



## E-Bulletin

# Secured Financing System Reform

## Colombia Expands Access to Credit for Small-Scale Producers and Micro-Entrepreneurs



Source: <https://www.mincomercio.gov.co>

The Minister of Commerce, Industry and Tourism, Sergio Díaz-Granados, explains how Law 1676 (2013) will provide faster and more effective access to credit for micro, small and medium enterprises

### Movable Property

Movable property is a generic term that refers to everything other than immovable property.

The term includes tangible property such as equipment, inventory, and agricultural products, and intangible property such as account receivables and intellectual property.

One of the Secured Financing System Law's major innovations is that a business may transform or sell the asset it uses for collateral. This is especially important because it allows assets such as raw materials, goods in process, inventory, crops or livestock to be used as collateral.

Source: USAID Financial Sector Knowledge Sharing Series #10 (2010)

The micro, small, and medium enterprise (MSME) sector is globally regarded as the driving force behind economic growth and job creation. These businesses play a major role in generating employment and wealth in the Colombian economy. The development of a vibrant MSME sector is key to resolving many societal challenges, including unemployment.

The main problem faced by owners and operators of MSMEs is the inaccessibility of bank financing. This presents a particularly serious constraint during the formation of new ventures, as well as puts limitations on MSMEs at later stages in business development. All companies depend on credit to survive, but it is especially crucial for this sector, as MSMEs have limited access to external equity capital, such as venture capital. This implies that most MSMEs must rely exclusively on internal equity, which is often inadequate. Historically, small-scale producers and micro-entrepreneurs in Colombia have faced the highest barriers to credit mechanisms because they lacked collateral in the form of real estate that banks often demanded for a loan.

The principal challenges that result from the MSME sector's restricted access to financing include: an inability to expand or promote the growth of businesses; a lack of capacity to compete with bigger firms in the market; a difficulty employing skilled labor; a failure to register claims against default loans; a lower quality in goods or services; an inferior approach to marketing; and, a negative reputation or public image.

President Juan Manuel Santos enacted the **Secured Financing Law (Law 1676)** on August 20, 2013. This innovative law modernizes Colombia's legislative financing framework by expanding the scope of acceptable collateral for loans to include **movable assets** and establishing the creation of a **Single National Registry**. The Registry ensures that the process of registering and publicizing claims against movable property is easily accessible, efficient and economical. Law 1676 also establishes an effective and low-cost **enforcement mechanism** that does not require creditors to obtain a court order before

*Last year Colombia came in at 149<sup>th</sup> in a ranking of 183 economies in terms of the ease of enforcing contracts, earning the unfortunate position as the worst country in Latin America on this indicator (World Bank/IFC, Doing Business 2012 – Colombia). Additionally, the average cost of resolving a commercial lawsuit is 48% of the value of the initial claim.*

they repossess collateral and sell it for cash when debtors default on their loan payments.

Before the **Secured Financing Law** was approved in Colombia, the institutional financing framework was outdated and based on pre-industrial systems in which goods were tangible, and real estate was considered superior to movable property. Legal constraints on using movable property as collateral resulted in lenders rejecting loan applications by many businesses, particularly micro-enterprises, SMEs, and small-scale producers who do not own land or lack formal land titles. Furthermore, there was no centralized Registry for publishing information about claims made against movable property (with

the exception of automobiles) and enforcement procedures to collect on loan default were costly and could take several years.

When the **USAID Public Policy Program** began working with the Government of Colombia (GOC) on this reform, the Government had already engaged in discussions and made reform attempts over the past twenty years. **The Program supported the GOC** by organizing one seminar and two workshops with international experts from the National Law Center for Inter-American Free Trade and the Louisiana State University Law Center to present the bill to key stakeholders, such as Small and Medium Sized Enterprises (SMEs), financial institutions, and members of Congress. The experts explained how a modern secured financing regime would facilitate and expand access to credit. They shared their experiences, distributed information on best practices from other countries, and presented compelling evidence to the GOC to demonstrate how a modern secured financing system is a critical component to economic development, as it:

- Enables private capital to be used as loans to create new businesses and expand existing businesses;
- Increases credit security, which reduces credit risk, and consequently decreases lenders' disincentives to issue more loans with better terms; and,
- Provides lenders with an alternative to recover the loan if the borrower fails to perform.

**The Program** also supported the GOC in the drafting of the Law by making comments and recommendations on the Draft Bill developed by the GOC. With the Law's passage and final enactment in August 2013, the GOC can now count on a modern legislative financing framework to promote a positive business climate, increase the country's competitiveness and encourage economic growth.

Now, small-scale producers such as rural farmers who lack land titles may use other possessions as collateral for loans, such as crops or livestock. Thus, in adopting the **Secured Financing Law (1676/2013)**, the GOC has taken a major step toward expanding access to credit for micro, SMEs and agricultural producers in Colombia, and has moved in the direction of its overall goal of greater prosperity for all citizens.

The challenge will be the Law's implementation. In order to complete the ambitious goals envisioned by the GOC, the Government must turn its attention to establishing the National Registry and focus on the adoption of new assessment schemes for collateral securities by banks. Both of these efforts will necessitate technical assistance and training.