Should governments intervene to improve financing for small businesses?

- Salman Alibhai
- Miriam Bruhn
- Caio Piza
- Claudia Ruiz

June 03, 2025

This page in:

- English

Small and medium-sized enterprise concept. | © Shutterstock.com

According to the World Bank, micro, small, and medium-sized enterprises (MSMEs) power the global economy, making up 90% of businesses, providing 50% of jobs, and driving 40% of economic output. Yet, they remain stuck in a financing trap—unable to access the credit they need to grow. Governments around the world have stepped in with subsidies and guarantees to nudge banks into lending more to small firms. Do these interventions work? Fresh insights from Brazil, Ecuador, Indonesia, and Kosovo reveal lessons about what is effective and what needs fixing.

Mixed evidence on increased access to credit

The Indonesia People's Business Program (Kredit Usaha Rakyat, KUR) is one of the world's largest public credit schemes for MSMEs. Since its inception in 2007, the program has disbursed more than 50 million loans totaling more than US$100 billion. By subsidizing interest rates (capped at 6%) and providing partial credit guarantees, KUR aims to help small businesses access formal bank loans for the first time and transition to commercial credit.

A recent impact evaluation examined more than 8 million borrowers and found that KUR increased access to finance as most KUR borrowers had never received a bank loan before. However, the program did not help firms borrow from other sources. More than 50% of the borrowers took repeated KUR loans, but only 3% transitioned to commercial lending. Following these findings, Indonesia introduced a graduation policy, phasing out subsidies for repeat borrowers. Early data suggest that the change has improved the program's reach—by 2024, the share of new borrowers increased from 50% to 93%.

Another interesting case is the Brazilian earmarked credit program, which aims to stimulate investment by providing below-market-rate loans to MSMEs via commercial banks. A recent study found evidence that the program had limited additionality as larger firms benefited most from it and private banks used a "cross-selling" strategy to offset lower profits from government-subsidized loans by increasing interest rates on free-market loans for the same borrowers. Thus, smaller and riskier firms—those the program was designed to help—were excluded or paid more for other types of credit (Ornelas et al. 2024).

In Kosovo, the Credit Guarantee Fund (KCGF) was designed to encourage banks to lend to unbanked small firms by covering up to 50% of commercial banks' losses. During the COVID-19 crisis, the program was revised to cover up to 80% of commercial banks' losses. A recent World Bank report showed commercial banks channeled the subsidized credit mostly to firms with existing credit histories.

Impact on firm performance and job creation is higher for underserved borrowers

A recent impact evaluation assessed the causal effects of an unexpected increase in the subsidy levels of the Brazilian earmarked credit program. The authors showed that the step down in the interest rate had mixed impacts depending on firm size. Despite the high uptake among larger firms, the authors did not detect any effects on investments and debt, suggesting that the increase in subsidies had no additionality. For smaller firms, the authors found short-lasting effects on debt and employment (Grimaldi and Ornelas 2024).

To assess the KCGF's impact on firm performance, the authors used a matching-difference-in-differences design comparing firms served by the KCGF with two groups. The first group was composed of MSMEs with similar observed characteristics but no credit history. The second group contained MSMEs with similar observed characteristics borrowing from traditional credit lines and therefore paying market-level interest rates. The impact evaluation found positive and economically relevant effects of KCGF on firm productivity and job creation when the comparison group was MSMEs without credit histories, suggesting that credit-constrained firms benefit most from accessing credit.

A new study explores the impact of World-Bank-funded credit lines for MSMEs in Ecuador. As a second-tier lender, the development bank Corporación Financiera Nacional extended credit lines to participating financial institutions in 2021–24, which then screened and selected MSMEs to receive loans funded by the program. As in Brazil and Kosovo, banks were more likely to allocate loans to firms with prior credit access than to MSMEs without existing loans. However, the program's positive effects on job creation and sales were concentrated among firms without prior credit access (Bruhn et al. 2025).

Key takeaways for policy makers

Despite the different contexts, the studies of Brazil, Ecuador, Indonesia, and Kosovo point to a common challenge: although government-backed credit programs have some additionality, they often struggle to reach the most credit-constrained businesses. Banks naturally prefer lending to firms with existing credit histories, larger operations, or the ability to cross-subsidize other banking products.

The evaluation of KCGF found that small tweaks in the credit line eligibility criteria (for example, assigning lower weight to a firm's credit history) could help more firms access credit. Simulations based on regression analysis and machine learning revealed that the program had the potential to reach 25 times more firms with similar observed characteristics as those served by KCGF if banks were willing to serve businesses without prior loans. These findings highlight that (i) governments need to ensure that guarantee funds are used to encourage new lending, not just lower risk for banks serving existing clients; (ii) profit-maximizing commercial banks might leave money on the table by adopting an excessively risk-averse lending strategy; and (iii) banks could experiment with their screening tools to serve more firms without jeopardizing the quality of their portfolio.

Governments can play a crucial role in addressing market failures in small business finance by paying more attention to publicly funded program additionality, financial intermediary lending strategies, and program impacts.