

Microfinance in Europe

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Authors address: "Giordano Dell'Amore" Foundation, via L. Manara 17, 20122
Milan – Italy, phone: +39.02.54184430, fax: +39.02.55193005

microfinance@fgda.org
www.fgda.org

Refer to: Laura Viganò, Luciano Bonomo and Paolo Vitali

Abstract

The aim of this paper is to highlight the reasons why microfinance can be considered relevant within the European context.

The reality of microfinance organizations is examined, describing the mechanisms of adaptation and inclusion of microfinance products and services into the European environment.

Microfinance, as it was observed in different countries in Europe, presents some features typical of developing countries and some distinctive features specific to industrialized economies. These features are discussed in this paper. The effort of the authors aims at providing some keys to interpret a phenomenon which materializes in very different forms, avoiding the pitfall of considering microfinance as a transparent universe of linearly comparable entities.

Keywords: Microfinance, Europe, Financial Institution, Sustainability, Outreach

Foreword¹

“Microfinance in Europe”, a joint project promoted by the Giordano Dell'Amore Foundation² and the Guido Venosta European Foundation³, was conducted during 2003.

The aim of this research project was to analyse and investigate existing microfinance experiences in European Union countries according to the theoretical background of microfinance, which mainly relates to experiences in less developed countries (LDCs). The main objective was to investigate, on one hand, if there is a market in Europe which is not yet covered by the formal banking system and, on the other, how this market can be served in a sustainable and effective way.

The outcome is a book which shows that microfinance (MF) products can effectively foster development within the European context and investigates whether MF programmes could be implemented successfully to address financial and social exclusion.

The study as a whole is organised into five chapters. The first chapter presents a background theoretical apparatus supporting the conclusions later reached in the empirical analysis. Some of the main issues are related to the development of MF, such as the problem of asymmetrical information, and other distortions found in existing financial markets, and demonstrates how they could be partially overcome by the innovative introduction of MF. After analysing different approaches and methodologies used to provide MF services, the first chapter concludes with the presentation of some significant examples of microfinance institutions (MFIs) operating in less developed countries (LDCs).

In the second chapter, the European context is analysed. The historical experiences of MF are considered: the Reiffeisen Bank in Germany, the lending Charities in England, and the co-operative model of “Casse rurali” in Italy are some examples which demonstrate the strong roots of MF in Europe. Despite a broader financial deepening in comparison to LDCs, failures within the financial market lead to financial exclusion and constitute a problem for some European citizens. Financial exclusion in Europe is mainly concentrated among those people suffering from poverty and social marginalization. In Europe, also, since the core of the economic system is characterized by the important role played by micro and small enterprises (MSEs)⁴, the capacity of the banking system to reach and serve such small entities is crucial to

¹ The research study “Microfinance in Europe”, sponsored by Pirelli S.p.A., was conducted by a group of six researchers: D. Stefanini, F. Bellio, L. Bonomo, A. Limone, C. Segrado and P. Vitali, all graduated (2002) from a Master's Program on Microfinance promoted by the Giordano Dell'Amore Foundation, CiPSI and sponsored by the Italian Ministry of Foreign Affairs. The study was supervised and coordinated by Laura Viganò, professor at the University of Bergamo and executive advisor at the “Giordano Dell'Amore” Foundation. Giuffrè Editore of Milan is publisher of the forthcoming book on this work.

This working paper was prepared by Laura Viganò, Luciano Bonomo, and Paolo Vitali.

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² The Giordano Dell'Amore Foundation (www.fgda.org) has been active since the 1960's in providing training and technical assistance, and in conducting research in the field of banking and finance for development.

³ The European Foundation Guido Venosta (www.fondazionevenosta.it) works mostly in *not for profit* management techniques.

⁴ The European Commission (2003) adopted a new recommendation regarding its definition of MSEs: companies employing less than 10 people with an annual turnover up to €2,000,000 are regarded as micro, companies employing

the achievement of general socio-economic improvement. This capacity, however, is not fully exploited. In fact, exclusion from banking services often constitutes an obstacle to the start up of new business activities. These activities could show significant potential in terms of expected cash flow and profitability, but are not taken into consideration by financial entities due to a lack of guarantees and other information usually required under traditional banking system standards.

In this context the development of MF services, either by banks or other intermediaries, seem appropriate to fill the gap. The various types of MF intermediaries, as well as the threats and opportunities generated by existing banking regulations, are taken into consideration. To conclude, the EU countries are singularly analysed with a particular focus on poverty, unemployment and MSEs.

This sector characterises all European economies, even if there are important differences among the 15 member states. MSEs play an important role in terms of the number of people involved, and therefore the capacity of the financial system to also reach and serve these target clients is crucial in achieving general socio-economic development.

Chapter three presents each of the 15 EU member states individually⁵, mainly considering four variables: poverty, financial exclusion, current status of the MSE sector in the economy, and MF programmes.

Chapter four presents the empirical analysis. A sample of European MFIs was investigated through a questionnaire, grouping them into three categories as follows: 1. co-operatives, 2. financial institutions, and 3. NGOs, associations and foundations. Variables (proxies of sustainability and outreach) were then introduced in order to test the main issues of the theoretical framework analysed in chapters one and two.

The final chapter includes individual cards for the sample institutions and the others entities analysed. Each card includes a brief description of the institution and its products, some financial figures, and contact information.

This paper represents an excerpt of the overall study (book). The authors focus mainly on the empirical analysis (chapter four in the research), to highlight the reasons why MF can also be considered relevant within the European context for: reducing financial exclusion, which is mainly concentrated among people affected by poverty (lack of assets) and social exclusion, and supplying financial products and services to MSEs.

The paper ends with some lessons learnt on a "winning" MFI in the European context.

from 10 to 50 people with an annual turnover up to €10,000,000 are regarded as small, and companies employing from 50 to 250 people with an annual turnover of up to €43,000,000 are regarded as medium-sized. For further details see: www.europa.eu.int/comm/enterprise_policy/sme_definition/index_en.htm

⁵ The analysis was focused on European Countries as they were before the enlargement of May 2004.

1. Introduction

The financial systems of LDCs faced major transformations during the last two centuries, and these were often linked to the historical events characterizing these countries; the battles among tribes to dominate regions, the colonies, the periods of independence after the decolonization process took place, and the constitution of elected governments from military regimes. The inheritance from the past contributed strongly to the constitution of financial systems which, even if different, present similar features and dualistic structures (formal-informal) common to all developing countries (Mauri, 2000).

The formal and informal⁶ financial sectors present specific features which can be combined in order to benefit from synergies and solve some of the constraints which some people face in accessing financial services. A result can be obtained through many different solutions, as demonstrated by the variety of institutional settings present in the international MF marketplace. To this extent, MF seems to arise as a natural element from the awareness of these possibilities⁷.

MFIs, due to their diversity in terms of institutional settings and aims, can be placed somewhere between two very different ends of the spectrum. At one end are the NGOs which are established to address poverty, and work by fine tuning the so-called “poverty lending approach”. The other end of the spectrum represents commercial financial institutions which work at the frontier of financial services, following the so-called “financial system approach”.

The poverty lending approach assumes that an increase in the depth of outreach (capacity to reach the lowest segments of society) “compensates” for a reduced number of clients, a smaller portfolio of products and services, and a shorter term horizon.

The financial system approach assumes that a large number of clients and products, and a longer term horizon, could “compensate” for a lower depth of outreach if this is not compatible with an overall economic equilibrium (Gonzalez-Vega, 1998b)⁸.

In this framework, the goal for the MFIs should not be the choice among approaches, but to maximize the difference between the costs and benefits of MF to society, supplying financial services in the long run (Schreiner, 1999).

To supply financial services in the long term, institutions must either be self sustainable or must obtain subsidies.

One could assume that the poverty lending approach (which aims at reaching the poorest) neglects the negative elements which might arise from low profits and use of donations.

⁶ By formal sector the authors refer mainly to the banking system and use here informal sector indicating the non regulated different typologies of indigenous financial organizations.

⁷ For more details see, for example: Adams, Graham and Von Pishke (1984); Adams and Fitchett (1994).

⁸ The issue is largely explored in literature, among the others see also for example: Von Pischke (1999); CGAP (1995); Christen et al. (1995); Conning (1999); Gulli (1998); Hulme and Mosley (1996); Navajas et al. (2002); Schreiner (1997); Schreiner and Yaron (2001); Yaron (1994); Zeller and Meyer (2002).

In the presence of subsidies, prices for products and services are not fully charged to clients, and this may result in a greater net worth to the client, given that all other conditions remain constant.

The financial system approach (aimed at long term sustainability), on the contrary, might exclude the poorest from the supply of their services; but, the goal of achieving sustainability in the long run would lead to a wider range of financial products offered, thus compensating for an eventual decrease in net worth to clients, in the short term, due to higher prices.

The entrepreneurial stimulus often represents an incentive to innovate which can realize an increase in the net worth to clients, as well as a decrease in the price of the product; however, research, product development and innovation, are often problematic due to the trade off between costs and quality.

Considering the framework, after reviewing the history⁹ and most recent evolution of the MF phenomenon in industrialized economies¹⁰, some of its outstanding features were described, and the state of the art of MF in the European Union outlined, which was one of the main objectives of the research.

The reality of MFIs in the 15 EU member countries was examined. To do so, a questionnaire designed to describe in detail the current state of MF was circulated; a number of MFIs were contacted by telephone and e-mail, and the representatives of some of them were met personally. The objective was to verify certain working hypotheses and to collect concrete evidence of success or failure in the innovative and evolving world of European MF.

The result is a complex and multidimensional collection of data which, just like the world of MF, is difficult to define and interpret clearly. Our effort aimed at providing some keys to interpreting a phenomenon which materializes in very different forms, to support our statements statistically, but to avoid the pitfall of considering MF as a transparent universe of linearly comparable entities. After a short description of the methodology used for the empirical analysis, this chapter presents a descriptive analysis of the data, which aims at giving a brief and concise, albeit not exhaustive, picture of the collected information, which can be a starting point for concrete reflections on the evolution of MF in Europe. The last section is devoted to an analysis of selected aspects of strategic importance for MF development, through a focused cross-use of available data. The ensuing conclusions can be considered as being the first step towards gaining a better insight into this complex phenomenon.

⁹ For more details about the “roots of microfinance” in Europe, see for example: Kempson, Whiley (1999); Mc Gill (2002); Hollis and Sweetman (1998); Guinnane (1994); Masini (1989); Hollis (1999); Soto (2001).

¹⁰ See among others: Evers, Lack, Loeff, Siewertsen (2002); ADIE (1999); ILO (2002b); Schreiner (2001); Cheryl (2001); Sullivan (1998); Tucker and Lean (2001).

2. Methodology and organization of data

The empirical analysis involved the study of selected MFIs operating within the European Union. MFIs were identified through direct knowledge, internet, literature review, and documentation on MF in Europe.

In order to obtain the vital information needed to achieve the objectives of the research, each MFI was asked to fill out a questionnaire designed for this purpose. In drafting the questionnaire, the following conditions were considered: the simplicity of the interview (refers to the number of questions asked in order to obtain the necessary information); the usability of information (refers to how the information was collated and processed in order to serve the purposes of the research); the cost of systems development (refers to the time and effort needed to realize the computing systems development); the quality of data (refers to system accuracy in the collection of information); the reliability of data (refers to the risk of data being “forged”).

The questionnaire was composed of two parts. The first part focused mainly on the qualitative features of the institutions, while the second part referred to the quantitative information considered of interest for the purposes of the research.

The first part contained information on the institutional features and operational characteristics of the respondents as well as information on the categories of clients and types of services and sources of funds. This part was filled out by the person in charge of each institution who was best able to provide such information.

The second part mainly contained information, and requested numerical data, drawn from financial statements or internal procedures, and brochures on the institution's products. For the sake of clarity, the grid was divided into two sections, one concerning the institution and the other concerning the products; the latter was in turn subdivided by lending products, savings products, payment services, and insurance services.

Before analysing the data, tests were performed in order to fine tune both questions and the overall efficiency of the questionnaire. Questionnaires were predominantly distributed electronically (by e-mail or fax) and, after they were returned and checked, the information obtained was collated and processed¹¹. Generally it was not possible to visit directly the MFIs, except in Italy where questionnaires were often submitted directly to a staff member of the MFI by one of the researchers.

The collected data was used to produce the analyses presented below (sections 2, 3, 4, and 5) and mainly treated as aggregates¹², where the aim was to highlight some main features of the respondent MFIs on the basis of the theoretical framework and the major characteristics of the MF industry in the EU environment (described in full in the book). It is worth highlighting that,

¹¹ It was often necessary to submit part of the questionnaire several times to the same institution before obtaining correct information and reliable data.

¹² The full text of this research presents, in chapter five, detailed information on individual respondent institutions.

among all respondents, MFIs were selected based on the information available to the research staff.

Moreover, the number of MFIs varies between countries, but is not related to the prevalence of MF in each country. In the descriptive analysis, the authors included 32 of the respondent institutions (31 in the multidimensional analysis section): eight are located in Italy, eight in Spain, five in the United Kingdom, three in Ireland, France, Belgium and Germany have two each, one in Finland and one in Portugal (Table 2.1 presents a detailed list).

For this reason the analysis is not meant to be conclusive of the full reality of MF in EU member countries. However, the selected sample may well be used to test some theoretical assumptions, and give the reader a good general overview of the present state of MF in the countries of the EU.

Table 2.1 – Investigated institutions

Countries	Institutions
Ireland	Aspire
“	Western Development Commission
“	First Step
Spain	Fundacion La General para el Desarrollo Solidario
“	Acció solidaria contra l'atur
“	Fundacio Un sol mon (Caixa Catalunya)
“	Fundacion Laboral – Women World Banking
“	Instituto Municipal de Formacion y Empleo-IMFE
“	Fidem
“	Associazione Reas net
“	COOP57
Belgium	Credal
“	Netwerk Vlaanderen
Finland	Finnvera plc
Italy	Antiusura S. Maria del Soccorso Foundation
“	San Carlo Foundation
“	CGM Finance
“	MAG 2 Finance
“	MAG Verona
“	MAG 4 Piemonte
“	MAG Venezia
“	Banca Etica - branch of Treviso ¹³
Germany	Investitions Bank Berlin
“	Projekt Enterprise
United Kingdom	Salford MoneyLine
“	Art
“	Weetu
“	Street UK
“	OneLondon
France	Socodem
“	Adie
Portugal	Andc
<i>Note: Only those institutions considered for the empirical analysis are listed</i>	

¹³ Banca Etica has been excluded from further sample analysis (sec. 4) due to insufficient data available.

3. Descriptive analysis of the sample

The data collected from the questionnaire allowed the authors to perform an in-depth analysis of the institutional and prevalent characteristics of 32 MFIs operating in nine EU member countries. The rate of returned questionnaires was 31%, as many institutions (or projects) which were initially contacted were later considered unfit to be included in the sample (e.g. because they had provided incomplete data, or because they were not strictly operating in MF or because, although based in a EU member country, their MF project was being undertaken outside the EU, etc.). In this section, a descriptive analysis is reported, which highlights the characteristics of the investigated sample of MFIs.

Fifty-six percent of the respondent institutions mainly provide financial products and/or services directly. The remaining 44% mainly provide credit as well as non-financial services such as assistance in the preparation of credit applications, the provision of collateral to third parties, training, technical assistance, and advisory services (especially for the drafting of projects).

MFIs in the sample belong to a wide and diverse range of institutional types (Table 3.1). Only 7% of them are established and operate as financial institutions with bank statutes, while NGOs, associations and foundations account for over 43%. Non-bank financial institutions and co-operative organizations account for the remaining 50%.

Table 3.1 – Institutional types

Banks	Non-bank financial institutions	NGOs	Foundations	Associations	Co-operatives	Total
2	6	3	8	3	10	32
7%	19%	9%	25%	9%	31%	100%

About 22% of the institutions investigated operate at local level, while over 40% of them operate at regional level, and 25% at national level. Regarding the areas where they provide services, 53% of the institutions operate at the urban level exclusively, while the remaining ones do so at both the urban and rural level¹⁴.

It is interesting to note (Table 3.2) that of the MFIs investigated, 81% had established a close formal relationship with financial institutions, 68% with research centres and universities, 84% with not for profit organizations and 78% with public entities.

As shown within the results, MFIs provide services to a diverse range of clients, and over one third of respondent MFIs appear to have no specific client targeting strategy. It will be interesting to see in the analysis reported in the following section (sec. 4) if, and how, the use of a client targeting strategy affects the performance of the institution.

¹⁴ Only one institution serves exclusively rural areas.

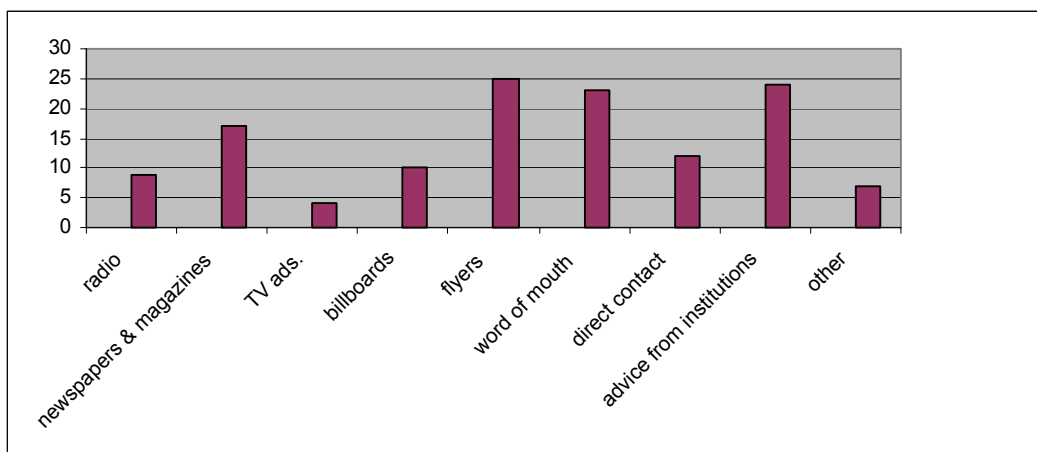
Table 3.2 – Relationships with other organizations

Type of relationship	Financial Institutions	Universities and research centres	Public entities	International organizations	Not for profit organizations
<i>Formal</i>	22 (85%)	10 (45%)	22 (88%)	11 (69%)	19 (70%)
<i>Informal</i>	4 (15%)	12 (55%)	3 (12%)	5 (31%)	8 (30%)
Total	26 (81%)	22 (68%)	25 (78%)	16 (50%)	27 (84%)
<i>Permanent</i>	18 (69%)	2 (9%)	12 (48%)	11 (69%)	17 (53%)
<i>Occasional</i>	8 (31%)	20 (91%)	13 (52%)	5 (31%)	10 (47%)
Total	26 (81%)	22 (68%)	25 (78%)	16 (50%)	27 (84%)

Analysing the sample, it became clear that the category of the unemployed receives the greatest attention of the MFIs (34%). Women do not appear to be among the priority targets, contrary to what happens in LDCs. In such countries, women play a very significant role in MF programmes, as many donor agencies rank gender empowerment amongst their top priorities. Regarding the legal status of MFI clients, most are private individuals (served by 69% of MFIs), followed by co-operatives (56% of MFIs) and not for profit organizations (50% of MFIs).

By industry, the services of MFIs are equally distributed over trade and services to individuals and enterprises, while the agricultural sector represents 9%.

Regarding the information channels (chart 3.1) used by MFIs to communicate and to promote their products, 75% of them use informal person-to-person (word of mouth) communication either by their clients or by other institutions operating in the industry (development and employment agencies, other financial institutions).

Chart 3.1 – Information channels used to promote MFI products (percentage of total institutions)

The most widely used traditional advertising channels are flyers (leaflets) and newspaper advertisements, which are used by 78% and 53% of the institutions respectively. Advertising on radio and television is used in only 28% and 12% of cases respectively.

The questionnaire allowed researchers to identify the sources of funds for respondent institutions. Approximately 35.5% of them operate using only private funds, 58% use mixed funds (private and public) and a mere 6.5% are supported by public funding alone.

Table 3.4 clearly shows that households and financial institutions are among the major contributors to the funding of MFIs; the nature of their contributions being mainly donations and loans at market rates. As for public financing, funding is equally spread between the European Union, national governments, and regional governments, with most of the funds being provided in the form of grants (73%).

Table 3.3 – Classification of sources of funds

PRIVATE FUNDING	Individuals Families	Companies	Financial institutions	Associations Foundations	Other	TOTAL
Market rate	2	0	5	1	5	13 (22%)
Subsidized rate	2	1	4	2	0	9 (15%)
Zero rate	3	1	2	2	0	8 (13.5%)
Own capital	4	1	1	3	2	11 (19%)
Donations	5	2	4	5	2	18 (30.5%)
TOTAL	14 (26.5%)	5 (9%)	14 (26.5%)	11 (21%)	9 (17%)	100%
PUBLIC FUNDING	European Community	National	Regional	Local	Other	TOTAL
Market rate	0	1	0	0	1	2 (5%)
Subsidized rate	0	2	0	1	1	4 (10%)
Zero rate	1	1	0	0	1	3 (7%)
Own capital	1	0	0	0	1	2 (5%)
Donations	8	8	7	5	2	30 (73%)
TOTAL	10 (28%)	11 (31%)	7 (19.5%)	6 (16%)	2 (5.5%)	100%

All institutions offer two credit products on average, five institutions also offer savings products, two institutions offer insurance products, and only one institution offers payment services.

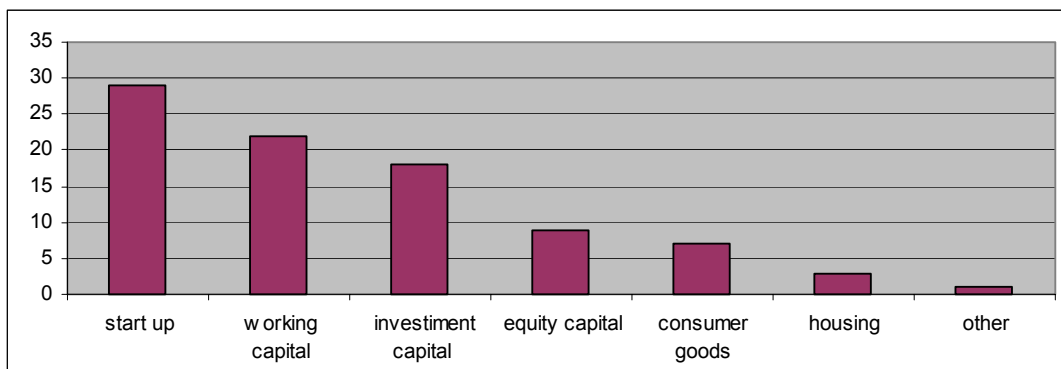
Moreover, if it is considered the provision of non-financial services directly and indirectly (in partnership with other organizations) supplied, 75% of the MFIs provide non-financial services, such as technical assistance and advisory services in general.

Table 3.4 – Non-financial services of MFIs

	Assistance in business plan preparation	Assistance to clients in accessing financial institutions	Legal aid	Technical assistance	Training	Other
N° MFIs	14	15	9	15	8	4
% MFIs	43%	47%	28%	47%	25%	12%

Almost all MFIs provide credit for business start ups (over 90%) and working capital (about 70%), while approximately 25% of loans are for consumer goods (see Chart 3.2).

Over 69% of MFIs in the sample offer individual credit, 9% offer group loans, while 12% do both. In most cases (59%) no collateral is required against loans, but some MFIs (approximately 35%) require real collateral (9%) or personal guarantees¹⁵.

Chart 3.2 – Destination of loans (percentage of total institutions)

The average loan size is about 13,000 euro, with a minimum amount being 118 euro and a maximum of about 70,000 euro; a size that matches with the average amount shown in the MF literature for EU countries¹⁶. Considering the distribution of the average loan size, 53% of the MFIs show loan sizes of less than 10,000 euro and, moreover, 75% of the sample MFIs offer loans with an average size of less than 15,000 euro, with the most frequent size being about 6,000 euro (14% of the MFIs).

Average interest rate (i.r.) charged is 5.5% per annum, with a minimum value at 0% (6.5% of the analysed cases) and the highest being 19.5% per annum. While the most frequent interest rate charged is 5% (29% of analysed cases), 90% of the sample MFIs do not charge more than 9.5%. Sixty seven percent of the MFIs charge a fixed interest rate, while 26% of them charge variable interest rates.

¹⁵ In spite of the well known theoretical advantages (Stiglitz, 1990; Varian, 1990; Besley and Coate, 1995; Conning, 1999) and the empirical evidence in some LDCs arising from the use of group lending technologies, it seems that in the EU, but also in some LDCs like Bolivia for example (Rhyne, 2001 and 2004), individual credit better fits customers' needs (Von Pischke and Matthaues-Maier, 2004).

¹⁶ A study by the European Commission (2001) and other sources define every loan up to € 25,000 as microcredit.

Most frequently, reported loan maturities are 36 months (39% of the sample) and 60 months (19%). In 71% of the cases, maturity is not longer than 36 months.

Unlike LDCs, where loans are repaid shortly (often within 12 months), loans in the European environment are more commonly repaid over the medium-long term.

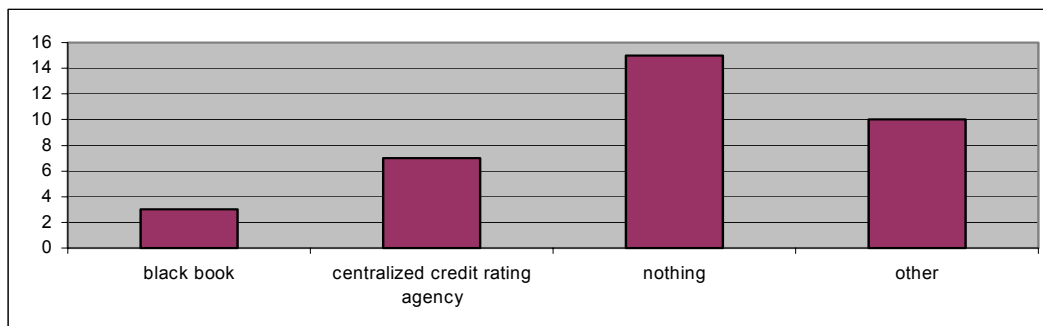
Tab. 3.5 Credit details (average values)

	Av. Amount	Av. Repayment rate	Av. Interest rate	Maturity	Waiting period
Loan	13,091	89.7%	5.5%	36 months	29 days

One third of investigated MFIs charge clients an opening fee; in 60% of cases the amount is proportional to the loan amount and ranges from 0.5% to 2% of the size. For the other 40%, the amount is fixed and ranges from 50 euro to 104 euro (75 euro on average). Moreover, loans are mainly repaid in installments (90%), and one third of MFIs charge penalties for late repayments which vary, on average, between 2% and 16% of the installment.

To serve an average of 422 clients, an MFI has on average three counters (outlets) with a staff of 33 people (11 involved in loan disbursement procedures). Loan processing takes 29 days (from the date an application is presented to the date of disbursement), and among the documents and information required are: a business plan (required by 87% of MFIs), fiscal documentation (46%) and job contract (40%); most of the institutions sampled (50%) also evaluate information provided by previous applicants to other institutions (if that person has borrowed from other credit institutions in the past).

**Chart 3.3 – Information collected about risky clients
(number of institutions)**



Moreover, once supplied the credit, the most part (52%) of the institutions use some source of information systems to control the portfolio at risk and monitor the client repayment performance.

Over 56% of the MFIs have a well defined marketing strategy¹⁷. A clear marketing strategy and orientation drives the MFI to be mature in analysing the demand, and to fine tune its product portfolio according to the repayment capacity of a specific clientele.

On average, the repayment rate is 89.7%, but this varies considerably among MFIs according to their institutional typology, target clientele, and other features which will be analysed further in the next paragraph. It will also consider whether, and to what extent, the application of non-structured systems of inquiry into the creditworthiness of clients affects the performance of the institution¹⁸.

Tab. 3.6 Repayment rate / Institutional relationship with other partners

	MFIs who work with FFIs	MFIs who work with NFPIs	MFIs who work with both FFIs and NFPIs
Repayment rate	92% (86%)*	91% (87%)	92% (86%)

(*) average repayment rate for equivalent MFIs who do not have the relationship in question

It is interesting to observe that the better performance of an MFI could also be related to the professional relationships it develops towards other institutions.

Table 3.6 reports repayment rates for MFIs categorized into three classes:

- those which formally and continuously work with formal financial institutions (FFIs)
- those which formally and continuously work with not for profit institutions (NFPIs)
- those which formally and continuously work with both FFIs and NFPIs

Higher repayment rates are found in MFIs which formally and continuously work in collaboration with other institutions, compared to those MFIs that do not collaborate with others. The positive correlation between repayment rate and the kind of relationship an MFI has with other partners shows a clear sign of the importance of FFI and NFPI contributions to the overall performance of an MFI. The contributions were probably, as previously mentioned, the supply of resources and appropriate training from FFIs, and a closer and deeper knowledge of target clients from NFPIs.

The repayment rate and the focus on target clients also seem to be positively related. MFIs that adopt a clear strategy of client targeting show an average repayment rate of 91%, and those who indiscriminately serve any applicant have repayment rates on average of 87%.

Section 4 will consider how this aspect may affect some performance-related variables, such as the number of clients and the repayment rate.

¹⁷ About this issue see, for example: Churchill and Halpern (2001).

¹⁸ For more details about credit risk management techniques see, for example: Viganò (1996a and 2003).

4. Multidimensional analysis

The analysis reported in this section was carried out with the aim of highlighting the outstanding characteristics of the sample MFIs under investigation, but in ways which differ from that done in the descriptive analysis (section 3.2).

The MFIs in the sample were initially divided into three different institutional groups. Then, the dimensions by which characteristics of the defined groups could be studied were identified, and some complementary variables to the given dimensions were selected in order to get a deeper insight into the dynamics characterizing the MFIs under investigation. Finally, the MFIs' institutional profiles relative to notions of sustainability and outreach were outlined, and the above-mentioned dimensions were used to identify them.

In the next section, the group identification criteria is described, and the analysis keys (sustainability and outreach) are specified. Following that, we report the results of the empirical study carried out on the sample of respondent MFIs, and make some concluding remarks.

4.1 *Typology of the MFIs identified*

The 31 MFIs in the sample used for the following analyses (see Table 3.2) were grouped primarily by institutional form based on the respondent institutions' own declarations.

By institutional form, we mean the legal-statutory structure of the institution, as outlined in the questionnaire. As the sample included organizations with a mixed institutional form, three more aspects were considered in the group selection process: (a) the main types of clients served, as this might be the result of an institutional approach having obvious repercussions on the organization of the institution's activities and services, (b) the nature of the institution's sources of funds, as an a priori choice of the sources of funds reflects the institution's philosophy and a posteriori affects the institution's management, and (c) the institution's supply of non-financial services, which usually indicates a willingness on the part of the institution to assist the client in their use of the loan and the management of their business, and consequently affects the institution's management costs and the complexity of the service offered. It is important to underline here that, even if it has been considered as a selection criteria in the group formation, the supply of non financial services characterizes most of the institutions in the sample (75%). The differences are evident among groups, but in the European context, in comparison to LDCs, the importance (ex-ante) of the non financial component in the microfinance programs is more stressed (even if implemented following mainly a minimalist approach)¹⁹.

¹⁹ Financial services are often associated with non-financial assistance in order to further strengthen the customer's capabilities and the relationship between the institution and the beneficiaries of the project. If the program implemented gives more importance to the non financial components, it is working following a maximalist approach. On the contrary, if the program stresses more the financial components, it is working following a minimalist approach.

Based on the answers obtained, three macro-categories were defined as follows²⁰:

- Financial institutions (FIs): this group includes those institutions which, while often lacking the legal status of a “bank”, are mainly oriented to financial intermediation but also provide technical assistance and non financial services. The 78% of these institutions offers, in fact, both the services (financial and no-financial), to individuals and enterprises by the use of essentially mixed funds, i.e. both public and private funds. Only the 22% of these institution offer solely financial services, strictly following a minimalist approach. Nine institutions in the sample belong to this category.
- Co-operative societies (COOP): this group includes those institutions having the legal form of a “co-operative society”. They offer services primarily to other co-operatives or associations (90%), by the use of private funds almost exclusively collected from the co-operative members. A large number of co-operatives (40%) provide services which are solely financial. It is important to consider that the number of final loan or service beneficiaries is very often much larger than the number of formal beneficiaries. In fact, a loan formally granted to a co-operative has an economic and social impact on all activities of the individuals in the beneficiary organization. Ten institutions are grouped under this category.
- NGOs, associations or foundations (NAF): this group includes non-governmental organizations, associations and foundations. Their legal status is linked to the nature of their funding sources, characterized by a substantial share of both public and private donations. Generally (92%), NAFs offer also non-financial services as technical assistance, training, legal and advisory services. Twelve institutions are grouped within this category.

4.2 *Dimensions of the analysis*

Considering the system used for the collection of accurate information, it was decided to address the notions of sustainability and outreach by examining some dimensions which would indirectly allow the researchers to achieve a measurement of these two characteristics for each group.

As a possible proxy for sustainability, considered as the ability of an MFI to generate enough profits to cover operating and financial costs, the following variables were considered:

²⁰ It is possible to find different classifications, for example, in: Taborga and Lucano (1998); Von Pischke and Schmidt (2002).

- interest rate
- repayment rate
- staff productivity

Following the works of Navajas et al. (2002), outreach can be defined as the social value of the output of a microfinance organization in terms of depth, value to users, cost to users, breadth, length and scope. In this work, to observe outreach (considered as the MFIs' ability to reach the identified targets with respect to some of the characteristic dimensions²¹), the following proxies were used:

- number of clients (breadth)
- number of products (scope)
- duration of MFI programme (length)
- average loan size/per capita GDP (depth)

The variables further considered in the following section are some of the complementary aspects which were deemed to be the most interesting and to ensure a better insight into the institutional dynamics of the sample groups of MFIs, in terms of sustainability and outreach.

The selected complementary variables are:

- whether the institution focuses on the clients it serves
- whether they have a structured management information system (MIS) to hedge against credit risk (e.g. a black book, joining a centralized credit rating agency, the monitoring of clients)
- whether they have a marketing strategy
- whether they lend based on collateral

The purpose of the analysis is to highlight the characteristics of the MFI types which have been defined, while identifying trade-offs, if any, between the dimensions explaining sustainability and outreach.

Firstly, a purely statistical description for each variable used in the definition of dimensions (i.e. repayment rate, interest rate, etc.) is presented; then there follows an interpretation of the findings based on the relationships existing between the dimensions at issue, using the complementary variables whenever possible in order to provide a clear interpretation of the operating trends of the MFIs under investigation.

▪ Repayment rate

Repayment rate is one of the simplest yet most significant measures of the financial performance and success of a MF programme. If, as in the sample under consideration, the average rate of repayment is 89.7%, with a minimum amount of 50% and a maximum of 100%, then the distribution is particularly interesting:

- 11% of the sample MFIs reported repayment rates below 70%,
- 7% of the sample reached repayment rates ranging from 71 to 80%,
- 22% of the sample reported repayment rates ranging from 81 to 90%,
- 60% of the sample boasted repayment rates over 90%.

Repayment rate is very high for co-operatives (96.1 percent), and decreases gradually for financial institutions (FIs) and the group of NGOs, associations and foundations (NAFs) (89.8% and 83.3% respectively).

As mentioned earlier with reference to co-operatives, the higher repayment rate reported may be connected with non-financial services they provide to assist their borrowers, and the socio-economic environment where their clients operate. The latter are, in fact, most often backed by a strong relational network, tied to a geographical area.

▪ Interest rate

The interest rate is the remuneration earned by an MFI on lending, and should be set to cover administrative and operating costs, and also consider potential portfolio at risk, and inflation.

Besides being affected by the ability of the lender to reduce relevant costs (efficiency), the rate of interest might also be influenced by the lender's special "mission" (often described in the "statutes" of the institution).

Hence, it is worth stressing that an MFI's low interest rate may be due to both its efficient cost reduction policy and an ex-ante decision based on the lender's particular social and political choice rather than an economic efficiency-related rationale. When low interest rates are associated with high repayment rates, it may reflect the first case, while low interest rates associated with low repayment rates are more likely to happen in the second hypothesis.

In the sample, the average interest rate is 5.5% per annum, while the minimum and maximum amounts range from 0% (hence, free loans) to 19.5%. (In Europe, market interest rates on loans in the period of the analysis varied from 8% to 12%).

²¹ For more details, see: Navajas et al. (2002).

Moreover, in the sample MFIs, interest rate distribution is as follows:

- 19% of the sample MFIs apply rates below 3%,
- 16% apply rates ranging from 3.1% to 4.9%,
- 29% apply an interest rate of 5%,
- 26% apply rates ranging from 5.5% to 9.5%,
- 10% apply an interest rate exceeding 10%.

Hence, 64% of the MFIs in our sample apply a rate of interest lower than 5.5%. The lower interest rate (i.e. 4.5%), on average, is applied by the NAF group, while co-operatives and financial institutions apply rates of 6% and 6.6% respectively. In particular, it can be noted that there is no definite trade-off between interest rate and repayment rate, and that there is a high variability of repayment rates associated with rates of interest below 5%, while for higher interest rates, this performance indicator never falls below 88%. This observation indicates that the institutions lending at subsidized rates achieve less satisfactory results on average than those adopting a more sustainability-oriented approach. In the following sections, the relationships between the need for sustainability and interest rate level setting will be discussed.

▪ **Staff Productivity (Number of clients handled per staff member)**

This indicator defines the number of clients handled annually by each staff member working within the MFI. It provides an indication of staff productivity and institutional efficiency²².

The higher the value, the lower the cost incurred by the MFI in handling each client. Saving on this cost may affect the ability of the MFI to recover its management costs and, therefore, to improve its financial sustainability in the long run.

For the whole sample, the average number of clients per MFI officer is 34, the maximum client number being 312. As an aggregate, the distribution is:

- 50% of MFIs reported productivity of less than 20 clients per staff member,
- 36% of MFIs reported productivity ranging from 21 to 50 clients per staff member,
- 14% of MFIs achieved productivity of over 50 clients per staff member.

The highest productivity of staff members is reported in the NAF group, whose employees handle approximately 48 clients each, while employees in financial institutions handle on average 28 clients and in co-operatives 24 clients each. This indicator falls when considering

COOP group because of the nature of the customers which are mainly legal entities (i.e. associations and co-operatives).

It is important to stress here that the lower productivity of MFIs when compared to financial organizations not operating in MF is partly linked to the limited lifetime of many institutions (and, hence, the fact that they are still working at an experimental stage) and partly to the types of non-financial services they provide to meet the needs of their clients and to serve the purposes pertaining to the social mission of a large number of them. The high repayment rate mentioned earlier may be partly related to the willingness of MFIs to establish strong personal relationships with their clients. This is not often the case with traditional financial institutions, but is often reported by MFIs, and obviously involves lower staff productivity.

▪ **Number of clients (breadth of outreach)**

This variable refers to the average number of clients serviced by an institution during a year of activity. The average number of clients served for the whole sample is 437, with the following distribution:

- 50% of the MFIs served less than 100 clients,
- 40% served from 101 to 340 clients,
- 10% served over 2000 clients.

Financial institutions provide services for 738 clients on average, the NAF group provides services to approximately 532 clients. In both cases, the MFIs provide also specific and careful assistance to clients due to the deficiencies and disadvantages characterizing the target clients of the latter. This indicator falls considerably when considering co-operatives that serve 91 clients on average (which, as stated, are legal entities, i.e. associations and co-operatives in 90% of cases).

▪ **Number of products offered (scope of outreach)**

This figure indicates the degree of diversification within the product range of an MFI. On average, the value for the whole sample is about 2, with a minimum value of 1 and a maximum value of 4. As an aggregate:

²² For more details see for example: The MicroBanking Bulletin, Focus: Productivity, Vol.6, 2001.

- 54% of the MFIs offer 1 credit product only,
- 25% offer 2 credit products,
- 16% offer 3 credit products,
- 4% offer 4 credit products.

Financial institutions offer 2.1 credit products on average, while the figure reduces to 1.7 for the NAF group and falls to a minimum 1.3 for co-operatives. In many cases, instead of standardizing several product models, MFIs prefer to define one or two products, which are then remodelled to suit individual clients' needs, due to the diversity of potential clients in the market niches where they operate. The argued logic is that this strategic approach to clients should ensure satisfactory repayment rates, especially when the number of clients is not so large. However, it might also produce low profitability due to the high costs implied in diversifying the service²³.

▪ **Length of outreach of the MF programmes (duration of service)**

The indicator measures the number of months the MF programme has been operating. The variable shows an average duration of 95 months, varying from a minimum of 12 to a maximum of 429 months. Distribution is as follows:

- 34% of the programmes have been operating for less than 36 months,
- 19.3% of the programmes have been operating for 36 to 60 months,
- 22.5% of the programmes have been operating for 61 to 120 months,
- 24.2% of the programmes have been operating for over 120 months.

The programmes which have operated longer are those registered in the form of co-operatives (159 months on average), testifying to the long-established presence of those institutions in the European context. On the contrary, the average duration of programmes for the NAF and FI groups is considerably shorter (65 months and 63 months respectively). It is worth stressing that one third of MFIs are less than 3 years old and over half of them are only 5 years old. These data confirm that the MF industry is very young and is still at an experimental and developmental stage, which partly explains some of the findings mentioned above (small number of clients, low productivity), being typical of infant financial institutions.

²³ About the issue see, for example: Meyer (2002).

▪ **Depth of outreach**

This indicator is given by the ratio of the MFI's average loan amount to the average per capita GDP of the country where the MFI operates²⁴. The smaller the value of the indicator, the more likely the MFI is to reach the poorest, and those shunned by traditional bankers. The indicator shows values varying from a minimum of 0.03 to a maximum of 2.9, which means that in the former case the loans granted are equivalent to 3% of per capita annual GDP, while in the latter they are approximately three times the value of the per capita GDP. The average value of the indicator is 58%, with the following distribution over the sample:

- 28% of institutions have a depth of lower than 20% of per capita GDP,
- 28% of institutions have a depth varying from 21% to 49% of per capita GDP,
- 25% of institutions have a depth varying from 50% to 100% of per capita GDP,
- 19% of institutions have a depth of over 101% of per capita GDP.

It is hard to make a consistent comparison of the three types of MFIs. As might be expected, the depth of outreach of the FI and NAF groups (.29 and .30 respectively) is much greater than the co-operatives' depth (1.18). It should not be forgotten, however, that co-operatives almost always lend to other co-operatives and, hence, the outreach should be much stronger than shown by the indicator.

4.3 Interpreting the sample

In order to give a consistent in-depth interpretation of the MF phenomenon, in the light of the above mentioned variables, it may be interesting to cross-analyze the data listed above in order to highlight the relationships between variables and to make some relevant observations (table 4.3.1).

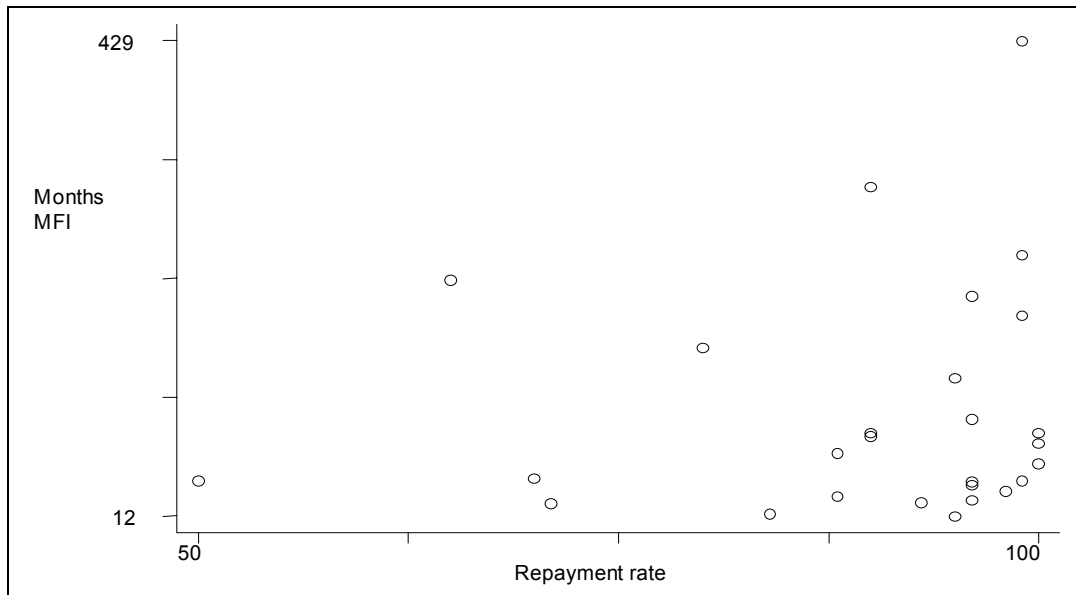
²⁴ For more details about the ratio calculated in different countries and for different typologies of MFIs, see also: Churchill (2000).

Table 4.3.1 – Dimensions of analysis: institutional profiles by group

PARAMETERS	Co-operatives (COOP)	Financial Institutions (FI)	NGOs Associations Foundations (NAF)	Sample mean
SUSTAINABILITY (Dimensions of analysis)				
Repayment rate	96.1%	89.8%	83.3%	89.7%
Average interest rate	6%	6.6%	4.5%	5.5%
Private sources of funds	98.1%	44%	69%	71%
Public sources of funds	1.9%	56%	31%	29%
OUTREACH (Dimensions of analysis)				
No. of clients	91	738	532	437
No. of products offered	1.3	2.1	1.7	1.6
Depth	1.18	0.29	0.30	0.58
Longevity of MF programme	159	63	65	95
COMPLEMENTARY VARIABLES				
There is a focus on clients	90%	34%	67%	63%
There is a system of information collection on risky clients	40%	89%	34%	52%
There is a marketing strategy	40%	89%	50%	56%
No. of clients handled by one general staff member	24	28	48	34.5
Real securities	10%	0%	16%	9%
Personal securities	80%	33%	0%	34%
No collateral	20%	67%	84%	59%

Repayment rate might be affected by the MFI's length of outreach. One can expect that in the early stages of a MF project, an institution is ready to accept low repayment rates as the result of an aggressive marketing policy, but as the programme continues and strengthens, those rates should reach satisfactory levels in order to ensure the full sustainability of the programme. Therefore, it is worth considering the MF programme's temporal dimension (see chart 4.3.1). "Younger" programmes, i.e. those promoted by FIs and NAFs, show lower repayment rates than co-operatives (a group boasting the "oldest" MF programmes), while the NAF group shows repayment rates even lower than the sample average. It is also worth stressing that, in the case of co-operatives, the repayment rate is also positively affected by their clients taking the status of "members".

Chart 4.3.1 – Relationships between length of outreach and repayment rate

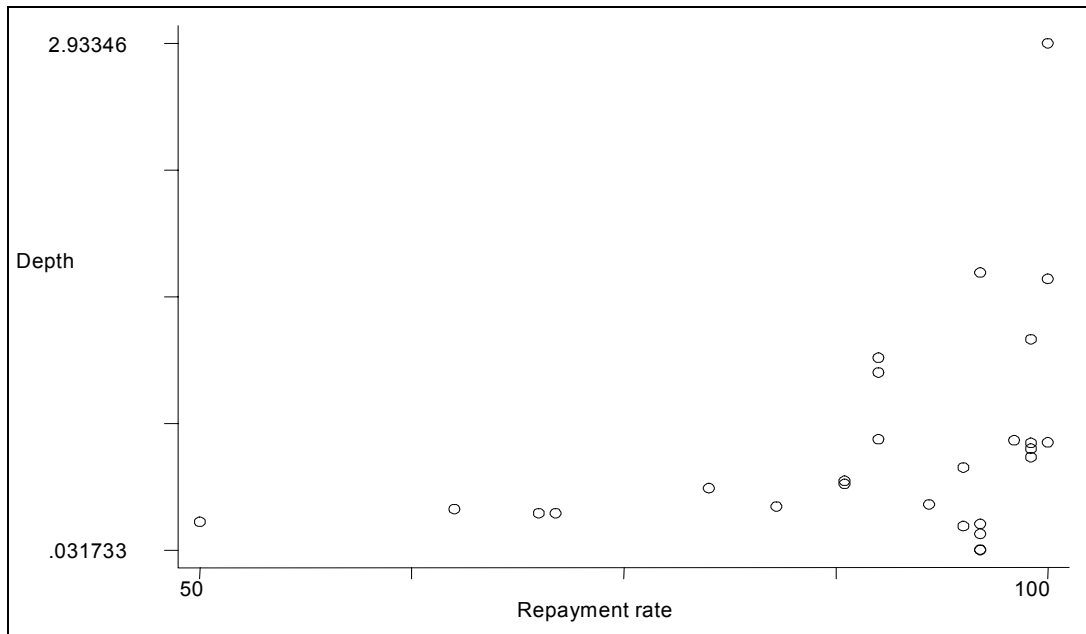


At the same time, it is also interesting to focus on the relationship existing between the repayment rate and the depth of outreach calculated for the sample institutions in order to see whether their performance depends on their ability to reach marginal clientele or not.

Chart 4.3.2 compares repayment rate, a proxy of sustainability (this rate, as mentioned earlier, depicts the ability of an institution to survive over time fairly accurately, given that a high repayment rate is associated with minimum loss on loans and a lower credit risk level), with the proxy of the institution's depth of outreach (as defined above).

In particular, the COOP group, which boasts the highest repayment rate, is also the sample group with the lowest depth indicator. The finding might be related to the fact that their services are offered to a well-defined target group of clients, i.e. other co-operatives and associations in 90% of cases, which are generally also members of the lending institution.

Chart 4.3.2 – Relationships between depth of outreach and repayment rate



For this reason, the depth of their outreach is lower, as it is calculated on the amount of credit and the number of clients served (both private individuals and legal entities). Hence, as mentioned earlier, the value of the depth indicator for the COOP group would have been very different if the number of members of each client co-operative and association had been considered²⁵. As for the other two sample groups (FI and NAF), which show a lesser propensity to focus on specified target client categories (34% and 67% respectively), and mainly service all those who are indiscriminately excluded from traditional financial services (small and micro-businesses, private individuals), they achieve greater depth of outreach, but lower repayment rates.

There is an apparent negative correlation between the depth of the outreach of an MFI and its sustainability. Although, as mentioned earlier, such relationship is distorted by a lack of homogeneity among groups, it reveals a difficulty in achieving high degrees of depth while at the same time ensuring sustainability.

It can also be observed that the institutions showing greater depth (FI and NAF groups) are also characterized by having a larger number of clients.

²⁵ Considering a loan of 100 granted to 1 association of 10 members, the corresponding value of the depth indicator, as calculated in our analysis, would be: 100/per capita GDP.

The major difference between COOPs and other types of MFIs lies not only in the legal nature of their clientele (private individuals and legal entities)²⁶, and in their focus on a given client category, but also in the use of particular marketing strategies. FIs very frequently (89%) make use of a well defined marketing strategy, and have a larger number of clients (738) on average than NAFs (532), where only 50% of institutions use marketing tools. In the case of the COOP group marketing strategies are used in 40% of the cases; even so, because of their institutional nature, others mechanisms may replace the function of them. The relationship, however, between the number of clients and the use of marketing strategies still remains unclear. As it is, this relationship might be interpreted in both directions, i.e. it is unclear whether a more aggressive marketing strategy would favour an increase in the number of clients, or whether the growth of the MFI would promote the organization's rationalization and ongoing expansion through defined marketing strategies, made possible also by greater available resources.

At the same time it is also interesting to note that, depth being equal, the variability in repayment rate would also appear to be affected by using (or not using) a structured information collecting system on risky clients. Leaving aside the COOP group, due to the particular client relationship mentioned earlier, the findings seem to confirm the above hypothesis. We can observe that the MFIs in the FI group, which reported a 7% higher repayment rate than the NAFs, are also those most often using a structured information system (89%) and a well defined marketing strategy. On the other hand, the low repayment rates reported for the NAF group (besides being possibly related to the special nature of their funding sources, their governance structure, or their social and political orientation and aims) might also be affected by their still infrequent use of management tools.

Considering the sample MFIs, one can also note that a maximalist approach, which is more evident for the NAF group, generally implies a lower (4.5%) interest rate as compared to those applied by the remaining two groups (6.02% and 6.58% respectively for COOP and FIs). It is worth stressing that the MFIs in the NAF group, characterized by lower-than-average repayment rates and the supply of non-financial services (training, legal and advisory services), are in a position to charge lower interest rates thanks to the substantial share of donations and subsidized financing within their sources of funds (about 60%)²⁷.

It is also interesting to note that the number and type of clients vary in proportion to the number of lending products offered by the institution. In fact, FIs offer a wider range of products (2.1) to meet the financial needs of a more diverse range of clients than COOP (1.3 products) which, as mentioned earlier, offer their services primarily to other co-operatives and associations.

The characteristics of the credit products change by changing methodologies. Parallel to the collateral free lending schemes offered by all sample MFIs (83% of lending for NAFs, 67% for

Should we consider depth based on the number of members of the client association, then depth would be: 10/per capita GDP.

²⁶ In general, co-operatives do not necessarily have a lesser outreach because of their lending policy to other co-operatives.

FIs, 20% for COOPs), a growing number of schemes envisage the supply of personal guarantees (33% for FIs, 80% for COOPs, and 0% for NAFs), which points to a search for continuing innovation aimed at identifying the contract pattern which can best meet the financial needs of the client.

The different distribution of the collateral required to back loans might affect repayment rates and interest rates alike. Considering that credit risk can be suitably hedged by introducing loan contract innovations (and therefore structuring the loan based on the clients' characteristics) it appears that those groups of institutions which less frequently request real securities (COOPs and FIs) are those reporting higher repayment rates as well as higher interest rates.

5. Conclusions

Even if the majority of MF practitioners and academics agree that the main objective of MF is to provide an increase in the wellbeing of people who have been excluded from formal financial institutions by the provision of quality services and products to even the poorest of them, a wider debate arises about how a better result in terms of efficiency and outreach can be obtained (Zeller and Meyer, 2002).

To begin with, it is important to underline that MF refers generally to those subjects that are defined as "active poor"; those people who, even if living in poverty, prove to be technically skillful and entrepreneurial to such a degree as to enable them to develop, and autonomously run, an economic activity, or to at least produce a constant flow of resources which can be used for repayment of debt or for savings (Gonzalez-Vega, 1998a).

In fact, microfinance is not a panacea and cannot be thought to address all different issues related to poverty; there are poor people who do not present the prerequisites required to access financial services; they require welfare measures that MFIs might not be able to, and should not, offer.

Many MFIs claim to be able to reach the poorest among the poor, but empirical evidence only seldom succeeds in determining the true poverty level of clients, or determining under which specific conditions MF programs and methodologies succeed at meeting poorer targets compared to others (Navajas et al., 1996).

²⁷ Moreover, their maximalist policy might also generate cross-subsidization effects, i.e. non-financial services, or subsidies offered for non financial services, subsidizing financial services.

Contractual innovations such as group lending, and the introduction of dynamic incentives, allow service quality to improve and an increasing number of beneficiaries to be assisted.

As Hulme and Mosley (1996) comment: “[...] a further phase of institutional experimentation and innovation [...] is required to extend financial services deeper down the socioeconomic pyramid”²⁸.

It still stands as an open question and debate whether, and to what extent, MF can address poverty situations and, even prior to this, whether financial services can truly be efficiently implemented at helping poor people to build their lives under better conditions.

The evidence which arises from empirical studies shows a positive answer to this question, if financial services are used to the same extent to which they were created, and this happens when finance (Gonzalez-Vega, 1998a) and therefore MF:

- allows transfer of resources from activities characterized by low marginal return rates to ones with higher rates;
- contributes to make more efficient inter-temporal decisions about savings, capital and goods accumulation, and investments;
- drives toward a cheaper management of liquidity, and accumulation of assets;
- offers better alternatives to face the risks implicit in all economic activities.

It is important to remember that for an MFI to be able to achieve these results, the presence of some external conditions are required to allow the MFIs to develop and work successfully.

A relatively stable political environment and macroeconomic framework, together with an infrastructural base which allows the regular carrying out of activities on diverse markets, are fundamental conditions. Moreover, it is preferable if the environment is characterized by: an overall positive sense of trust towards financial institutions, interpersonal relations based on traditional and social links, a sufficient diffusion of public services (education, health services, and so on) and, finally, a regulatory framework which allows the development of MF (Doyle, 1998). If these conditions do not characterize the environment, other instruments might well be more appropriate to address the most disadvantaged segments of society, and poverty (Gonzalez-Vega, 1998a).

The above observations lead to the conclusion that different components are required so that poor people can move out of poverty, that credit is only one of these and, while it is certainly an important one, it is probably not the single most important. Financial services in fact play an

²⁸ From: Hatch and Frederick, (1998).

important role in fostering entrepreneurship if most of the conditions under which development occurs already exist (Viganò, 1996c).

A brief summary of the lessons learnt up to now about the existing connections between finance, poverty, and development might include:

- poor people do not only need financial services; non-financial components and social intermediation services play a relevant role;
- poor people do not only need credit, but saving facilities might be even more relevant;
- poor people look for, in addition to the possibility of obtaining credit, a stable-flexible-reliable relationship that lasts in the long term;
- poor people consequently need sustainable, efficient, profitable and well-managed financial intermediaries, so as to be engaged in said long term relationships.

Moreover, given the MF industry developments and evolutions since the 1990's, a triple goal could be drawn up for institutions:

1. to be subsidy-independent in the long term (financial sustainability);
2. to develop the capacity to reach the poorest of the poor (depth of outreach);
3. to produce within the program a positive impact (for example in terms of economic growth or poverty reduction)²⁹.

The analyses discussed above have aimed to highlight the relationships, if any, between sustainability and outreach for MFIs in Europe. In general, and mainly with reference to LDCs, it can be said that in recent years there are few MF programmes reporting significant progress in terms of outreach as well as sustainability (Yaron, 1994; Christen et al., 1995; Schreiner and Yaron, 2001).

The ever-evolving MF market seems to be moving towards gradual commercialization³⁰ of the industry, especially in some LDCs (Bolivia and Bangladesh) characterized by great dynamism and strong competitiveness. But the major difficulty encountered in developing these programmes, and especially those aiming at reaching the poorest of the poor, is the achievement of financial sustainability. Even the most renowned MFI (the Grameen Bank) has not achieved full sustainability and has only succeeded in recovering approximately 70% of its total costs (Murdoch, 1999).

²⁹ See for example: Zeller and Meyer, (2002).

³⁰ Commercialization here means the process of approximating the management practices of MFIs to market logic, characterized by full (both operating and financial) cost recovery. See on this issue: Christen R. and D. Drake, (2001); Gonzalez-Vega (1996).

In Europe, although MF has different origins and takes particular institutional forms, the industry trend does not appear to be very different. The analyses performed have somehow confirmed that independent of the approach used (maximalist vs. minimalist or poverty lending vs. financial system approach), the efforts of MFIs should be aimed at maximizing the difference between the costs and the benefits derived by the institutions through:

1. the use of financial technologies which should allow MFIs to reach the identified market segment in a long term perspective;
2. the minimization of costs inherent in the supply of their services;
3. the maximization of the benefits which their clients gain from those services.

However experimenting with this, and introducing new tools, is problematic due to the trade-off between the cost and the quality of the service.

The models developed in LDCs and their successes have given the MF industry in Europe a new boost, rekindling the interest and attention of both private and public entities, and paving the way for significant development and continuation of applied research.

In the course of the analysis three prevailing institutional forms (COOP, NAF, FI), with different approaches to the supply of MF services, were identified. As described earlier, the MFIs in the three groups differ not only in terms of institutional setup, but also in terms of the characteristics of their products, the sources of funding, and the clients serviced.

Different MF market segments exist in Europe, and these vary both in terms of size and maturities. Diverse institutions, which range in structure and objectives, serve these market segments. Amongst these, Co-operative societies (COOP) best represent the historical roots of MF in Europe, primarily serving other co-operatives and associations (90%), almost exclusively using funds of a private nature. These funds are mainly collected from among the membership. A large share of these organizations (COOP) tends to focus (40%) on the supply of financial services only, contrary to what was observed for associations, foundations or NGOs in the NAF group. The latter tend to also provide auxiliary non-financial services (92%), and regard credit as only a marginal component of their activities.

Their legal status and governance structure are also connected with the nature of their sources of funds, which are characterized by a substantial component (approximately 60% on average) of public and private donations. These are among the reasons why these MFIs (NAF) can provide their services at a lower cost, even though their repayment rates are below average (and lower than those reported for the remaining two groups of COOPs and FIs).

While it is clear that the better performance of co-operatives is primarily due to their nature and the "member" status generally assumed by their clients, for organizations included in the FI group, better performance seems more linked to the use of structured systems for collecting information on risky/default clients and to the adoption of marketing strategies.

Even when these organizations do not have the status of a “bank”, they are primarily oriented to financial intermediation, and provide their services (only financial in 22% of cases) to private individuals and companies. These use both public and commercial funds, which even if smaller compared to NAF, contain a component of donation.

However, despite this aspect, which concerns all European MFIs to varying extents, the FI group of MFIs appears to be the one most oriented to the commercialization and innovation process characterizing many of the MFIs operating in LDCs.

Generally speaking, MF commercialization reflects the institutions’ approach towards full sustainability, which is often the necessary condition to be granted permission to operate in a market regulated and supervised by a central authority (Christen and Drake, 2001). Commercialization may improve competition among the institutions operating in the same industry, and competition stimulates innovation which, as mentioned earlier, is the springboard for performance improvement in terms of outreach and sustainability.

It is, however, too often apparent that many MFIs have given up searching for new “solutions”, and confine themselves to replicating one single scheme of action with growing uniformity. In so doing, they forget the true strength of MF which lies in its capacity to utilize the interpersonal links between community members, thus exploiting its unique potential.

The main difficulty in providing these types of financial services seems nowadays to lie in the choice of an organizational design (governance) with the appropriate incentive structure and definite administration structure linked to a clear definition of the organization’s governance mechanism (Gonzalez-Vega, 1996).

During the research, a number of key aspects emerged which make it possible to outline a number of choices that can be regarded as “winning” for the establishment and management of an MFI. It is clear, however, that although some of the indications are amenable to and valid for almost all realities in the European context, it is only the organization’s sensitivity and purpose which can ensure its successful realization at an operational level. It should not be forgotten that another of the key strengths of MF lies in its ability to become embedded into the local context, exploiting existing synergies and using resources which had been previously neglected or not taken into consideration by traditional credit institutions. Hence the statements below, far from expressing specific certainties, are only meant to be general indications.

The analysis carried out so far, and the authoritative opinion of certain distinguished MF scholars, lead this study to state, with all due and necessary caution, that a winning MF institution in Europe should be specialized, commercial and minimalist. This type of institution³¹:

- a) Tends to specialization in order to benefit from the economies of scale;
- b) Mainly uses an individual lending technology, while considering the possibility of using group lending, in order to best service its target clientele. If and when necessary and worthwhile, it also provides technical assistance and training (which is also important for improving the client's loan management ability and responsibility and, hence, improving loan repayment), but always from a minimalist perspective;
- c) Defines the price of the financial services it provides (rate of interest) in such a way as to cover operating and administrative costs (financial sustainability) and ensure the organizational growth in the long run;
- d) Generally uses subsidized funds only in the medium term, in an attempt to become self-sufficient in the long term, through a full-financial sustainability-oriented commercialization process. In general, subsidized resources are considered to be costly and unstable sources of funding. The activity of a subsidized institution would not enjoy autonomy because it would firstly have to pursue the aims established by the donors and then, only in the second place, would the objectives of the MFI, as set by its board of management, be pursued;
- e) Considers innovation as a crucial element for institutional development without ever losing sight of the trade-off between the quality of its services and the costs incurred in designing and providing them.
- f) Develop and implement specific technologies tailored to supply services in the long term, being sustainable, and finally producing positive external effects (Gonzalez-Vega, 1998b).

³¹ These statements are mostly shared with J.D. Von Pischke. For more details see: Von Pischke (2002).

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