. This includes writing a business plan, e-learning and coaching by volunteers. Qredits also targets schools with a special program to decrease youth unemployment and provide the tools for the young to become entrepreneurs. Moreover, Qredits has adapted their loan collection processes to their clients. Even when loan payments fall behind, the relationship between client and Qredits remains

61 Interview Korpodeko

62 Interview General Manager SBDF

63 Interview Director Qredits

aimed at cooperation. In this manner, clients learn to engage in conversation with the lender instead of avoiding difficult conversations. Still, lending to MSME's contains a high(er) risk, and this risk and extra guidance is paid for with a higher yearly interest rate than larger loans from commercial banks. Although Qredits started in the Netherlands with a maximum micro-loan of €25,000, they now also provide credit to smaller and medium sized businesses up to €250,000⁶⁴.

The SER established that Qredits is pursuing to open offices in Curaçao, Aruba, Sint Maarten, Saba and Statia. Their office in Bonaire is already operational and issuing microcredits up to USD 25,000. The governments of Curaçao and Aruba are currently cooperating with Qredits, especially concerning a future school programme, to start operations. In both countries, Qredits asks the government and the banking sector for a contribution to cover start-up costs (total USD 200,000). Through this contribution, the government would stimulate the MSME's sector, and all the clients of Qredits will inevitably become clients of commercial banks; it is in their commercial interest. In their plan of approach for Sint Maarten, Qredits aims to do the same with the assistance of government and the commercial banks. They would start with microcredits up to USD 25,000 with a yearly interest rate of 8.75% to cover the higher risk and guidance⁶⁵.

4.7 Local learning concerning financing microenterprises

An outside microcredit organisation such as Qredits entering Sint Maarten increases the chances of development for microenterprises because Qredits has a positive track record, funding and established lending processes. At the same time, this contains the possibility that local learning on microenterprises will not take place. The cooperation between an organisation such as Qredits and government should ensure local learning, and thereby empower Sint Maarten. Such learning can be insured by making public the anonymised disbursed loans and economic activity they support, and by supporting the activities of existing BSO's to complement the services of Qredits. The latter needs the approval of both existing BSO's and Qredits, and this should be explored as part of the cooperation between Sint Maarten and Qredits.

4.8 Chapter conclusion concerning a Development Bank

MSME's are important for the regional economy, but are regularly overlooked in policies to stimulate the development of MSME's or the outcome of policies

64 Interview Director Qredits

65 Qredits, Plan van Aanpak versterking ondernemerschap op Sint Maarten, 2016, page 3, 4

disappoints. The same seems to apply to Sint Maarten. A Development Bank supplying only credit to MSME's is not an answer to the development of MSME's in Sint Maarten. Moreover, a Development Bank only targeting MSME's will not be self-sustainable. Other Development Banks targeting MSME's need to compensate with more profitable loans to larger companies because issuing credit to MSME's carries higher risks. Other chapters already elaborated why this is not feasible for Sint Maarten. Only guidance, training and adapted loan processes decrease that risk, but also increase operational costs. Successful credit extension to MSME's needs guidance and training as mandated components of loans. Microenterprises need a different approach than SME's.

The development path for MSME's shows that Sint Maarten would benefit from a microcredit institution. Qredits has been successful in the Netherlands, and the European Union fully funds Qredits. Furthermore, Qredits is a foundation and therefore does not seek to maximise profitability, but instead aims for development objectives. Moreover, they do not compete with commercial banks, but would complement the existing credit products in Sint Maarten. The established SME policy framework supports financing and guarantee schemes for (M)SME's from international sources. The policy framework also supports entrepreneurial training. Qredits delivers both. Even though Qredits targets microenterprises with small credits, its development path in the Netherlands shows that, if successful with microenterprises, they also serve SME's with larger credits. This would be an extra advantage for the development of SME's in Sint Maarten. Furthermore, the cooperation between Sint Maarten and an outside microcredit organisation should include local learning on microenterprises and their contribution to the economy.

Commercial banks should cater better to SME's than they currently do. Commercial banks require a different attitude and should adapt their lending processes to achieve this. The SESNA programme illustrates what happens when a bank supplies credit to MSE's but does not adapt its lending processes, in this case disbursing loans and collecting loan payments. Especially the requirements concerning asset quality, financial statements and collateral obstruct loans to SME's. Although these requirements serve to identify risks, other means can also identify and decrease risks. As long as commercial banks do not serve SME's sufficiently, especially in a situation of lackluster economic growth, SME's will not develop fully. According to the Caribbean Development Bank, together with MSME's in other Caribbean countries, these businesses have fallen into a revenue trap.

From a macro point of view, also other Caribbean countries have an overly liquid banking system even though private loans are not increasing. Also other Caribbean countries know lackluster economic growth, disappointing domestic consumption and increasing non-performing loans after the 2008/2009 financial crisis. Clearly, if

the growth of the economy and consumption spending would increase, the challenges of MSME's would decrease. Together with the issue of the balance of payment of the Monetary Union in chapter 2, this is another argument for (M)SME's to export their products and services or replace imports.

5. Advice

The Sint Maarten banking system has an excess of liquidity. This excess has not increased lending or sparked new financial products, and commercial banks operate with a lower risk appetite. Furthermore, the Central Bank uses its monetary policy instruments to decrease the excess of liquidity in Sint Maarten (and the Monetary Union). The latter is executed to suppress imports to be bought with (extra) credit to keep the balance of payment within international standards in order to keep the peg between guilder and dollar intact. In other words, (the supply of) credit itself is not the problem of Sint Maarten, but a lack of viable economic activities of businesses with access to credit of commercial banks is. Preferably, these activities should increase exports or decrease imports. A Development Bank, mainly supplying credit, would not address this situation.

Successful Development Banks have a clearly defined mandate, high corporate governance standards, strong risk management capability, proper regulation and supervision and a strong management team. Unsuccessful Development Banks are characterized by poor lending decisions, high amount of non-performing loans, political influence, capture by interest groups and diffuse mandates. Given the characteristics of Sint Maarten, such as lack of compliance enforcement, limited human resources, interwoven interests in a small scale society and an instable political climate since 10-10-10, the latter seem more likely to occur than not, and would therefore constitute a risk for a self-sustainable Development Bank. Moreover, the characteristics of a successful Development Bank increase the operational costs, and would therefore threaten the sustainability of a Development Bank with limited opportunities in a small scale economy.

A credit institution that serves currently excluded borrowers would be an effective alternative. Setting up fully-fledged corporate governance practices and other quality safeguards while serving excluded economic actors with small(er) loans would undermine the self-sustainability of a future Development Bank considerably, especially in a small scale economy. At the same time, if an external financial institution would provide the credit process with its corporate governance already in place, this would benefit the Sint Maarten economy. If such an external institution fails, possible financial risks are also carried elsewhere.

The data of the COSME study on the demand for credit by MSME's do not allow to aggregate the demand for credit by MSME's. The interviews concerning current lending practices of commercial banks show that businesses without collateral, private or otherwise, are not able to secure a loan in Sint Maarten.

The SER has found no data indicating that commercial banks in Sint Maarten or the international financial market do not serve larger businesses, but commercial banks don't issue credit to businesses without collateral, and these tend to be MSME's, not larger businesses. Moreover, the international consensus is that Development Banks should finance economic activities not financed by commercial banks. Within the regulatory framework, commercial banks are free to conduct their business as they choose. The SER adds that lowering their operational costs, and then issuing better priced credit to more local economic actors, especially currently excluded ones, would benefit the economy of Sint Maarten.

MSME's are important for the regional and Sint Maarten economy, but are regularly overlooked in policies to stimulate the development of MSME's or the outcome of policies disappoints. A Development Bank supplying only credit to MSME's is not an answer to the development of MSME's in Sint Maarten. Moreover, a Development Bank only targeting MSME's will not be self-sustainable. Other Development Banks targeting MSME's need to compensate with more profitable loans to larger companies because lending to MSME's carries higher risks and operational costs. Only guidance, training and adapted loan processes decrease that risk, but also increase operational costs. Moreover, microenterprises need a different approach than SME's.

The optimal development path for MSME's shows that Sint Maarten would benefit from a microcredit institution that brings financial services to MSME's. The microcredit foundation Qredits is an example of such an institution. It has been successful in the Netherlands, and the European Union funds Qredits with loans for MSME's. Any organisation such as Qredits would not compete with commercial banks, but would complement the existing credit products in Sint Maarten. The established SME policy framework by the Ministry of TEATT supports financing and guarantee schemes for (M)SME's from international sources. The policy framework also supports entrepreneurial training. Qredits delivers both. Even though Qredits targets microenterprises with small credits, its activities show that it now also serves SME's in the Netherlands with larger credits up to €250,000. Furthermore, local learning should be included as part of the cooperation between Sint Maarten and an outside microcredit organisation.

Commercial bank should cater better to SME's than they currently do. Commercial banks require a different attitude and should adapt their lending processes to achieve this. Especially the requirements concerning asset quality, financial statements and collateral obstruct loans to SME's. Although these requirements are understandable and serve to identify risks, other requirements can also identify and decrease risks. As long as commercial banks do not serve SME's sufficiently, especially in a situation of lackluster economic growth, SME's will not develop fully.

Other Caribbean countries also have an overly liquid banking system even though business loans are not increasing. Other Caribbean countries also experience lackluster economic growth, flat-lining consumption and increasing non-performing loans after the 2008/2009 financial crisis. Clearly, if the growth of the economy and consumption spending would increase, the challenges of MSME's would decrease. Together with the issue of the balance of payment of the Monetary Union mentioned earlier, this is another argument to issue credit to MSME's that export their products and services or replace imports.

The information presented above, and taken the earlier chapters into consideration, the SER unanimously advises government to:

- not establish a Development Bank

But instead to:

- support microenterprises by cooperating with a microfinance institution such as Qredits.
- enter in a dialogue with the commercial banks concerning credit extension to small and medium sized businesses.
- take measures, including an evaluation of the SBDF, to create sufficient support for micro and small sized enterprises.
- make the process to obtain business licenses, permits and CRIB-numbers for starting businesses shorter to accommodate and stimulate new entrepreneurs.

We trust to have informed you sufficiently herewith.

Respectfully,

Oldine V. Bryson- Pantophlet
Chairwoman


Gerard M.C. Richardson
Secretary-General

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- OBNA Sint Maarten – Mr. Lei, Representative Dutch Winward Islands
- Sint Maarten Bankers' Association – Representatives of all the (commercial) banks in Sint Maarten
- Sint Maarten Business Development Foundation – Ms. Richardson, General Manager
- Qredits – Mr. Groenevelt, Managing Director



The Social Economic Council Sint Maarten (“Sociaal Economische Raad”, referred to below as “SER”) is an independent advisory body to the government of Sint Maarten. The SER advises upon request by one or more Ministers (solicited) or on its own initiative (unsolicited) on all important social economic issues.

The SER was established by law (“Landsverordening Sociaal-Economische Raad GT no.19”) in 2010.

The SER consists of representatives of employees’ and employers’ organizations as well as independent experts. The objective of the SER is to achieve a broad concept of wealth in Sint Maarten by offering quality advice and reaching consensus on social economic issues.

For more information, please visit our website www.sersxm.org



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