

Microfinance, its concepts and development, lessons to draw for Europe

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“Implementing the EU Microcredit Initiative
What can be learned from developing and transforming countries?”

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¹ This paper draws from "Microfinance, (only) for enterprising people?...a diverse market requires a novel approach ...", 2008, by the author, Professor Microfinance and Small Enterprise development at the University of Applied Science INHolland and General Director Triodos Facet NB

1. There is a wealth of experience out there; it is not all new, still developments are...

The micro-credit and microfinance industry would not have developed so rapidly if both were not supported by in-depth insight in the small- and micro-enterprise sector at large and the theories developed in the late eighties. Rarely do we see development processes being supported by a well-founded theory, but the microfinance sector is one of them. The start and growth of the sector with the launch of many, fast growing micro-credit programmes for the poor was based on a theoretical framework and a strong awareness that something needed to be done about the plight of the poor. What first started in developing countries gained ground as well in European countries with the Netherlands following only a few years ago. Comparisons are difficult to make, but they do demonstrate that the matching of client groups and services/ channels deserves more attention, not in the least in order to continue serving the less advantaged in our society.

Setting the millennium development goals and the International Year of Microcredit, and awarding the Nobel Peace Prize to Mohamed Yunus, have definitely given an enormous boost to microfinance worldwide, as it has also done in the Netherlands. Initially, most developing countries accepted microfinance as an instrument to combat poverty. Then it was acclaimed as an instrument to boost entrepreneurial initiatives. Subsequently, MFIs developed comprehensive programmes offering a wider range of products and services to micro-entrepreneurs. Now, the sector is considered an industry, and legalisation and regulatory frameworks are developed and introduced in support of the sector. However, in spite of the interest shown, such is not yet the case in Europe.

Microfinance is not really something novel. It is not something invented in the eighties nor was its foundation laid in Bangladesh. Having said this, this does not preclude that we need to have tremendous respect for people Mohamed Yunus in Bangla Desh or Maria Novak in France, who both gave the microfinance a face and the industry such a tremendous impetus. But savings- and credit-groups have existed for longer periods and were set up by men and women all over the world for many reasons. SuSu schemes (in Ghana) or Stokvels (in South Africa) existed for longer periods and were set up spontaneously in many places, as cooperative savings- and lending groups were in Europe at the beginning of the past century. The special thing about Yunus was that he demystified the art of banking, believed in poor people, used existing knowledge and linked that to poverty, and that he saw micro-credit as an instrument to promote social participation and a way for people to break away from the poverty trap. Similar things have happened before in the past. In a very capitalistic and liberal economy, the savings- and credit cooperatives were an answer to the exploitation of people, reflecting an understanding that the actual users themselves could not necessarily lead and manage the organisations on their own. They had already enough problems on their hands to cope with, and were better served with well-run financial institutions that offered them proper services at the right price. In the beginning of the past century, it was Friedrich W. Raiffeissen who took steps to organise poor farmers in credit- and savings cooperatives. He succeeded in making the poor visible and in showing them a way out of their social exclusion by organising cooperative savings- and credit groups, both with and for them. Indeed, there is also an early example of the Rhineland principles². Raiffeissen stimulated various stakeholders, such as teachers, leading public figures and business leaders, to join the cooperatives, and to sit on their boards and (management and advisory) committees. This way he secured social imbedding of the cooperatives, which in turn contributed to their sustainability.

² Rijnlanders durf te denken en te twijfelen. Piet Moerman, Essay, 2008

However, very little has been done with this knowledge in developing microfinance.

1.1. Evaluations and theory as a basis for the start and growth of micro credit

Small and medium-sized enterprises (SME) have received ample attention in the seventies and eighties and many programmes have been experimented with. Special SME financing programmes were developed, as well as training and consultancy services. Evaluations of SME development programmes in the eighties showed the limitations of the methods and programmes: they did not reach large numbers of people, were considered costly and were offering all kinds of services to the SME sector in a supply driven, ineffective and inefficient way.

The comprehensive evaluations³ of the small-scale industries sector in the late eighties (Keddy, Nanjundan et al. 1988) provide an in-depth insight into the numerous pitfalls encountered in small and micro-enterprise development and promotion programmes. Their studies clearly spell out the weaknesses of the Small and Medium-sized Enterprises (SME) support systems adopted, programmes developed and policies pursued. These weaknesses led to supply-focused, often isolated support, reaching few people at a relatively high cost.

The lessons drawn from such analyses are manifold and have an important influence on the design of micro-enterprise programmes and on the role of related Business Development Services (BDS). Some of these are:

- ☞ The need for an enabling environment that will be conducive to the development of the micro- and small enterprise sector;
- ☞ The importance of involving financial institutions in credit and financing programmes and the need to think in financial systems rather than in credit lines proper;
- ☞ The importance to professionalise intermediary institutions and organisations and to assist these in their organisational and related human resources development processes;
- ☞ The importance to boost and promote local entrepreneurship resulting in clear demand for services;
- ☞ The need for flexible programmes that can be adjusted to changing needs in the small and micro-enterprise sector.

The studies conducted by the State University of Michigan on the effectiveness of small and micro-enterprises and the work of Stewart and others stressed the importance to focus on the impact of macro-economic policies for SME development (Gosses, Molenaar et al. 1989). Governments, it was argued, needed to concentrate on creating a suitable enabling economic environment and need to withdraw from service rendering, which should be left to the private sector and non-governmental organisations (NGOs). This was used by governments as an argument to cut down on allocating funds for the sector. Furthermore, donors decided to concentrate more on policy issues and less on financing of recurrent costs for services in SME support programmes. These changes sped up the process of separating Business Development Services completely from financial services; in some cases it was even decided to discontinue BDS delivery all together. But we failed to indicate how these services could then be funded and financed. With the neo-liberal wave that affected the SME industry in the early 1990's, it was not surprising to see that BDS services and their institutions disappeared.⁴

Lessik and Farbman managed to accelerate the debate by introducing a pragmatic way to classify the SME sector steering us away from endless definition debates. They introduced

³ The most important was organised by United Nations Development Program (UNDP) / Dutch Government / International Labour Organization (ILO) / United Nations Industrial Development Organization (UNIDO) thematic evaluation *RSIE, Development of Rural Small Industrial Enterprise: Lessons from Experience*

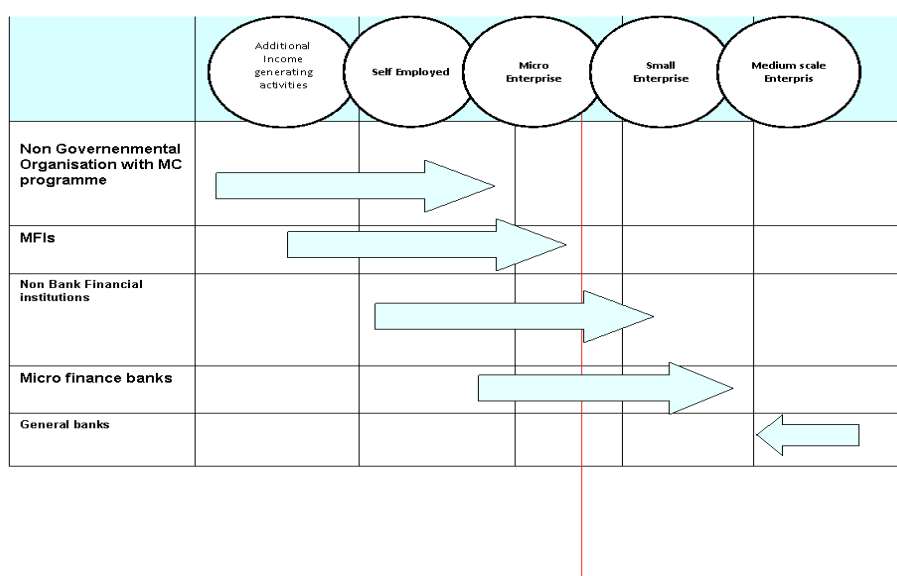
⁴ In the Netherlands similar processes took place; look for instance at the history of IMK a state supported BDS provider that went bankrupt after it was partly privatised.

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a simple way of describing the sector in four major categories, survival activities, micro, small and medium-sized enterprises (Gosses, Molenaar et al. 1989).

Following their work and drawing lessons from the micro-enterprise programmes under the GEMINI programme⁵, the *minimalistic theory* gained ground. The basis of this theory is quite straightforward: it supposes that the development of micro-enterprises is hampered by one or two critical factors. Eliminating or reducing the effects of those factors can have a relatively high effect in the development of the enterprises. Furthermore, it is argued that (access to) credit is the major bottleneck in micro-enterprise development. The minimalistic approach has indeed led to an intensified attention to micro-credit programmes.

Figure 1 *Development and evolution trends of organisations offering microfinance*



Source: Triodos Facet, based on classification by Farbman and Lessik

Blending this approach with a neo-liberal view contributed strongly to the emergence of microfinance initiatives. The state and the donors withdrew from support programmes for the SME sector. People were expected to pay for the services offered (without further subsidies) and non-governmental organisations (NGOs) were expected to take over the tasks of the public sector. Besides donors told NGOs to become financially sustainable. The NGOs could only do so if they could offer a product for which people are willing to pay. Micro-credit is such a product, with large numbers of poor women and men willing to pay for it. The market consisted of poor people who initiated very small economic activities, often generating some additional income next to other income generated by the household. With the introduction of micro-credit as the single support instrument, attention shifted dramatically from small and medium enterprise development to the survival economy, but not yet to the micro-enterprise sector. This came later, when micro-credit evolved into microfinance, when group-based credit distribution systems evolved into individual lending, new services and products were developed and loan amount increased slightly. The next step has been that some NGOs graduated in Non Bank Financial Institutions (NBFI), that in turn graduated into (quasi-)banks attending micro and even small entrepreneurs.

Following the classification of the sector advocated in the late eighties we can combine those developments into one framework linking classification with the channels that emerged

⁵ A comprehensive USAID funded SME support programme in developing countries, that was studied extensively.

over time as presented in figure 1. This can be used to assess the apparent logical developments and we can ask ourselves whether developments in Europe at large and in the Netherlands in particular will be similar and whether there is proper matching between the channels (organisations) and the target groups. Equally important will be to appraise the market the microfinance institutions (MFIs) operate, the segmentation of the clients and shifts that take place in the labour market there.

1.2. Can we compare developments and draw lessons?

It is claimed that micro-credit and microfinance in developing countries have reached large number of clients and significant volumes in lending. Various databases report so accordingly but unfortunately present different figures, not surprisingly, as we deal with a significant number of informal operators (both the NGO community and the clientele). We tend to believe that there are more than 10,000 organisations worldwide (NGOs and NBFIs, specialised banks but excluding regular banks) engaged in offering micro-credit and microfinance services.

There are about 3,000 organisations that are in a position (or are willing) to submit comprehensive data about their performance. Based on those data, it is reported that over 300 MFIs are commercially self-sustainable. Based on the data of MIX (Microfinance Information eXchange 2007) we estimate that these 3,000 MFIs have approximate \$100 billion of loans outstanding and have over 150 million clients⁶ (of which over 60% are women) with a growing preference for individual lending (see also chapter 2).

Many of the NGOs started off as projects with micro-credit funds. They applied what we now label "traditional" methods, such as solidarity loans (group-based) or gradual lending systems, all methods to extend the very small credits to the poor. Over time, NGOs became aware that the real issue was access to (a wide range of) all-inclusive financial services and the building-up of sustainable financial intermediaries. They began to offer more services to their clientele and became non bank microfinance institutions, some of which nowadays have become regulated financial intermediaries. As this all appears quite simple, we often seem to believe that the same could happen (without much modifications or adjustments) in Europe and the Netherlands.

Micro-credit and microfinance in Europe are rather new phenomena and were first put seriously on the agenda in the early nineties. In a relatively short period both have been embraced fully by politicians at the European Union - and at some national levels - as a valuable instrument for social and economic development. This has culminated in the announcement of a European initiative on micro-credit in 2007.

The number of (specialised) MFIs in Europe is rather small (see chapter 3), just over 200, and the total portfolio of 42,000 to 80,000 loans outstanding is estimated to range from € 390 to 600 million). Compared to the population in Europe and moreover the overall amount of outstanding loan amounts, this is rather a low figure. More interesting are the growth rates and the average loan sizes. The number of loans disbursed between 2006 and 2007 has increased with 14%, while the growth rate of the value micro-loans disbursed in Europe between 2006 and 2007 was approximately 32%, with an increase of the average loan size from € 7,700 to above € 11,000 (Loans ranging from € 525- sometimes group-based - in Eastern / Central Europe mainly to over € 30.000 in Western Europe).

⁶ Three - reliable and frequently quoted - sources (Micro-credit Summit, CGAP- World Bank and World Savings Banks Institute), give different data but the generally accepted figure fluctuates around 150 million; nevertheless care must be exercised since there is a tendency to overestimate demand in the sector - see also CGAP (2008). "Are we overestimating demand?"

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In the Netherlands we are quite late in discovering microfinance. As yet, we have no significant micro-credit programmes in the Netherlands, nor a NGO community engaged in this work. There are about 12 private organisations⁷, of which only six are in the position to report on their performance: Annually they reach approximately 900 clients with individual loans ranging from € 4,000 to over € 31,000 (See chapter 4). However, we do have clear policy recommendations. The private and public sector are invited to increase their efforts and mobilise more resources to promote more entrepreneurial initiatives. Furthermore, it sets a challenging target of an additional 10,000 new starters per annum. While it aims at providing micro-loans of an average of € 10,000, it also acknowledges the importance of mentoring and coaching.

Some may label this as a small loans programme aiming to provide finance to starting (micro-)enterprises; others may claim it is a microfinance programme that creates more access to finance for those who normally are left aside. What's in a name, we may ask.... or is there a need to be more precise?

A deepened and broadened understanding and proper comparisons (illustrated in Table 1) can indicate how to further develop and introduce microfinance, the services, which organisations to develop and what policies to pursue.

⁷ Data exclude the government sponsored programme for social welfare beneficiaries

Table 1: *Different regions, different developments of the microfinance sector (2007)*

	Developing countries	Europe	The Netherlands
Number of NGOs/MFIs estimated to be operating fully engaged micro-credit/microfinance ⁸	> 10,000	> 200	~ 12 ⁹
Number of NGOs/MFIs in position to submit data/	~ 3,000	~ 100	6
Number of commercially viable MFIs	~ 300	Not reported yet	None
Number of active clients	> 150 million	42,000 to 80,000 ¹⁰	~200
Proportion of female clients (%)	60 - 65	~ 44	~ 32
Total portfolio of loans outstanding (€)	~ 80 billion (~ \$100 billion)	390 - 600 million	900,000
Range of loans (€)	100 - 850 (((\$145 group loans -\$ 1,150 individual loans)	545 – over 30,000(on average 11,000) (4,000 - 30,000 (on average 13,000- 15,000)
Proportion of individual loans (%)	81 (half of which with group guarantee systems)	~ 95	100

The hard data as such do not tell us much about the way the sector developed. If we want to develop the sector in the Netherlands we need to be open to study the phenomenon in detail to find out how awareness is related to policies and which channels and services are the more appropriate ones for the respective target groups. In doing so, it can be useful to critically evaluate a number of “common beliefs and statements”, asking ourselves what we can learn from the South and how we can use it in the North.

2. How green are the pastures in Europe?

We are very *rich* in Europe. Our wealth allows us to introduce and develop systems and programmes. There are a number of successful organisations that have grown significantly, but it is not yet clear in which direction things will evolve. There is a rather top-down approach, with the EU now taking a prominent place, launching the “European Initiative for the development of micro-credit in support of growth and development”, but stakeholders are stuck between a focus on combating poverty, social exclusion at the one hand and enterprise development at the other. The Lisbon Agenda plays a dominant role in that debate.

⁸ Excluding banks

⁹ Data Centrum voor Microfinanciering INHolland; corrected by taking out organisations without any loans and taking out general banks – except for two Municipal Banks; they claim to be sustainable; their microfinance operations are not self sustainable

¹⁰ Range influenced by two larger MFIs/ Microfinance banks, i.e.. Fundusz Micro, Poland and Procredit, both with significant portfolio's

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The people successfully running MFIs have learned from practice, from each other and from the many evaluations carried out. However, there is not one single approach overall. There are a variety of programmes and methodologies, most of which are engaged in enterprise development (regardless of the client groups they target). The biannual survey on microfinance in Europe undertaken by Foro Nantik Lum on the request of the European Microfinance Network EMN demonstrate this clearly (Jayo, Rico et al. 2008)

Most noteworthy is that average loan sizes are rather high compared to that in developing countries. Still, there are a large number of enterprising people in Europe who see themselves excluded from the existing financial system. A rich society which has become very diverse, with dramatic changes in the labour market, is in need of innovative approaches to strike a balance between two overriding objectives: making Europe more enterprising and reducing social exclusion. Thus, linkages between policies and practitioners trying to develop MFIs need to be established and due attention needs to be paid to further boosting organisational development, with the aim to serve the market.

2.1. Enterprise development or social inclusion?

... The mission of EMN is to promote microfinance as a tool to fight social and economic exclusion by developing self-employment and micro-entrepreneurship. This will be achieved by supporting the development of microfinance organisations through the dissemination of good practices and by improving the regulatory framework at European Union and country level.....

(Mission statement of the European Microfinance Network - EMN)

Microfinance is still a new phenomenon in Europe and gradually receives more attention and support. It is embraced as an effective instrument either through stimulating social inclusion through economic participation or through the promotion of entrepreneurship and develop businesses. A wide range of initiatives are deployed, resulting in emerging NGOs setting up programmes for the unemployed, state owned development banks developing business start up programmes or private financial institutions embarking on small enterprise lending . In most cases the initiators claim to be engaged in microfinance.

There is no consensus yet as to the role of microfinance in Europe, yet the European Commission and some governments centrally state that it needs to be supported. In the past five years micro-credit and microfinance have evolved dramatically. This goes hand in hand with a progressive understanding of possibilities and limitations of these instruments in Europe. Scattered over Europe, initiatives have been taken without much uniformity: community based micro-credit programmes versus donor supported programmes. Interestingly, a number of them have flourished, often attributed to the charismatic leadership of the founders.

In 2005, it was still difficult to report significant results in terms of numbers of people served and hardly any common objectives among the initiatives could be revealed; in 2007, data have demonstrated that the sector has gained ground. (Jayo, Rico et al. 2008)

The number of loans disbursed between 2006 and 2007 has increased with 14%, while the growth rate of the value micro-loans disbursed in Europe between 2006 and 2007 was approximately 32%.¹¹

The loan sizes vary with the institutional type in Europe. Banks, non-bank financial institutions and government bodies tend to offer bigger loans than credit unions, NGOs, savings banks or foundations (Table 2).

Table 2 *Average loan sizes and microfinance organisations in Europe*

¹¹ The highest growth rate can be seen in Spain (154%), followed by Netherlands (63%), Austria (59%) and Belgium (54%), where the sector is very young but fast growing.

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Type of intermediaries	Approximate average / range of (individual) loan sizes (€)	Microfinance organisations engaged (in %)
Credit Unions	4,500	2
NGOs/Foundations	8,200	54
Savings Banks	9,700	6
Public/private bodies – project status	11,000 - 13,000	23
Banks/non-bank financial institutions	14,500 - 15,500	14

The aggregate data demonstrate that there is an apparent tendency for the attention to shift to larger loan amounts and therefore to small enterprise development. This implies a change in the type of clients targeted. A closer look at the distribution of this growth within the EU shows us that this upward trend is spread evenly across all member states. In 2005, the average loan size increased from €7,700 to above €11,000, with loans ranging from € 545 – sometimes group-based – in Eastern / Central Europe mainly to over € 30.000 in Western Europe.

There are two distinct developments in Western and Eastern/Central Europe. In Western Europe microfinance is seen – by policy makers – as a valuable instrument, following the Lisbon agenda, designed to promote growth, employment and social inclusion. Social security systems undergo drastic changes, stimulating people to become social and economical active. This goes hand in hand with changes in the labour market, stressing the importance of self-employment and placing more emphasis on the education systems on entrepreneurship. Those changes “produce enterprising people” in search for new financial instruments for business start-up and self-employment.

In spite of the presently developed financial markets and institutions in Western Europe, people wishing to become self-employed and/or setting up an SME have difficulties in obtaining external financing for economic activities (due to costs, risk perceptions, and evaluation methodologies) and the absence of relevant additional financial services (pensions, insurances).

Initiatives have a more local and personalised character, with local organisations experimenting with micro-credit programmes (Underwood 2006) and, in spite of all policy support received so far, the microfinance sector in (Western) Europe has difficulty demonstrating that MFIs can operate in an effective and self-sustaining way in an environment characterised by highly developed financial sectors and welfare systems (Everts and Lahn 2006).

In Central and Eastern Europe, the micro-lending providers main focus is on reaching larger number of people without, access to external financing, either due to the absence of financial intermediaries or due to the collapse of the overall financial system. We see a “traditional development pattern”, with NGOs and MFIs being set up – with external donor support – to provide services to people not reached by formal financial institutions. Their main aim is to reach large numbers of socially and/or economically excluded people.

According to the European Commission’s estimates, there are potentially about 700,000 (new) microfinance clients in Europe, representing a loan portfolio of € 6 billion. This seems to warrant special support. The debate about the role and purpose of micro-credit and microfinance is held most at central levels. Contrary to the situation in developing countries, the NGOs play a limited role in this debate. Representatives of the EMN are consulted on an

ad hoc basis. Banks appear to play a more important role; their representative bodies, such as Eurofi¹², are listened to by the European Commission and consulted more structurally in the policy formulation process.

Recently the European Commission has acknowledged the potential of microfinance with the launching of the “European Initiative for the development of micro-credit in support of growth and development “.Not only does the name of the initiative proper hint at the difficulty at reaching a consensus in which direction to work, but it also hints to the development of commercially self-sustainable microfinance institutions. The MFIs are expected to offer micro-credit to beat social exclusion and a financial system needs to emerge with a diverse set of financial intermediaries offering a wide range of financial services to large numbers of enterprising people who wish to set up their own business. Even the EMN seems to struggle with this dilemma, as can be learned from its mission statement at the beginning of this section.

2.2. Mismatch between mission(s) and practice

Over the past years, microfinance has been introduced and has rather quietly gained a place in a number of European countries, such as Finland, France, Spain, the United Kingdom and Rumania. Many of these programmes have been launched by people inspired by micro-credit in developing countries and are often lead by professionals with previous experience in such programmes. In most cases the launching of the programmes was not the result of explicitly formulated policies, policies often followed practices. Exchanging experiences and ideas from the South constitutes the start of the policy formulating process among the practitioners. The European Microfinance Network (EMN) plays a catalyst role in this process. At present, it has 67 members from 21 EU member states(EMN 2008), with a joint portfolio size of over 80.000 clients

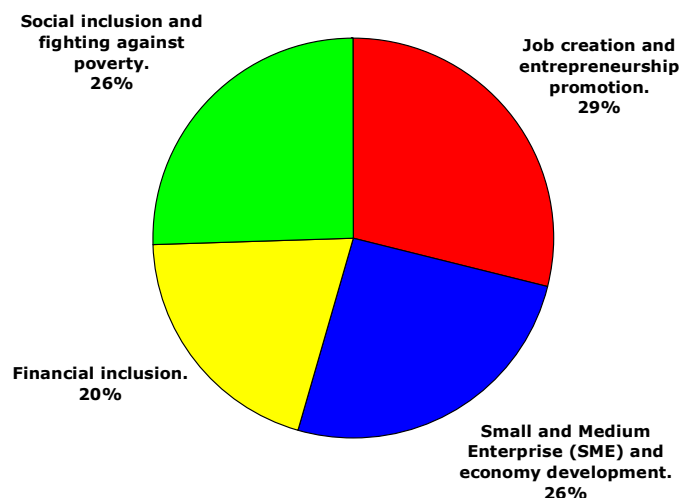
For the European Initiative to be effective, coherence between the European and national policies needs to be sought. In the 2007 Survey of the Microfinance sector in Europe (Jayo, Rico et al. 2008) an assessment was also made of the Mission Statements of the majority of the organisations. These could be classified into the following four main categories:

- Job creation and entrepreneurship promotion
- Small and Medium Enterprise (SME) and economic development
- Financial inclusion
- Social inclusion and the fight against poverty

Creating jobs and promoting employment, as well as social inclusion and fighting poverty, are considered to be the primary goals (29%). Twenty-six percent focus on SME and economic development and 20% on financial inclusion. Overall, the greatest emphasis in Western EU countries is on job creation and financial and social inclusion, and in the Eastern EU states on SME and economic development. See figure 2

¹² Eurofi, a European think tank of EU leading Financial, Insurance and Banking Institutions (based in the main EU countries) created in 2000.

Figure 2 *Microfinance; diverse mission statements in Europe*



Source; EMN survey 2006-2007

The EMN survey reveals that most of the foundations and NGOs claim that they concentrate on employment and on a combination of social and financial inclusion, whereas banking institutions (banks and savings banks) concentrate on financial inclusion and SME development. Governmental bodies focus on employment and SME development and non-bank financial institutions focus on SME development.

Apparently there is a mismatch between reality and mission statements, and overall loan sizes are increasing. In Western Europe, most microfinance organisations tend to focus on business start-up and business development; this is the type of economic activity the banks and existing financial intermediaries prefer to support and for which they have services in place. This trend may leave the self-employed person still without being served. Additionally, it will not reach the many socially excluded who seek ways to supplement limited household income with small economic activities (for example for those depending on social welfare and those who just want to do something in addition to formal – part time – work).

In Eastern/Central Europe, the microfinance institutions seek their own self-sustainability. As this can be achieved by attending large numbers of clients with “traditional” micro-credit, loan sizes tend to increase. Larger loan amounts offered to existing clients gives clients the opportunity to improve income and to relatively reduce costs. This might be sustained as long as the clients are willing to pay relative high interest rates, but it still lures the intermediary away from its original mission.

2.3. A large number of organisations, but only a few are actively engaged

In the European Union there is a wide spectrum of organisations (most of them being not-for-profit entities) offering micro-credit and/or microfinance: non-governmental organisations, foundations, government bodies, savings banks, banks, credit unions and non-bank financial institutions. This variety is related to the regulatory framework in each country.

The vast majority of the European Union lenders are not-for-profit organisations in the form of Non-Governmental Organisations (NGOs), foundations (; 54% of microfinance organisations) or government bodies/projects (23%). In Central/Eastern European countries

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(e.g. Rumania or Hungary), micro-credit providers tend to have a for-profit legal status. In Europe, banks have not yet made serious attempts to move into the microfinance market. So far they incidentally assist NGOs, but no special programmes have as yet been set up by them independently. If they would do so, they will most probably seek to serve the small and micro-entrepreneurs. Additionally, they might opt to form a coalition with NGOs to reach the lower end of the market. This remains an area where policies and options still need to be worked out. Credit unions, state banks, ethical banks, savings banks and non-bank financial institutions also disburse micro-loans within the EU, but they form a smaller part of the spectrum.

In Poland, Portugal and the UK, hundred percent of the organisations are NGOs. In Italy, NGOs and foundations make up two-thirds of the market. In Spain, Germany and Finland, lending activity is restricted to banking or government agencies. In the UK, non-governmental lending institutions have a specific legal status: "community development financial institutions".

This group of organisations engaged in microfinance service delivery can be split up again into small – specialist – organisations and larger institutions, where the micro-credit programme represents a small portion of their activity.

Most non-bank lenders have a geographic scope limited to regions or localities. The most striking issue is that most of them (above 50%) tend to disburse fewer than 50 loans per annum.

In 2007, only 20% of the organisations reported that they were disbursing more than 400 loans per annum. Most of these organisations are located in the Central/Eastern EU countries (Poland, Bulgaria and Romania). In these countries, MFIs are also founded with that perspective. In Western Europe (France, Finland, UK and Spain) there are also some larger organisations operating on a large scale, but there is as yet no general consensus that the market needs to be served by larger organisations. Many organisations in Western Europe became engaged through project funding (European Social Fund, local, central government funding). Their organisation life cycle seems to be determined by the project funding and no clear policies have as yet been formulated to support them beyond such period.

Banks, non-bank financial institutions and government bodies tend to offer bigger loans (ranging from € 15,450 to €11,000) mainly for micro and small enterprises (start-up) than credit unions, NGOs, savings banks or foundations (€ 11,100 to € 4,500). In most - Western - EU countries, well established networks of banks and financial intermediaries exist, covering almost all types of services (contrary to the situation in many developing countries). To reach out to a large number of clients, their networks of banks and their administrative and IT systems are of great value. Microfinance operators state that they wish to operate with banks. However, working with banks also pushes microfinance programmes towards financing of business (start-up) and enterprise development. This also appears to be the case in pilot schemes such as the ones set up in the Netherlands with the Ministry of Social Affairs. Whether the present banking system is geared up for rendering services that lead to active social inclusion remains to be seen, but active policy formulation and implementation in that direction by the banking community should not be expected.

2.4. So many services, and yet the primary focus is on SMEs

Almost all microfinance institutions in Europe offer credit in the form of small individual loans (ranging from € 525 to more than € 30,000). Hardly any of them have opted for group-based lending or lending supported by group guarantees. The MFIs and other organisations do not offer "traditional" micro-credit, e.g. very small amounts with relatively high interest rates and

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extremely short repayment periods, nor are the loans offered intended for survival economic activities. Rather, there is a tendency to offer smaller loans in support of enterprises and self-employment.

i. *Clients are mainly the self-employed and the micro-/small entrepreneur*

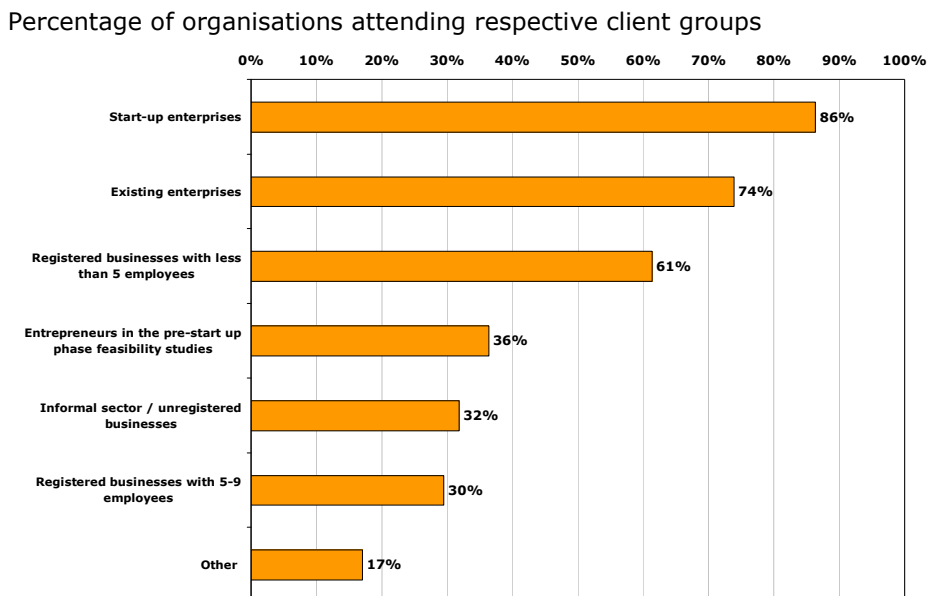
The client groups reached and serviced by microfinance organisations in Europe tend to be quite different from the traditional target groups of MFIs in developing countries. Again, it becomes apparent that their main focus is on enterprise development. The following significant issues emerge:

- Focusing on SMEs
- Relatively large proportion of business start-up (in Western Europe)
- Tendency to increase loan size
- Less presentation of women in the portfolio
- Less dominance of rural/urban differences

MFIs claim that they focus on the unemployed people or people on welfare, ethnic minorities and immigrants. Some MFIs also claim that special attention is given to youths and people with special - physical or psychological - needs.

Whatever target group they claim to attend to, MFIs main focus is on enterprise development and business creation. The majority of MFIs currently active in Europe target start-up businesses (86%) as well as existing enterprises (74%). The smaller enterprises are of major concern, with 61% of the organisations supporting businesses with five or fewer employees. Most operate in the formal economy, with approximately one in three (32%) rendering services to unregistered informal sector businesses. Lenders subsequently tend to assist businesses in making the transition to the formal sector (see figure 3).

Figure 3: Organisations in Europe offering microfinance and their client groups



Source : EMN 2007 Survey 2006/2007

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In the UK and the Netherlands, micro-lending is primarily an urban phenomenon. In France, Spain and Italy, the organisations focus both on urban and rural areas. In Romania and Poland, the main emphasis is on the rural population (although 50% of the MFIs target both rural and urban clients). This focus is in response to high rural unemployment after the closure of state farms during the transition from a centrally planned to a market economy. But again the tendency is to attend the relatively larger clients.

With 44% of microloans (Jayo, Rico et al. 2008)¹³ extended to them, women remain under-represented in lending figures, both in relation to their proportion in the population and in relation to micro-lending programmes elsewhere in the world.¹⁴ Again it shows that more attention is being paid to the higher end of the market and less to the issue of social exclusion often without explicitly opting for this direction..

ii. Service packages mainly geared for small and micro enterprises

The services packages that prevail in Europe reflect the (implicit) preference to support SMEs. The key characteristics are:

- Individual loans rather than group-based lending. Almost all operators in Europe prefer individual lending programmes rather than group-based lending.
- The average loan size in Europe is around € 11.000 ranges from € 525 to more than € 60,000, far above the EU defined of € 25,000, and increasing over time with the higher loans offered by a number of German, Hungarian and Italian MFIs and Dutch – governmental programmes¹⁵.
- Loan terms are determined by the type of business: The current average loan term is three years, quite long in comparison with most developing countries. Grace periods are normally six months. Again, comparing this with practice in developing countries, it is apparent that the financial burden plays a determining factor in defining such conditions.
- Interest rates remain a controversial and unsolved issue The average interest rate charged in Europe by MFIs is 8%, which is more than three points above Euribor (4.9%). There is, however, a clear distinction in Europe: in Western Europe market rates are indeed acceptable but extreme high rates are not accepted on moral or ethical grounds. In Eastern and Central Europe in countries such as Romania, Bulgaria, Slovakia and Hungary, more for-profit organisations can be found, which strive for self-sustainability and charge high interest rates to cover operating and financial costs.
- In addition to interest, most MFIs –in their desire to cover costs - in the EU area charge loan application fees, loan processing and interest penalties on top of the interest as a means of covering operational costs. This is most common where MFIs strive for their own self-sustainability.

iii. Other financial services coming up

¹³ This lending rate, however, is greater than female entrepreneurship rates in Europe, which are estimated to be 30% see Middlesex, U. B. S. (2000). "Young Entrepreneurs, Women Entrepreneurs, Ethnic Minority Entrepreneurs and Co-Entrepreneurs in the European Union and Central and Eastern Europe."

¹⁴ Combined lending data for Central and Eastern Europe, the Balkans and the Newly Independent States suggests that 62% of micro-loan clients are women. In North America, 59% of clients are women and in developing countries well over 80% of clients are women (Underwood, T. (2006). Overview of the Microcredit Sector in Europe 2004-2005. *EMN Working paper*. 4.).

¹⁵ The Ministry of Social Affairs and Employment finances a support programme offering training, advice and subordinated loans up to € 31.900 for business start up to social welfare beneficiaries

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Microfinance refers to the provision of a range of financial services that includes small loans for enterprise development but also to non financial services or better referred to as business development/support services

Almost one third of the MFIs in Europe offer “other financial services” (next to individualised lending for self-employed and SMEs), such as consumer loans, savings products, insurance, money transfer services, pensions, home mortgages and debt counselling services geared towards vulnerable people with no access to formal banking.

Unsecured lending is not very common in the Europe. Most MFIs seek ways to secure loans through collateral or through external guarantees (third party guarantees or guarantees from guarantee funds). In quite some EU countries, general and specialised guarantee funds are in place in support of lending to SMEs. MFIs tend to seek cooperation with such guarantee funds, especially when they themselves move more towards supporting SMEs. Interesting enough, in Central/Eastern EU countries such as Hungary, Bulgaria and Romania, where achieving operational sustainability is a main goal, most organisations make secured loans.

iv. Business support services widely accepted

There is a clear segregating in Europe between financial services and business support services. When training, counselling, mentoring or business advisory services are needed, most of the MFIs cooperate with specialised SME support organisations and refer clients to such organisations. Most of the services developed are geared towards support for small business start-up and enterprise development. Often they are focused on special target groups and fail to become mainstream (Triodos Facet and IMES 2008).

In some instances there are special programmes for the social excluded to motivate them or to remove psychological barriers that prohibit their participation in society. There are, however, no special business support programmes that are geared towards people who wish to embark on small economic activities¹⁶. In both cases the real challenge is to develop cost effective systems that have the potential to reach out to large numbers and that are fit for the enterprising self-employed and for individuals who wish to embark upon small economic activities.

¹⁶ Only recently some initiatives to develop Financial Literacy programmes are launched in Europe

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