EUROPEAN MICROFINANCE network

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EMN Issue Paper

Status of microfinance in Western Europe – an academic review

By EVERS & JUNG

ACKNOWLEDGMENT

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FOREWORD

No one better than Jan Evers, co-founder of the European Microfinance Network, to summarize the state of microfinance in Europe. This academic study paints a fully nuanced picture of the advances of microcredit and the obstacles it faces, and constitutes an interesting reference point for anyone who is interested in the topic and knows that the dominance of waged labour and the welfare state creates a less favorable context for its development than prevails in the countries of the South.

This context is in the process of changing. Europe is de-industrializing, and waged labour is becoming more precarious. The ageing of the population creates a need for a more active employment policy. New technologies facilitate the creation of small production units and should allow a reduction in the cost of credit. For all these reasons, microcredit, which formerly seemed to be poorly adapted to the European economy, is on the contrary becoming a financial tool of primary importance for creating and developing microenterprises and self-employment.

If the experts' task is to describe reality, that of microcredit operators is to change it. This change, which has progressed very slowly over the past two decades, is in the process of accelerating. As is the case with every innovation, it will crystallize dramatically. Something that seemed difficult to admit, and thus to develop, is becoming a fact and a necessity. Moreover, there is an inevitable gap between the image given by a study that can only be static, and a reality which is in rapid movement and thus difficult to catch.

The change will take place thanks to the convergence of lenders' efforts to reduce the costs of microcredit, a more favourable institutional environment and an alliance between microcredit institutions and banks.

Maria Nowak
President of EMN

STATUS OF MICROFINANCE IN WESTERN EUROPE

- an academic review -

Expertise of EVERS & JUNG

sponsored by the European Microfinance Network (EMN)

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March 2007

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1. INTRODUCTION[1]

The economic trends of the last years have shown that the **fordistic model** as we know it is **running out of time**[2]. The great factories incorporating large amounts of capital and human labour are disappearing in the European Union. Consequently, Europe is struggling with high unemployment rates amongst people who have traditionally made their living through wage employment. Contrary to this development the service sector is growing. It accounts for 75 % of the GDP. Yet, the US is ahead with more than 85 % of its GDP produced by the service sector. New communication technologies and a society focussing on personal individuality and creativity accelerate this process. As a result, small production and service units are developing everywhere and provide new ways of earning an income. Today there exist 23 million micro, small or medium enterprises in the European Union[3].

Yet, the **new financing demand** is not met by the established banking sector. Lending to the specific segment of small and micro enterprises is considered risky and cost intensive. The banks argue that they are confronted with unacceptably high risks of default and low margins, which hardly cover their transaction costs let alone their rate on return.

On the other hand, despite the fact that huge production plants including many jobs have left the continent, the headquarters of those companies have not moved. Hence, the structural changes in the labour market have not necessarily affected banks. Their major clients such as company headquarters are from Europe and still based here. So the question remains, whether banks actually have a need to explore new customer segments at their own risks, especially if they do not consider them to be very profitable.

The very same problem existed more than hundred years ago in Germany and was targeted by Friedrich Raiffeisen, who established the first cooperative bank. The same holds true for many developing countries where banks are not interested in certain client segments - those that are considered too small and less lucrative.

Microfinance aims to **close this gap** by providing small size financing services to those who are excluded from the traditional banks. On that score, microfinance initiatives have been very successful in developing countries. To date, this success has not been transmitted fully to the Western European microfinance sector.

This paper traces the Western European experience in microfinance so far. It demonstrates where knowledge and practical experiences of microfinance in Europe exists and shows how one makes use of these resources. On the other hand it points out the obstacles that occur in translating microfinance theory into practice.

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1. EVERS & JUNG on behalf of the European Microfinance Network would like to express its sincere thanks to the following people for valuable comments during the creation of this review: Claudia Kreuz, Klaas Molenaar, Maria Nowak, Faisel Rahman, Anneli Soppi, Alexander Kritikos, Philippe Guichandut, Miriam Guzy and Tamara Underwood. Without their contribution to form and content, this paper would not have been possible.
2. Nowak, M. (2005), p. 4.
3. See the Magazine Enterprise Europe N° 21 – Jan-March 2006.

2. CHARACTERISTICS OF MICROFINANCE IN WESTERN EUROPE

Where microfinance schemes in developing countries often provide a broad range of financial services, microfinance schemes in Western Europe focus on the provision of micro-loans. According to the EU Multiannual Programme (MAP) for enterprise and entrepreneurship, microfinance focuses on the supply of loans up to a maximum of 25,000 EUR to new and already existing micro-enterprises[4]. Microlending is different from commercial banking in terms of small loan sizes, quick and easy access, non-traditional credit worthiness evaluation, and alternative collateral requirements[5]. Further, microfinance targets some non-profit maximising goals such as social inclusion, job creation, micro enterprise development and development of regions.

Social Exclusion – a large niche

Microfinance organisations offer loans to a broad range of clients who could not otherwise obtain funding through commercial banking sources. Typical client types of Western European microfinance schemes are people starting a business out of unemployment and (social) exclusion. Compared with general micro enterprise banking this is a niche market. However, as stated above, it is quite a large niche in Western Europe[6].

Microfinance programmes in Western Europe are not and possibly will not become profitable, but make economic sense. The average costs for someone supported within a microfinance scheme – particularly since the monetary support is interest-bearing and repayable – are often below the cost for one year of support in the traditional social welfare system, where costs thereby incurred are "lost" subsidies.

Business support measures are an integral part of most microfinance schemes due to the especially difficult-to-serve target group and the complexity of the business environment.

In summary, Western European microfinance has, compared to developing and transition countries, a strong focus on social inclusion and pays less or almost no attention to its profitability. The approach is driven by niche markets, focuses on disadvantaged people and funds start-ups based on their business plans. So far there exists no franchise nor commercial investor. However banks play an important role as co-operation partners and sometimes even as initiators of projects. Governments and public institutions are the main money source for microfinance providers.

4. European Commission (2003), p. 11.
5. Whyley/ Kempson/ Evers (2000), p. 5.
6. The number of unemployed people is constantly increasing and an increasing number of unemployed are becoming self-employed. In France 60,000 unemployed created their own company in 2002, until 2004 this number increased to 90,000. In Germany, the numbers increased even more significantly. In 1990 only 12,700 unemployed became self-employed. By 2000 this number had increased to 92,600 and in 2005 there were more than 250,000 who became self-employed and received start-up subsidies from the national employment agency. In the EU25 an estimated 72 million people live at risk of poverty.

3. THE (R)EVOLUTION OF MICROFINANCE

3.1 - FROM SOCIAL TO BUSINESS CASE – MICROFINANCE IN DEVELOPING COUNTRIES

The evolution of microfinance in developing and transition countries is closely linked to the paradigm change from "financing development" to "developing financing" in development cooperation[7]. Beginning in the 1970s experimental programmes in Bangladesh, Brazil and other countries started to disburse tiny loans to groups of poor, but economically active people to invest in micro-businesses. Experiments included micro-enterprise credit programmes and financial institutions organised on a self-help basis. The schemes were based on a solidarity group lending approach, in which the repayment of each member was guaranteed by all other members of the group.

Now, many microfinance institutions, whose origins were social, are becoming more professional and sustainable, and in some cases, even profitable. Many of these institutions are now seeking commercial funding[8].

At the same time, commercial institutions are also beginning to get involved in providing financial services to poorer clients. CGAP[9] has identified over 200 domestic retail banks or consumer credit companies getting involved in microfinance, often driven by competition and new technologies that promise to allow them to make **smaller transactions more cost effective**. E-Banking, smart cards and telephone technology are beginning to be used by microfinance providers to reduce transaction costs, a key to reaching poorer clients.

3.2 - THE ROOTS OF MICROFINANCE IN WESTERN EUROPE

Microfinance in Western Europe has its roots in various partly parallel developments.

(1) With growing numbers of unemployed, various countries and regions established loan funds in order to fight unemployment. Examples are the Fonds de Participation in Belgium, First Step in Ireland, the investing social help of the social service department in Kassel (Germany) and the Prince's Trust in the UK. Many of these initiatives, excluding the afore mentioned, were badly managed and lost huge parts of their loan capital due to high default rates, and even their existence. The more successful schemes are still in existence today. They managed to improve their lending technologies often by using foreign microfinance expertise and have become successful microfinance providers.

(2) Inspired by the success of microfinance in developing and transition countries, several individuals dedicated to the subject worked to transfer the ideas of microfinance to Western European countries. Examples are Maria Nowak with Adie[10] in France, Rosalind Copisarow with Fundusz Mikro in Poland and later Street UK in the United Kingdom, Niamh Goggin with Aspire in Northern Ireland and Alexander Kritikos' ideas used by Enigma in Hamburg (Germany). However, microfinance has not been easy to transfer

The Phoenix Development Fund (PDF) was set up in the UK in 2000 to support innovative demonstrator projects working in disadvantaged areas and with underrepresented groups. It supported a range of initiatives that:

- Explored innovative ways of promoting business start-ups in disadvantaged areas
- Helped existing businesses in those areas to diversify, to provide better services and become more profitable
- Provided specialist support to encourage isolated people and groups in those areas to consider setting up and running their own businesses.

The PDF was closed on 31 March 2006 and results were evaluated.

[7]. Schliwa (2003), p.1.
[8]. Schliwa (2003), p. 21.
[9]. Consultative Group to Assist the Poor (CGAP).
[10]. Association pour le Droit à l'Initiative Economique.

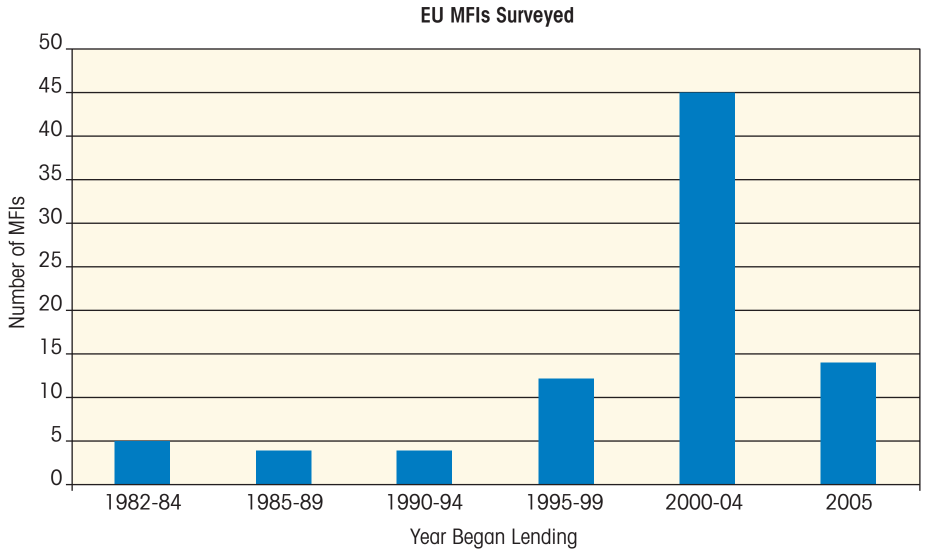
to the Western European context and many efforts have failed[11]. Reasons for these failures can be attributed to distinctive attitudes and expectations of donors, the market not reacting as expected and significant differences in the environment in general. A successful example, Adie, started initially with group lending. As this was not successful, after its first year of operation Adie forsook the common microfinance wisdom (group lending and step lending) and developed its own approach in France. Step lending is still used occasionally but only with very risky groups such as migrants.

(3) In the last five to six years a real boom of the sector has led to the establishment and/or entrance of many new institutions and actors into the market. One of their problems has been that they partly work with unbalanced subsidies for operational costs compared to loan capital (or vice versa as discovered in the new EMN survey on the sector). Often those microfinance providers have been under-funded on the capital side, whereby they have been over-funded for their operational costs, which in addition led to a boosting of those operational costs and is opposite to cost-efficiency.

(4) Lastly banks became involved in the sector. Development banks like Finnvera[12] and its predecessor Kera in Finland as well as the Kreditan-stalt für Wiederaufbau (KfW) in Germany[13] were the first banks to enter the sector. All to often this was under political pressure and with a social mission of politicians in mind. Also saving banks, especially the Spanish cajas have become active in microfinance, as part of their unique and specific social mission. So far, private commercial banks have not become directly involved. There has been some indirect involvement on the part of BNP Paribas and Bank of Ireland. These banks have provided refinancing funds to Adie and First Step, respectively. A direct and business-driven involvement of a commercial bank is however still missing. This is especially unsatisfying, since commercial banks such as Commerzbank AG are actively working in the microfinance sector in transition and developing countries – purely for profit. But the reluctance of commercial banks comes with no surprise, if they don't see microfinance as a potential business model in Western Europe (yet).

[11]. In this respect, the experience of Street UK and Aspire is here conceptually important. It has been evaluated in two reports: 'Lessons Learned from Street UK first three years' operations' and in 'Aspire – Microloans for Business: Operational and Funding Lessons for the Future of Microfinance in the UK'.
[12]. Formerly known as KERA.
[13]. In former times also known as Deutsche Ausgleichsbank (DtA). The DtA has been merged with the KfW in 2002/2003. Its business is continued by the KfW today.

Figure1: Age of MFI's



The microfinance industry in Western Europe is comparably young. In 2006, the EMN conducted a new sector survey. Based on 110 responses received - more than two thirds have only been lending since 2000. Most operate on a small scale and on local or regional level. There are some strong institutions such as Adie (France) and Finnvera (Finland), which operate on a national level. The largest microfinance providers are found in countries with few institutions in this sector[15].

→ 3.3 - MICROFINANCE – IN WESTERN EUROPE (STILL) A SOCIAL CASE

As in developing countries, the first actors in the microfinance sector started with social intentions in mind. However, unlike developing countries, microfinance in Western Europe has not moved forward to a more professionalized business approach. Most actors have an annual loan output of around hundred loans.

"Our social orientation is reflected by the choice of our clients. Once they become a borrower, we threat them as business like as any bank would do." Martin Hockley in 1999 for ICOF, now CEO of Street UK.

Three assumptions are presented to explain why Western European microfinance schemes have not managed to overcome the obstacles of outreach and financial sustainability:

- There is a less developed market:
  - Micro entrepreneurs have more options to finance their business project compared to entrepreneurs in developing countries. Due to a strong middle class, there are fewer constraints on **assets and equity**. And even if the entrepreneur him or herself faces constraints compared to the overall population in this area, family members or friends often help out by providing financing opportunities.
  - There exists a **highly developed financial market** with banks reaching the majority of the population. Although it is often stated that banks leave a financing gap in the micro sector, it can not be denied that banks do finance those micro projects which they consider less risky. Therefore banks cream off the 'good' risks.

[15]. "Overview of the Microcredit Sector in Europe 2004-2005", Tamara Underwood - EMN.

- Another form of access, although often viewed as inappropriate, is the provision of **consumer loans and credit cards**, which are available to the majority of the population. Business owners can finance their activities through credit card debt and consumer loans.
- Interest rate levels are much lower than in developing countries. They are often restricted by usury laws. Classic Moneylenders are absent in most countries, although exceptions are found in the UK.

- **There is too much social money:**
  - Microfinance institutions do not have the need to become financially sustainable or do not have to focus on profitability issues since they can finance themselves by obtaining funds donated to social aid on a regular basis. Donors take a social rather than a business approach, for instance to improve their public reputation.
  - There exists no shortage of money to finance social benefit schemes. Increasing welfare efficiency is the next step to take.
- **We have not learned enough:**
  - Microfinance institutions are still very young. It took years for microfinance institutions in developing countries to make the transition to a more professional approach.
  - So far, the existing incentives in and for microfinance institutions are not output oriented. Every newly granted loan just produces more costs and makes the programme more expensive. Many organisations providing micro loans are also engaged in a number of other employment/social welfare activities. Hence, microlending may not be their `bread and butter' activity. Therefore the incentive to get the right and most efficient lending model in place may be different than for those organisations focused solely on microlending[16].
  - Operational measures such as marketing and loan appraisal techniques are still weak.

Management and staff of microfinance providers may find the above provocative. It is important to be clear, though that the argument is not that microfinance is unimportant in Western Europe, but that there are reasons why it is developing differently and why, in particular, outreach remains limited so far.

"As regards to micro credit sustainability, in France we have not given up. After 18 years of existence, Adie has been able to increase the rate of interest above 7%, since the cap on interest rate has been abolished. I hope that in 5-10 years, with the increase and diversification of our activity we will be able to cover the cost of credit. Business advice which becomes now a separate cost center will have to be subsidized. We consider it as an 'inclusion service' to be financed by the public sector." Maria Nowak, 2006

"Microfinance is seen mainly as a social problem and not as a market failure". Christophe Guéné of SOFI, 2004.

[16]. For 42 % of the respondents to the new EMN sector survey microfinance represents 25 % or less of their general activities. Therefore microfinance is often not the main focus and sustainability is not the main objective.

4. MICROFINANCE BUSINESS MODELS

→ 4.1 - INTERNATIONAL MICROFINANCE MODELS

Various business models developed with an increased tendency towards commercialization of microfinance in developing countries. The success of microfinance has attracted banks and finance companies to enter into the market. Concurrently, NGOs providing microfinance services are transforming into licensed banks and formal institutions able to access public funds or deposits. Cooperation emerged between various actors and for-profit start-up MFIs established mainly in Eastern Europe. These different approaches are classified in general as follows:

(1) **Upgrading:** Semi-formal MFIs (primarily NGOs) alter into licensed and supervised formal financial institutions,

(2) **Downscaling:** Existing banks or financial institution enter into the microfinance business

(3) **Linkage Banking:** Banks cooperate with (or link to) NGOs or self-help groups, which are working with microfinance clients in order to enter the microfinance business.

(4) **Greenfield:** formal financial institutions specialized in microfinance business are built up from scratch.

→ 4.2 - BUSINESS MODELS IN WESTERN EUROPE

In Western Europe four different forms of microfinance business models developed

(1) **NGOs, Microfinance driven approach**

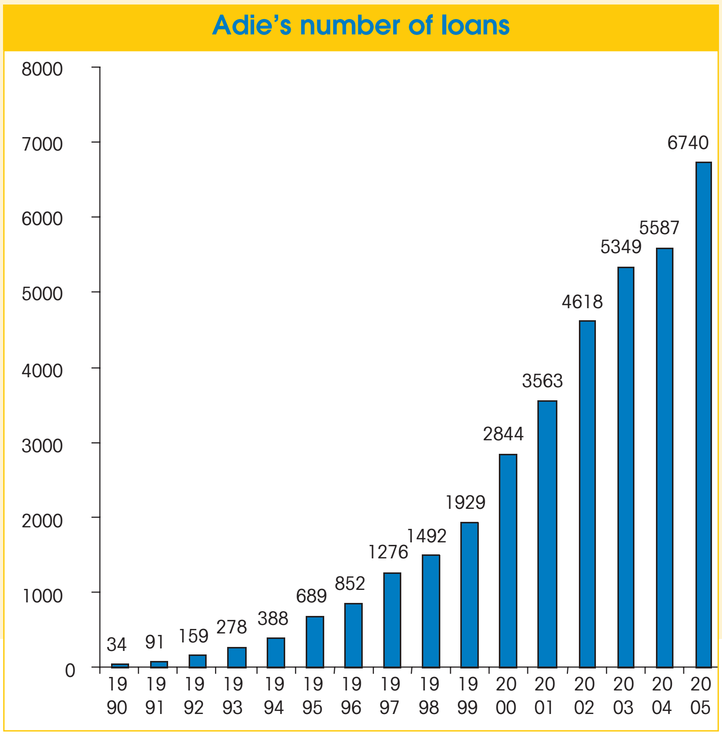
Inspired by the success of microfinance in developing countries, several institutions emerged with a microfinance driven approach in their business policy. Famous examples in this respect are Adie (France), ANDC (Portugal), Aspire (UK, Northern Ireland), and Street UK (UK). These NGOs focus on the business of issuing loans which should help them in outreach and efficiency. However, reality is less clear Street UK, while very professionally managed, could not manage to reach the number of clients, it first expected[17].

NGOs with a microfinance driven approach **focus on serving its clients with financial services**. Often they provide business support services too. However, business support services are rather viewed as an added value to finance, i.e. because they improve repayment rates[18].

[17]. Copisarow, R. (2004), p. 5-10.
[18]. nef (2004), p. 16.

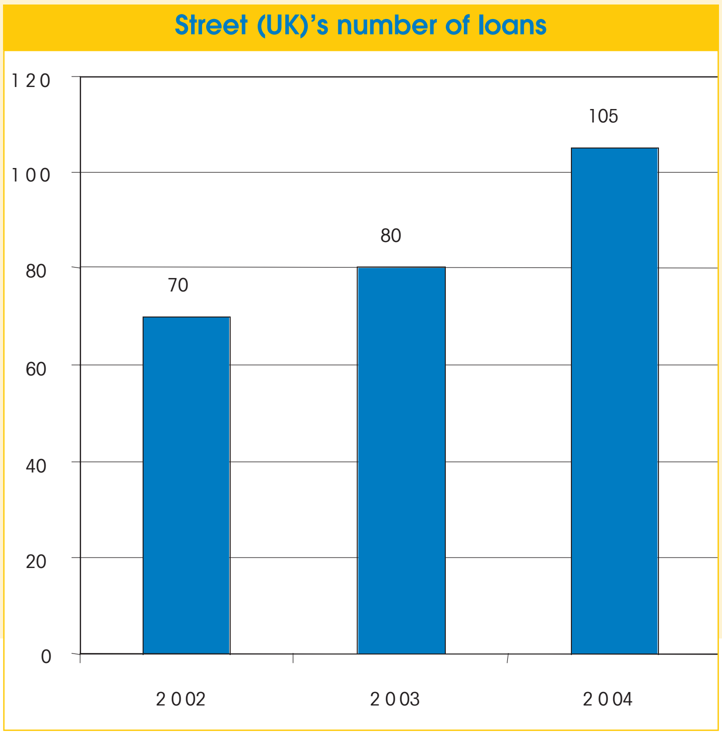
Example (1)1: Adie, France

- Based in France, established in 1989, nationwide active, 300 employees and 1,000 volunteers.
- Target group: unemployed and welfare recipients (95 %), active poor (5 %).
- Products: loans up to EUR 5,000 at markets rates, start-up grants financed and non-interest bearing subordinated loans co-financed by local governments, respectively.
- Individual or group based business advice to micro entrepreneurs.
- Income covers only a small percentage of real costs.
- Since 1989: 40,000 loans granted, 35,000 start-ups financed, in 2006: 15,000 active clients.



Example (1)2: Street UK, United Kingdom

- Launched in September 2000 in the UK
- Tasks: provision of financial support and advisory services for SME's
- Products for micro-entrepreneurs dispersing over £600,000 to indi-vidu-als borrowing an average of £2,000
- More that 1,000 micro entrepreneurs received business advice until 2004
- Repayment performance: 83% on time collection rate
- Less than 4% write-offs.



(2) **NGOs with a target group driven approach**

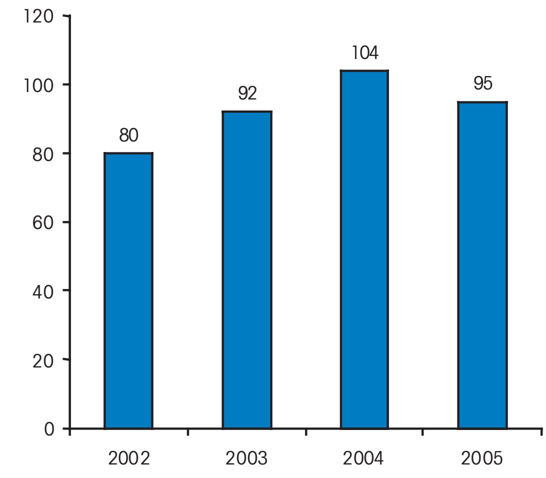
Several NGOs, who served specific target groups, expanded their services to include financial products. Their target groups, which were usually unemployed, recipients of welfare benefits, migrants, and so on, faced problems in accessing appropriate financing.

Eventually the NGOs started to include financial services in their overall programme. Examples include institutions such as the micro loan fund of the city of Hamburg (Germany), Weetu (UK), IQ/Enterprise (Germany), Hordaland Network Credit (Norway). NGOs with a target group driven approach are characterised by a **strong focus on business support** for their clients and by often only serving few customers with financial services. One exception is Prince's Trust (UK), which has helped 3,492 youth to start their own business and provides ongoing support to 8,658 young people and their enterprises.[19]
For this group, in general it can be concluded **that financing is seen as an added value to business support** and other social services.

Example (2): micro loan fund of the City of Hamburg (FHH-Kleinstkreditprogramm for unemployed), Germany

- The City of Hamburg (Germany) launched the FHH-Kleinstkreditprogramm für Erwerb-slose in June 2002
- Target group: unemployed and other people without access to finance
- SME's are promoted with a loan up to 12,500 EUR per borrower and up to 25,000 EUR per enterprise.

Micro loan fund of the city of Hamburg, number of loans



(3) **Support programmes initiated in existing institutions and development banks**

Often motivated by the public interest, existing institutions and development banks included support programmes for micro and small enterprises in their regular portfolio. Examples are the MSME programs of Finnvera (Finland), KfW (Germany), BDPME-Oséo (France), and ICO (Spain). This business model is attractive because the existing infrastructure of the overall institution can be used and existing distribution channels enable the programmes to quickly reach comparably large numbers of clients. However, problems arose related to the very small loan sizes of 5,000 EUR or less. The latter was probably due to image problems since the image of these institutions often suggests and/or is directed towards target groups who are very different from micro clients. Further, the motivation of clients to repay was low due to the traditional bank image or public ownership or even both. Borrowers felt that they did not need to reimburse their loan since the state was the debtor.
ICO and KfW issue loans only through bank partners which again may create an obstacle to reaching clients and limit their output to numbers below those observed in Finland where Finnvera disburses loans directly.

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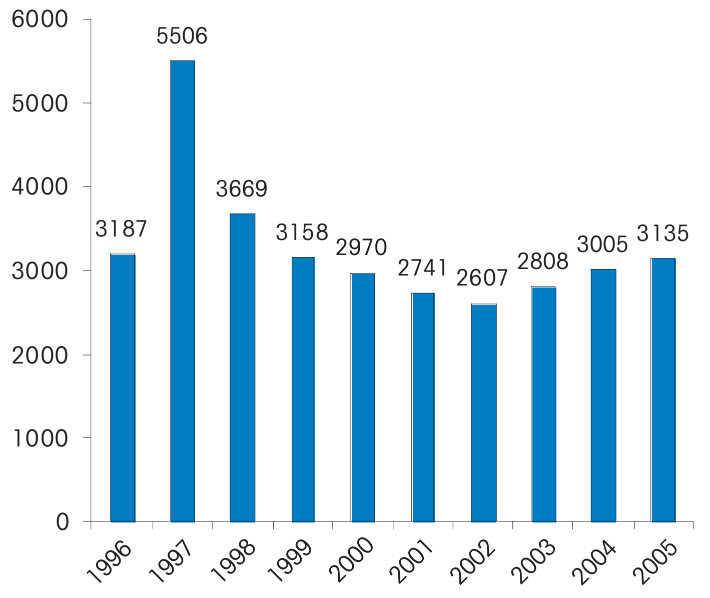
19. The Prince's Trust Factsheet (2005).

ICO recently run into trouble when the commercial bank share of the risk was increased (due to high write offs before) – at that stage most bank partners pulled out and very few made any loans in 2005. However, this business model could reach more potential in the future with incentives for sales partners. Incentives could be increased provisions as for example KfW in Germany did for loans below 10,000 EUR in 2005, or the creation of specialiced sales units of banks.[20]

Example (3)1: Finnvera plc, Finland

- Based in Finland, established in 1999
- Owned entirely by the Finnish state
- Target group: unemployed and welfare recipients (50 Percent of all borrowers).
- Finnvera's outstanding commitments 31.12.2005: credits and guarantees about 2,2 billion EUR
- export credit guarantees and special guarantees about 4,6 billion EUR
- Contributed to the creation of 10,550 jobs and 3,600 new enterprises in 2005
- Since 1997, 40 % on average of the total number of loans have been disbursed to women

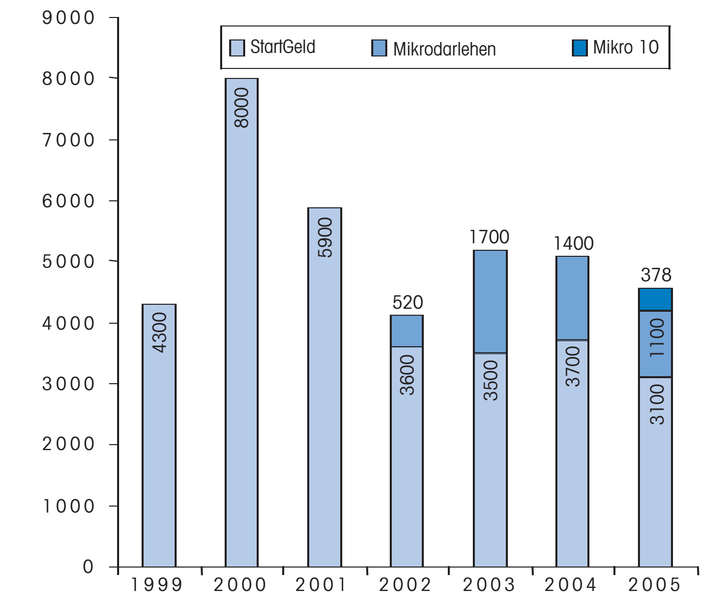
Finnvera's number of loans



Example (3)2: KfW-SME Bank, Germany

- Based in Germany, established in 1948 to support German economic recovery
- Today's tasks: Promotion of SME's, global loans, energy conservation, development cooperation
- KfW group: KfW Mittelstandsbank, KfW Förderbank, KfW IPEX Bank, KfW Entwicklungsbank, DEG
- Group figures in 2005: financing volume: 69 billion EUR, net income: 625 mio. EUR, balance sheet: 341 billion EUR
- Small loans for SME`s and start-up's: StartGeld up to 50 K EUR, Mikrodarlehen up to 25 K EUR, Mikro 10 from 5 to 10 K EUR

KfW's number of loans



[20]. For more information see the example of the "Service Company Model" of Accion in Chapter 5.3.

(4) **Specialised units of banks**

A successful business model can be found in Spain with Fundación Un Sol Mon of Caixa Catalunya and other Cajas having micro credit programmes. Fundación Un Sol Mon is a specialised outsourced unit of Caixa Catalunya, which provides microfinance services. Clients, who approach normal branches of Caixa Catalunya for microfinance services are actively referred to the offices of Un Sol Mon. Other Cajas use different methods. In "La Caixa" microfinance products are sold in ordinary branches of the banks, but approved, monitored, and implemented through a specialised back office. The experience is still young but the growth of issued loans points out that this model may have potential. In all these Spanish Cajas models the cooperation with social partners is essential since these partners are often referring clients, doing the interlinking work and providing parts of the preparation and follow up process[21].

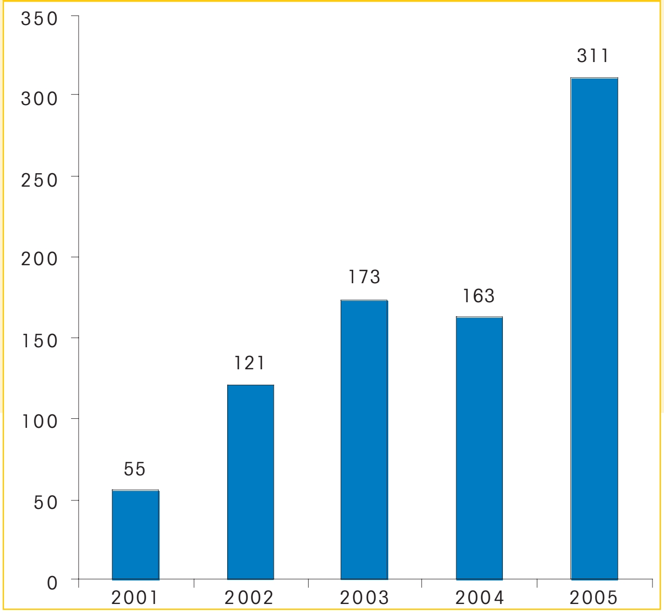
The use of specialised units of banks is still a young development in the microfinance industry. However, especially in Spain, they have experienced strong growth[22]. In addition, the Spanish examples mentioned above have achieved some successes in covering their costs partly through the granting of micro loans[23].

Another example, yet not fully appropriate in the above described context, is First Step in Ireland, which manages a Bank of Ireland loan fund.

Example (4): Fundación Un Sol Món, Spain

- Based in Spain, established by the savings bank Caixa Catalunya in 2000, operating on regional level.
- Target group: underprivileged people and communities, solo entrepreneurs in the service sector.
- Products: traditional bank loans between EUR 5000 to 8000
- At the end of 2004, the interest rate (6%) covers the risk (4,6%) and starts to cover transaction costs (>70%)
- Since 2000, more than 600 issued microloans with a total value of EUR 5,6 million.

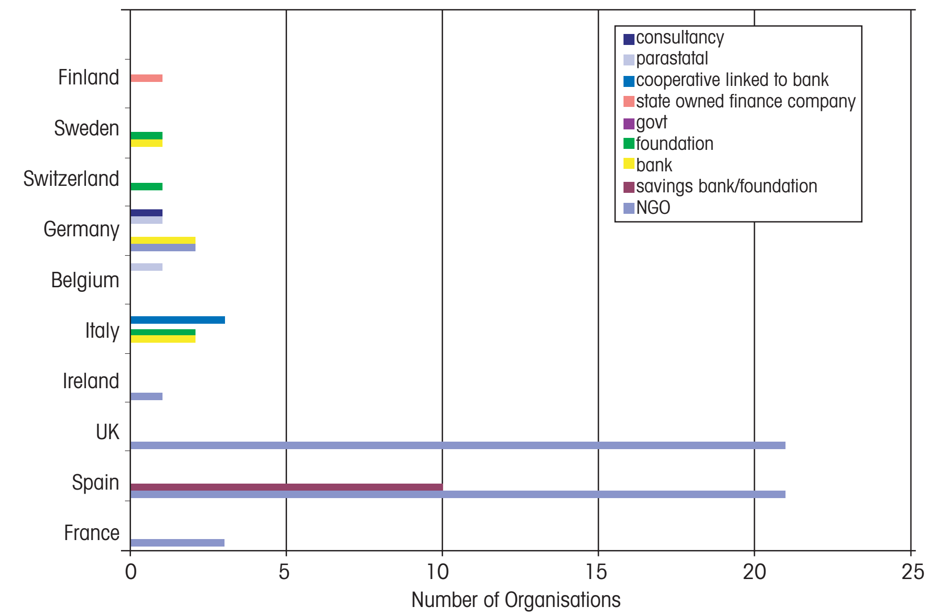
Un Sol Món's number of loans



[21]. «Microcredit in Europe: the experience of the saving banks, (2006), pp. 21-22.
[22]. Minutes of the 2nd European Microfinance Conference 2005,26 – 28 October 2005 in Barcelona, Spain.
[23]. Angel Font, the director of Un Sol Mon, mentioned at the Microcredit European conference in Brussels in 2004, that microloans cover 70 % of their costs already. However, in 2005 at the EMN annual conference in Barcelona the Cajas pointed out that this is the case because costs for business support measures are out-sourced to intermediaries financed by the European Social Fund (ESF).

Additional remarks on microfinance business models and their allocation in Western Europe can be drawn from the new EMN sector survey. It concludes that about nine out of ten microfinance providers in Western Europe have a not-for-profit status and four out of ten are non-governmental organisations. The latter are responsible for half of the loan volume in Europe. If compared by countries, NGOs dominate especially in France, Spain and UK the markets as the following graph shows.

Figure2: Microfinance Providers by Countries



5. WHAT WE KNOW AND WHAT WE DO NOT KNOW

One aim of this paper is to track Western Europe's microfinance experience so far. This chapter demonstrates, where knowledge and practical experience exist and show, how one makes use of these resources. Further, the obstacles are pointed out when translating theory into practice.

➜ 5.1 - DEMAND

The demand in Western Europe is less strong than in less developed countries. Yet,

We know:

The share of micro enterprises (enterprises with less than 10 employees) amounts to 93 % of all European enterprises. Small and micro enterprises account for 65 % of the European GDP[24].

A recent European survey among existing companies noticed that sufficient access to capital is still a huge constraint for about 20 % of Europeans MSMEs. Micro and smaller enterprises are even more affected than medium ones[25].

"... a segment of society that lies between the poor and non-poor: i.e. a population group that falls below the radar screens of mainstream financial institutions, but above the upper limits of most forms of charitable/state support."
Rosalind Copisarow (2004)

[24]. Taplin, R. (2005).
[25]. EU-Commission (2004), pp. 3-6.

The problem of financial exclusion affects 10 % of Europeans[26]. It varies substantially according to regions, countries, the type of people and so on.

Western Europe has a highly developed financial market. The majority of European households possess a banking account. Although banks are not very active in financing of micro and small enterprises, they try to cream off 'good' risks in this sector.

The well-established middle class is the reason why the majority of the population owns assets and/or equity and this is why most microbusinesses can collateralize their loans.

Likely microfinance product's clients are unemployed, social welfare recipients, members of minorities, and those generally excluded from the financial sector.

The demand and clients' business profiles are heterogeneous. There is no typical and single client profile, such as only farmers or taxi drivers. This is characteristic for developed countries.

"OECD-wide data suggest that both the least and the most educated individuals have the highest probabilities of being self-employed."

Alistair Nolan of OECD, 2003

What do we NOT know?

We know there are thousands of clients but are there ten**s** or hundred**s** of thousands of clients per country and year?

So far, no professional demand assessment has been done on a large scale. Then again, demand assessments are not easy to do for new products and new markets.

"The Telephone has to many seriously to consider deficiencies for a means of communication. This apparatus has no value for us."

(Western Union, Internal Memo, 1876)

So, the question remains: Is microfinance a mass market or rather a niche market?

> Good practice: To better understand the demand side of micro entrepreneurs in Germany, a survey was conducted among 213 entrepreneurs. They were interviewed about their funding needs and their inclination towards a typical microlending product. One main conclusion was that the market for microlending in Germany is smaller and the potential clients are different from what is widely believed. Although the size of interviewees was limited, clear recommendations to adapt marketing and product design were given[27].

Does there exist a potential for a standardised product targeting existing micro enterprises with small growth steps, which are not reached by banks yet?

Is there only a demand for loans? Would appropriate finance products including for instance micro insurance create a demand, too?

> Example: There are first movements in the sector: Street UK, Fair Finance and Credal demonstrated that there is a wider demand. Adie is starting an experimental program of micro insurance in partnership with insurance companies.

Are there reasons why Street UK has not been very successful in outreach? Are low levels of financial illiteracy and high levels of over-indebtedness in particular uniquely British problems?[28]

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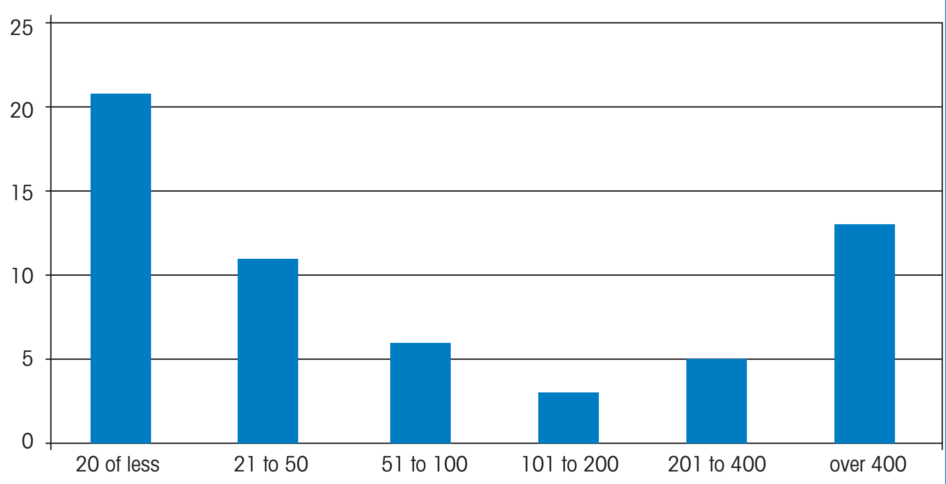
26. Microcredit in Europe: the experience of the savings banks, 2006, p.7.
27. Kritikos, Kneiding, Germelmann (2006), p. 24.
28. Copisarow [(2004), p. 6], former chief director of Street UK, identifies this as one of the reasons in her self-evaluation.

➜ 5.2 - OPERATIONAL LEVEL

We know:

Microfinance programmes face the challenge of slower growth and smaller sizes for loans clients and the market in general than initially expected. Most of the existing programmes have not reached large outreach numbers. According to the new EMN sector survey more than 40 % of Western Europe's microfinance providers do less than 50 loans per year and more than two thirds do less than 100 loans. Exceptions can be found in France with Adie, Finland with Finnvera, and Spain with the Cajas. It appears that there might be a correlation between loan numbers and the age of the lender (see also Example (1) 1: Adie, p. 14).

Figure 3: Loan disbursment by MFI's



Of respondents disbursing loans, 45 responded

At the same time, there has been low (or 'little') demand for marketing training on the part of microfinance providers. In fact, little time and money has been invested in efficient marketing for their microfinance products. Most microfinance providers seem to believe marketing is only promotion. Yet, a comprehensive marketing process involves market research and evaluations of promotional techniques, too.

The credit approval process is dominated by business plan assessments[29], which is a document-based criterion.

> Experience: Adie has reformed its methodology in the direction giving more importance to the assessment of the client than the assessment of the project. It is currently experimenting a scoring system worked out with the support of CETELEM, the French consumer financial institution. The purpose of this scoring is to prevent the risk by a better training and /or coaching of the client rather than to eliminate the client from lending.

Often collateral is required[30]. This is rather comparable to bank procedures as to international microfinance standards. Though, personal criteria are viewed as more important than business criteria.[31]

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29. Closely followed by personal criteria.
30. nef (2004), p. 12.
31. nef (2004), p. 12.

Almost all microfinance providers offer or even require the participation in post-loan support services from their clients[32]. As recorded by the new EMN sector survey two thirds provide pre-business support services and even more post-business support services. These services are mainly funded through the public sector.

In the specific market segment of start-ups, the good microfinance institutions have reached better repayment rates than banks[33]. On average a repayment rate of more than 90 % and a write-off rate far below 10 % have been recorded in the new EMN sector survey[34]. However, the client assessment is often too cost intensive. About 40 % rely on public subsidies for at least three quarter of their opera-tional costs.

<u>What do we NOT know?</u>

How can programmes reach clients on large scales in more Western European countries? Could professional marketing help to increase outreach? Is there a European way? Or can we transfer the excellent work from developing countries to Western Europe?[35]

Is it possible to judge 'real' risks of potential borrowers on large scale and in an efficient way, especially for those which have been rejected by banks before? How can the character-based screening approach be employed here?

Are business plans an appropriate tool to assess clients? Does the inability to prepare a business plan reveal anything about the client's ability to repay?

Are business support and training measures a real added value to financial services? Or do institutions risk mixing governance and organisational aims?

Is there enough motivation to repay loans? Does step-lending encourage motivation to repay?

> <u>Experience:</u> Aspire adopted the step-lending approach and experienced that subsequent loans were as or more risky than its first loans. This resulted in Aspire having more repayment problems with its repeat loans than with its first loans.

Does there exist a risk management tool equivalent to "zoning"[36] in developing countries?

"Does the institution want clients to come and ask for a loan, or does it want the clients to ask for assistance in writing a business plan?"

Evers/Siewertsen et. al. (1999)

"Evidence from Germany, the Netherlands, Sweden and France indicates that survival rates are comparable or superior to those among non-assisted firms started by both the unemployed and the employed."

Alistair Nolan of OECD, 2003.

[32]. nef (2004), p. 16.

[33]. Evers (2005), "the challenge of profitability for microfinance in West Europe", presentation hold at the "EIF SME Guarantee Facility Conference 2005"

[34]. The here mentioned data has to be taken with care because very few institutions responded to survey loan portfolio quality questions. So these results are probably biased as it may be that only the high performers responded, or those with management information systems. It could be that the majority of lenders have far lower repayment rates – since most did not report this information – it is just not known for sure.

[35]. See also Wright, G.: Strategic Marketing for MicroFinance Institutions: The Framework and Experience of *MicroSave-Africa.*

[36]. *Zoning* is regional splitting of the area an organisation is working in into zones that are looked after by a particular credit administrator. Typically the zones are local districts within towns or other local authorities. The aim is to enable the credit administrator to develop a high level of knowledge on lo-cal economy and other local issues. Often different borrowers know each other. Frequent contacts in the local area establish an information network that helps with the credit worthiness investigation and enables to acquire new clients. Additionally the administrator can visit his clients more often, as valuable time on far-distance travelling is saved. That way it is easier to find out if the financing needs adjustment. [Evers, J. (2000) p. 8.

What works:

Processes for micro clients, which are distinct from typical bank procedures for small enterprises work well.

If clients' benefits are maximised, for instance the usability of loans or short processing times.

Cooperations with banks for client referrals work in both directions. Gate openers, people and institutions which have close contacts to the target group, are very useful for appropriate referrals.

> Good practice: To improve access to micro finance the KfW (German Development Bank) published in 2005 a handbook on the cooperation of local banks with business support and start up institutions. The concept is based on a detailed analysis of two parallel processes. The credit decision making process of the banks was compared with the business support process of institutions supporting start-ups. The analysis showed that various steps are very similar in both kinds of institutions and that an intelligent interlinking of both processes can leverage substantial synergies. For the banks this reduces the transaction costs and sometimes also the risk costs and therefore makes it more attractive for them to lend to micro enterprises.

The reduction of loan amounts, which clients initially wished, hoped or strategically asked for, is often necessary. The renting out of machinery such as computers and cars to clients is one possibility to protect borrowers from over-indebtedness.

> Good Practice: Adie and Microsoft set off a mutual project, which helps micro entrepreneurs to start their business based on the use of new technologies. Second hand computers are re-cycled in a workshop employing excluded people and sold by Adie for 90 EUR. Microsoft finances the training.

Site visits and telephone calls are effective in screening clients.

> Good practice: TeleCoaching, which has been implemented in the city of Hamburg, Germany, combines the use of operational support programs and regular follow-ups. Borrowers of the regional micro loan programme can participate in this post-loan support service programme. They are regularly phoned by the TeleCoaching staff and business developments are assessed mutually. The coaches can give precise advice on upcoming challenges[37]. (TeleCoaching was developed and is implemented by EVERS & JUNG for the above quoted regional loan fund of the city in Hamburg)

Regular and in-time follow-ups during the actual lending process are a good warning system. In this respect, telephone-based interventions have proved to be a very cost-efficient methodology.

The creation of as many levels of increased debt recovery pressure as possible has been proven as useful for late repayments in other countries.

"Micro lending is different from small business lending. A more retail approach: credit scoring on application and behavioural, concentration on cycle time - the time to cash ratio, low cost application processing, risk based pricing, limit approach to credit granting."

Robert Kossmann, Raiffeisen International, 2005 in Luxemburg

"Organisations are often tempted to revise their promotional techniques when demand of their products is not as high as expected. However, CDFIs should first examine their product offering to ensure that it is attuned to what their potential customers need and want."

Whitni Thomas of nef and Niamh Goggin of Aspire (2004)

"People tend to wish to borrow 3 times as much as their cash flow permits. A £10k maximum offer therefore tends to produce £3k borrowers."

Rosalind Copisarow (2004).

"Don't give away potential for a higher pressure level too early"

Steve Walker of ART, the Aston Reinvestment Trust in the UK, 1999.

37. Behörde für Wirtschaft und Arbeit (2004).

Example: Fundusz Mikro and Accion New York practice eight levels of increasing pressure:

1. Phone call and letter from the loan officer with the request for payment,
2. Late payment = increased upfront fee for next loan,
3. Threat to deny access to new loans,
4. Involvement of co-signers who are threatened with denied access to new loans,
5. Involvement of internal collection officer,
6. Involvement of external collection agency,
7. Making use of collateral, taking away symbolic pieces,
8. Threat of court action[39].

Knowledge about the target group can be used for fundraising activities and to motivate staff to think strategically[39].

Group lending works for specific (minority) groups. However, clients value this approach more as a support measure than for access to financial services.

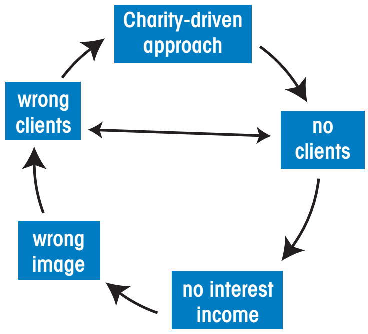
"Most of the customers joined because of the promise of getting a loan, but stayed in because of the network and support of their peers."
Unni Beate Sekkesaeter, Evaluation of Hordaland Network Credit, 2002.

Good practice: The Women's Employment, Enterprise & Training Unit (WEETU) was founded 1987 in Norwich, UK. It is a local microfinance institution focussing especially on disadvantaged women. WEETU is characterised by the importance of groups. Its Full Circle programme is based on the peer-lending approach, where all women of a group (5 to 8 members) guarantee mutually loan repayment. Repayment rates have been 98 %, with 200 women having been served in 2005.

What does NOT work?

Often microfinance providers seem to be trapped in a vicious circle. They have the image of being a charity that gives grants. Because of their social sometimes even charitable orientation, they do not do marketing. As a result they do not reach their target group but the wrong clients (not successful or not interested to repay). Further they do not receive sufficient interest income and have the wrong image, which then attracts again the wrong clients. Resulting from this programmes are not cost-effective and there do not exist any incentives to attract more clients.

Vicious circle of wrong image



→ 5.3 - INSTITUTIONAL LEVEL

We know:

The number of microfinance institutions and microfinance programmes has increased and is still increasing, because Western European countries have boosted and are boosting their efforts to modernise their welfare states.

In the future, more microfinance providers are expected to be created also due to the new EU-funding regulations in this sector which aim to recycle support programmes into loans instead of subsidies.

The existing microfinance institutions expect strong growth in their loan portfolio in future. The number of loans disbursed grew by more than ten percent between 2004 and 2005[40]. However, this very high growth rate has to be seen in the context of the absolute number of

38. Evers/Siewertsen et. al. (1999), p. 36.
39. Thomas, W. / Goggin, N. (2004), p. 7.
40. "Overview of the Microcredit Sector in Europe 2004-2005", Tamara Underwood - EMN.

loans disbursed the year before. Almost half of the institutions surveyed make less than 50 loans per year. In this respect, relative high growth rates are easily reached if only a few more loans are disbursed by the institution.

The interest spread should enable microlenders to cover loan losses and a share of the operational costs, if well managed. However, it is impossible to become profitable when only the risky target group of start-up entrepreneurs with an additional difficult background of financial exclusion is served.

Most microfinance providers have only poor management information systems. Therefore difficulties may arise in collecting data, monitoring activities and assessing performance.

If institutions aim to have a significant impact on fighting social inclusion high outreach numbers are essential. Institutions with low outreach numbers will only have a limited impact on the general change of the situation[41]. This might illustrate a certain lack of ambitions in the institution's part.

"...achieving scale is not just important for self-sufficiency but also for increasing impact."

Whitni Thomas of **nef** and Niamh Goggin of Aspire (2004)

What do we NOT know?

Are there appropriate incentives to motivate institutions and staff to 'sell' more microfinance products? (According to the new EMN sector survey, for almost half of all micro-finance providers surveyed, microlending represents less than 25 % of their overall activity. Only about one third consider microlending as a core activity)[42].

Is there a strategy to reach cost break-even with larger scales (higher outreach) or a change in target groups?[43]

Is it possible to establish a financially sustainable microfinance institution in Western Europe?

> Experience: Based on its experience, Aspire estimated that at highest its portfolio could have grown to GPD 1.87 million. At this level the income earned on Aspire's portfolio would have been able to cover 56 % of its operating costs. From this it follows that Aspire could have generated sufficient income from microlending to cover the cost of its loan officers, but would have needed ongoing grant support to cover its back office and other management and administrative costs.

In theory, interest rates should cover loan losses/risk (unless there is a loan loss reserve already budgeted for) and all operational costs related to loan processing. MFI's in CEE countries have interest rates between 20 and 40% which do this. It may not be impossible to become profitable if Western European microlenders covered their advice, support and BDS costs separately from loan processing costs. But the question is; what interest rate would be needed to do so, and would an interest rate let's say above 40% be politically and morally acceptable to the public, to policy makers, to MFIs and to clients in Western Europe (that is if there were no interest rate caps in force)?

[41]. Thomas, W. / Goggin, N. (2004), p. 4.
[42]. "Overview of the Microcredit Sector in Europe 2004-2005", Tamara Underwood - EMN.
[43]. The microfinance centre in Warsaw has information that for their region, at least 3,000 active clients are required for an microfinance institution pfoviding only financial services to become sustainable. In addition each loan officer needs to facilitate disbursemtn of 99 loans per year and of course the interest rates need to reflect risks and costs.

Would the "Service Company Model" of Accion (USA), where a micro client bank is the front shop of an established commercial bank, work in Western Europe?

Good practice: With its Service Company Model (SCM), Accion developed a less costly outsourcing approach to realize potential advantages of banks. The SCM is a non-financial company and legally a variant of subsidiary model to the bank without being a financial institution. Therefore, no separate bank licence and no large equity-base is required and it is easier and less expensive to launch and operate. The bank pays a fee to the SCM for promoting, evaluating, approving, tracking, and collecting loans, whereby the loans are in the books of the bank. Since the SCM only serves the bank, it can take advantage of the bank. For instance, the bank will handle processes which do not require specialized microfinance knowledge. The Service Company Model represents quasi a front shop of the bank. It is characterized by proc-esses, marketing and trained staff adapted to the target group.

What works:

"Offer creates demand" – once a certain institutional size and scale of customers is reached, growth is induced.

Example: The experience of Adie shows during the first year of existence of a branch, the demand is very low. Then it increases rapidly, the information being spread by the borrowers, the social services, the agency for employment, banks and institutions providing support to small businesses. Adie's increasing number of clients has already been illustrated in chapter 4.

"First loans were the hardest. We walked through Paris and could not spot the demand."

Maria Nowak, Equal Credit Conference 'Micorlending Menues' in Berlin, 2002"

Street Serve in UK divides work successfully. They separate sales and production (back-office)[44].

Good practice: StreetServe, a second business strand of Street UK, offers support service for non-profit organisations, which make loans to micro-enterprises, small businesses, social enterprises or individuals. StreetServe provides system support, operations support, and analyti-cal reports, documents and tools. The benefits for community development finance institutions (CDFI) and the CDFI sector are increases in sustainability of individual CDFIs, improved quality of systems, enabled collation of consistent data and a decrease in funding duplication.

➜ 5.4 - DONOR PERSPECTIVE

We know:

Many European donors prefer a social rather than a business style perhaps to improve the reputation of the donor. For instance, foundations of large companies and banks are actively funding microfinance providers.

Example: The Deutsche Bank Foundation – Alfred Herrhausen provided funds to five German microfinance providers. Hence, the money was only dedicated to reach the specific target group of young unemployed below a certain age. To receive a loan the applicants had to be registered unemployed. The limitation of the target group represented an obstacle to scale of outreach.

[44]. Copisarow, R. (2004), p. 40.

External funding of loan capital plays an important role. One quarter of Western European microlenders uses predominantly public sources, and one sixth private sources to refinance their loan capital. Less than one tenth finance their loan capital through earned income. The latter are all banks[45].

Mainstream EU funding, available up to now, distinguished between economic and social areas of competence. Microfinance however belongs to both sides of this divide. Capital/loan side and operational side including staff is often funded out of different resources. As a result microfinance operations are usually under-funded on the one and over-funded on the other side. An additional obstacle to sustainability issues comes up if the operational side especially staff is over-funded. Another result is that massive business support measures were created without establishing appropriate business financing schemes[46].

"Microfinance operators use a wide range of European funding programmes but nothing is really ideally suited. Due to a lack of alternatives they try to meet the funding objectives without harming their operations. It works but it doesn't work well."

EMN Issue Paper, May 2005

In developing countries the GDP per capita is substantially lower than in the developed countries of Western Europe. The same holds true for micro loans. Loans of 50-500 US$ can have a positive impact on the economic situation of the borrower. In Western Europe higher loan amounts in absolute terms are needed and demanded by potential micro loan borrowers. The EU-Definition considers loan amounts up to 25,000 EUR as micro loans[47]. If micro borrowers in Western Europe need on average 10,000 EUR. then to provide 1,000 loans of this size annually with a two year repayment period, would imply that 20 million EUR loan capital would be needed. Therefore an estimated ten to twenty times or even more money in absolute terms and time is necessary to finance a programme in Western Europe compared to developing countries until it reaches break even (if it ever does).

What do we NOT know?

Will new EU funding measures and new EU-initiatives such as JEREMIE be accessible for the typical regional MFI? So far, experience with SME guarantee facilities of the EU-Commission (MAP) is that only large national schemes (such as KfW, Finnvera, Adie, Prince's Trust, First Step, ICO) have access to guarantees due to limited administration capacities at the European Investment Fund (EIF).

> Good practice: One of the very few existing example where the EIF counter guarantees a portfolio of several regional institutions is Artigiancredit Emilia Romagna in Italy. Artigiancredit is a roof organisation and service provider for the connected regional CONFIDIs. The CONFIDI system consists of initiatives based on mutuality of small entrepreneurs to improve access to finance. Such a wholesale organisation would be appropriate to pool the loan portfolios of regional MFIs for a counter guarantee. However, technical challenges are high, in example the loan portfolio structure has to be transparent and comparable[48].

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45. "Overview of the Microcredit Sector in Europe 2004-2005", Tamara Underwood - EMN.
46. Please consider, that this will change from the new funding period (2007 – 2013) onwards. The EU has changed its regulation and focuses for example with the new JEREMIE-initiative particularly on micro and small business financing.
47. The average amount lent by country ranges from EUR 2,967 to EUR 22,753.
48. EVERS & JUNG investigated this in a study for a group of public banks aiming to access European risk finance for an interregional group. 2006

If cost-covering interest rates are not politically and morally acceptable to the public, which stakeholders are willing to make a long-term commitment to subsidising the interest rates/loan processing costs so that microfinance institutions are not dependent upon the ups and downs of government budgeting processes, changing priorities etc?

> Example: The UK experience with the Phoenix fund demonstrates that government priorities and methods of working change at least once if not twice in a 10 year period.

What works:

Learning from commercial funding and setting up clear objectives as regards to clientele is crucial. A commercial orientation will help to avoid the crowding out of the private sector for both the displacement of private suppliers and private sector jobs. A market-oriented approach can indeed contribute to the creation of private sector jobs. Market orientation has the potential for greater sustainability and therefore larger over-all impact. Higher operational cost should only be subsidized if they are caused by the special needs of the target group. Inefficient procedures should not be funded.

"The need for policy initiatives is often assumed rather than tested"

Alistair Nolan of OECD, 2003.

Co-operation with banks, where banks provide packages for refinance, for risk sharing and some subsidies for reaching clients as well as the enlargement of the market.

> Good practice: Adie (France) has had partnerships with banks for the past 12 years. The first partnership was with Credit Mutual in 1994. Other cooperative and commercial banks have followed summing it up to about 50 partnerships today. Under these partnership agreements banks provide loan funds and take over 30% of the risk, whereby the final loss rate is an estimated 3%. Adie takes over 70% but is counter guaranteed by two government and one European funds. The operational costs are covered by the local governments.

Private-Public-Partnerships, where processes of the loan assessment and the post-lending process are sourced out to a specialised organisation[49].

> Good Practice: The city of Hamburg, Germany, funds a micro loan programme targeting starting entrepreneurs previously unemployed. The micro-loan programme is combined with business support measures in both, the pre- and post-loan phase. A required pre-examination of loan applications including advice services, if necessary, is conducted by the Johann-Daniel-Lawaetz-Foundation.
>
> Post-loan support is provided by the telephone-based consulting service TeleCoaching run by EVERS & JUNG. Entrepreneurs are called quarterly. Consultants discuss mutually with the entrepreneurs the business progress and give precise advice on upcoming challenges. Due to this outsourcing process the city of Hamburg limited its administrative costs to 30 ct for each 1 Euro granted, roughly estimated, including selection, business support and monitoring[50].

[49]. BWA Hamburg (2004).
[50]. Behörde für Wirtschaft und Arbeit (2004).

➜ 5.5 - ENVIRONMENT AND IMPACT

We know:

Inactivity traps exist in most welfare states and create obstacles to start self-employment in gradually increasing steps[51]. People who want to start their business in progressive steps have the highest potential to become microfinance customers.

The grey economy is a typical market for microfinance providers. In Western Europe the informal sector accounts for 15 to 18 per cent of GDP. Of course, informal enterprises represent only a small part, apart from wage workers, illegal and criminal activities[52]. So far, it is difficult to serve people working in the informal market, because laws are strictly enforced on informal businesses. Microfinance providers might face punishment by legal authorities[53].

In most countries banking regulations are strictly enforced and are not very appropriate for microfinance[54]. In addition, usury regulations often prevent microfinance providers from charging cost-covering interest rates.

> Good practice: The French banking regulation opened a special window just for micro lending. Microfinance providers are allowed to provide the first most risky and most expensive credit to an entrepreneur. Bank services are not replaced by this credit provision, rather the contrary holds true: potential clients are prepared for bank finance.

Microfinance is not profitable but makes economic sense for welfare states. The cost of unemployment can be reduced, since the financial costs for job creation via self-employment are lower than annual costs of unemployment benefits. That is one of the reasons why it has become more and more popular during the last years.

> Example: Adie calculated the creation of self-employment costs 4,000 EUR in France including a small start-up grant. In comparison, the French Ministry of Economy estimated the costs of unemployment benefits at 18,600 EUR, including besides the direct costs also the lost tax and national insurance contribution[55].

Microfinance has an impact on the creation of jobs. Small enterprises are the job motor of Europe. Micro investments enable enterprises to grow and employ more workers.

> Example: INAISE surveyed the Financial Instruments of the Social Economy (FISE) in Europe and their impact on job creation in 1997. Although they stressed the difficulties and methodological limits of evaluating the impact on employment, it was estimated that the majority of microfinance providers surveyed are already able to instigate the creation of a job with financial instruments of between 1,200 and 8,000 EUR.

Microfinance helps to socially and economically (re-)include people through self-employment. Bridges are built for the excluded and long term unemployed welfare dependents to come back into society and economy[56].

"But microlending entails complex institutional and policy challenges"

Alistair Nolan of OECD, 2003.

"Current strategies for tackling informal employment are not working effectively, because they try to stamp it out, encouraging people to report others and threatening sanctions. These measures drive people further underground, away from the main-stream economy."

Rosalind Copisarow and Aaron Barbour (2004)

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51. Siewertsen, H./ Evers, J. et. al. (2004), Part 1, p. 12.
52. Nowak, M. (2005) p. 2.
53. Copisarow, R. / Barbour, A. (2004), pp. 29-32.
54. Siewertsen, H./ Evers, J. et al. (2004), Part 2, pp. 18 – 22.
55. Nowak, M., Mezieres, E., et al. (1999), pp. 28 – 30.
56. Siewertsen, H./ Evers, J. et al. (2004), Part 1, pp. 7ff.

What do we not know?

Do clients actually improve their living standards or do they rather become part of the working poor?

What works:

Well designed bridges from unemployment to self-employment encourage hundreds of thousands of potential clients to become self-employed.

Good practice: The German scheme Ich-AG supported previously unemployed starting entrepreneurs with decreasing amounts of monetary benefits for up to 3 years.
The transition period is considerably improved because time is longer and gradual decreases force businesses to become sustainable. The number of applicants has been enormous under-lining the success of the programme. However, politically motivated the scheme has been suspended in July 2006.

Good practice: The Irish Back to Work Allowance scheme encourages people, who receive certain social welfare payments, to become self-employed. People retain a decreasing percentage of their welfare payments for 4 years (Year 1 100%, Year 2 75%, Year 3 50% and Year 4 25%).

The creation of special microfinance windows in the banking regulations help to diminished legal obstacles for microfinance providers[57].

Good practice: As stated above, France has a special window in its banking act for associations lending to specific groups. Adie makes use of this window and is allowed to borrow for on-lending. This makes Adie's work more efficient because no intermediating bank is needed. However, the specialised window is restricted to a certain type of end client. To avoid competition with banks, clients need to be recipients of minimum welfare benefits or unemployed. Loan amounts are restricted to EUR 6,000 and only during the first five years of business creation. This window allows disbursement of the first small, hence risky loans to starting entrepreneurs, not being competitive but rather complimentary to bank financing activities.

"Accommodate needs of micro-enterprise support organisations that build financial bridges without distorting the financial sector"

Hedwig Siewertsen et. al. (2005)

[57]. Siewertsen, H./ Evers, J. et al. (2004), Part2, pp. 18ff.

6. CONCLUDING REMARKS AND FUTURE OUTLOOK

The microfinance process is still young and in progress in Western Europe. So far, the (business) models are not clearly defined. This concerns in particular the issues related to interest rate levels, accompanying business support, and whether the existing target group is the appropriate target group.

Microfinance is still young

The growth and size of some microfinance providers as well as the survival rate of their clients' businesses have demonstrated that microfinance is an effective instrument for Western Europe – even if it would prove not to be profitable, finally.

Microfinance is effective

Microfinance providers have still a lot to learn on operational efficiency. Achieving organisational self-sufficiency as well as growth in numbers of loans disbursed are the main challenges faced in the future[58].

Microlending has not become microfinance yet. Only few providers of microloans offer other financial services, most of them being banks.

Microfinance will only become significant, if more players take the responsibility and really look at the demand of micro entrepreneurs and enterprises, develop and implement lean processes and enter (aggressively) the current financing market in order to make microfinance core business.

Needed: more demand orientation!

The Western European environment is quite different from the one found in developing and transition countries. Welfare states systems have created and favoured inactivity traps. Obstacles in banking regulation hinder the efficient work of microfinance providers and often make it possible to establish only a second-best model , i.e. the German co-operation model with banks directly disbursing loans instead of micro-lending organisations[59].

Surroundings are changing slowly. Structural problems have led to the still ongoing revision of the social benefit systems in many welfare states such as Germany. In more and more areas subsidy systems prove ineffective and are replaced. For example, the EU-Commission changed its focus in funding regulation in favour of revolving loan funds. This will displace the previous concentration on subsidies. A unique chance is created for new and growing MFIs.

The environment for microfinance is changing and creates chances

These changes will make room for microfinance. Even more microfinance can be a driving force for welfare states to be less patronizing and more inclusive. For a new culture of support tax payers money will be used for self-help and not for never ending needy regions, branches and so on.

Building an inclusive and entrepreneurial economy…

As a consequence microfinance will be a driving force of an innovative, creative and dynamic European economy. The sooner the better for the players and the economy.

…microfinance will be a driving force

58. "Overview of the Microcredit Sector in Europe 2004-2005", Tamara Underwood - EMN.
59. „Existenzgründer und junge Unternehmen gemeinsam stärken - Ein Leitfaden für regionale Kooperationen zwischen Kreditinstituten, Beratungs- und Wirtschaftsförderungseinrichtungen." KfW Bankengruppe, Frankfurt 2005. (handbook for co-operations of banks and support organisations in Germany).

7. ANNEX

7.1 - REFERENCE LIST

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