



## MICROFINANCE IN EUROPE

### A MARKET OVERVIEW

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**Abstract:**

This study investigates the effects of microcredit in the European market. Based on the review of relevant literature and recent surveys, this research explores the general meaning of microcredit before addressing the European SME landscape with a special focus on micro enterprises and Microfinance Institutions (MFIs). Finally, the study reviews selected microcredit markets in both Western and Eastern Europe, analyzing aspects of social inclusion, job creation and market gaps.

In the extremely fragmented European economy and in the absence of a commonly accepted microfinance business model, the findings confirm the positive impact of microfinance on both poverty and social exclusion which currently constitute major obstacles to a sustained economic growth.



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## Executive Summary

Microcredit in the EU means loans smaller than EUR 25,000. It is tailored to micro enterprises, employing fewer than 10 people (91% of all European businesses), and unemployed or inactive people who want to go into self-employment but do not have access to traditional banking services. 99% of start-ups in Europe are micro or small enterprises and one third of these are launched by people who are unemployed.<sup>1</sup>

The efficient support of the European microfinance sector is an important way of further developing this young market segment; it is also an immediate reaction to attenuate effects resulting from the current crisis. The findings of this analysis show that there is a potential market gap; especially important in this context is the expected positive effect on employment for both, job creation and job sustainability.

In this paper we first explain in detail what is meant by microcredit.<sup>2</sup> The beneficiaries of microlending are often micro enterprises (or they create micro enterprises). Hence, in the second section we explain the European SME landscape with a special focus on micro enterprises before we focus in a third part on Microfinance Institutions (MFIs). In the fourth part we have a look at selected microcredit markets in Western and Eastern Europe. Moreover, we analyse aspects of social inclusion, job creation, and market gaps.

The main findings of this paper can be summarised as follows:

- Financial exclusion in Western Europe is often concentrated among the people suffering from poverty and social marginalisation. But also in Eastern Europe the exclusion from traditional banking services constitutes a major obstacle to the launch of new business activities.
- While research in the field of microfinance in Europe is still in its infancy, there is clear evidence that microfinance is an effective financing channel for job creation and social inclusion.
- The objective of microfinance is the creation or expansion of income-generating activities. Evidence collected from studies, surveys conducted by microfinance market participants, and from EIF's own experience in the field indicates that there is still a significant un-served market demand in Europe.
- SMEs constitute the majority of all companies, irrespective of national boundaries. The majority of these companies are micro enterprises; in the EU-27, 91% of the companies

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<sup>1</sup> See: European Commission (2009), p. 4.

<sup>2</sup> Please note that we address here only the microlending area and not aspects of e.g. microinsurance. We use the terms microcredit and microlending synonymously.

have less than 10 employees. The ability of a financial system to reach such small entities is crucial for the achievement of general socio-economic improvement.

- In the EU member countries, micro enterprises are often to be found in the following sectors: construction, real estate, and hospitality, as well as in wholesaling and retailing.
- The European microfinance market presents a dichotomy between the Western Europe and Central Eastern Europe in terms of characteristics of intermediaries, target beneficiaries, loan size etc. In general, there is no common microfinance business model in Europe.
- The average size of microloans in the EU is increasing. In 2007, the average microloan size across the EU sample was around EUR 11k, compared to EUR 7,7k in 2005. Lenders which focus on SME support and job creation tend to lend larger sums whilst those focusing on social and financial inclusion tend to make smaller microloans. Ratings of MFIs are gaining importance in the microfinance arena, but currently with a focus on development countries. The efficient support of this sector is not only an instrument to further develop this important market segment, but also an immediate reaction to attenuate effects resulting from the crisis.
- Often, there is a transformation process for MFIs: they start as NGOs and finance their business via donations and/or public money. Over time they “grow” toward formal financial institutions and regulated entities.
- In order to address a wide range of funding needs of microfinance intermediaries, and to reach out to the lower end of the microborrower segment, public actors appear critical to ensure the necessary initial subsidy element to catalyse start-up.
- There are wide spectra of final beneficiaries and intermediaries and the target groups of support measures need to be sufficiently broad in order not to unnecessarily confine the products and to provide efficient support. Moreover, the support measures themselves need to be flexible enough to fulfill the markets’ needs.
- Not only the financial support of the sector and the final beneficiaries is crucial - non financial support measures, i.e. mentoring, training and counselling are important for the microfinance sector in Europe as well.
- Main challenge for MFIs in the EU is to develop and maintain a flexible and sustainable funding model for microfinance operations that allows them to realise their individual approach.



## Résumé d'analyse

Au sein de l'Union Européenne, le microcrédit se définit comme tout crédit inférieur à 25,000 EUR. Cet instrument financier est destiné aux micro-entreprises, qui emploient moins de dix salariés (91% des entreprises européennes), et aux personnes sans emploi qui souhaitent créer leurs micro-entreprises mais n'ayant pas accès aux services bancaires traditionnels. 99% des start-ups en Europe sont des micro-entreprises ou des petites entreprises et un tiers de celles-ci sont créées par des personnes sans emploi.<sup>3</sup>

Soutenir efficacement le secteur de la microfinance en Europe est capital dans la perspective de développer de façon significative ce segment du marché Européen encore jeune. Le soutien à la microfinance doit en outre être perçu comme une réponse aux effets néfastes de la crise économique actuelle. L'étude montre qu'il existe une défaillance de marché potentielle, défaillance de marché particulièrement importante à combler lorsqu'on considère le rôle capital de la microfinance en termes de création d'emploi et de pérennisation des emplois existants. Les principaux enseignements de cette étude peuvent être résumés ainsi :

- L'inclusion financière en Europe de l'Ouest cible en général un public pauvre et socialement marginalisé. En Europe de l'Est, l'exclusion des services bancaires traditionnels constitue un obstacle majeur à la création d'entreprise.
- Alors que la recherche dans le champ de la microfinance en est toujours à ses balbutiements en Europe, il est reconnu que la microfinance est un instrument financier efficace pour favoriser la création d'emplois et l'inclusion sociale.
- L'objectif premier de la microfinance est la création ou le développement d'activités génératrices de revenus. Les informations recueillies au travers d'études de marchés, d'études réalisées par les praticiens du marché de la microfinance, et de l'expérience acquise par le FEI tendent à montrer qu'il existe une demande potentielle importante de microcrédit en Europe.
- Les PME constituent la grande majorité des entreprises et ce quels que soient les pays Européens considérés. La majorité de ces PME sont des micro-entreprises. Au sein de l'UE-27, 91% des entreprises sont des entreprises de moins de 10 employés. La capacité du système financier à servir ces petites structures est indispensable à l'amélioration du cadre socio-économique dans son ensemble.
- Dans les États membres de l'UE, on retrouve principalement les micro-entreprises dans les secteurs d'activité suivants : construction, bâtiment et services à la personne.

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<sup>3</sup> See: European Commission (2009), p. 4.

- Le marché Européen de la microfinance présente une dichotomie saisissante entre les pays d'Europe de l'Ouest et les pays d'Europe de l'Est : caractéristique des intermédiaires, type de bénéficiaires, crédit moyen...etc. D'une façon générale la microfinance dans les anciens États membres se concentre sur l'inclusion sociale tandis qu'elle se concentre davantage sur les retours financiers dans les pays d'Europe centrale et orientale.
- Le montant du microcrédit moyen augmente au sein de l'UE. En 2007, le microcrédit moyen au travers des pays de l'UE étudiés se situait autour de 11,000 EUR, alors qu'il était de 7,700 EUR en 2005. Les intermédiaires qui se concentrent sur le soutien à la micro-entreprise et à la création d'emploi ont tendance à prêter des sommes plus importantes alors que ceux qui se concentrent sur l'inclusion sociale et financière prêtent des sommes plus petites. La notation des IMFs gagne en importance au sein de la sphère de la microfinance mais reste aujourd'hui principalement focalisée sur les pays en développement. Un soutien efficace au secteur de la microfinance n'est pas seulement un moyen de développer plus avant ce segment du marché mais également d'atténuer les effets de la crise qui frappe actuellement l'économie mondiale.
- On observe un processus de transformation des IMFs : elles commencent en général leur activité en tant qu'organisation non gouvernementale ou association en se finançant principalement à l'aide de fonds publics (subventions). Elles se transforment ensuite progressivement en institutions financières régulées, supervisées par les Banques Nationales.
- Afin de subvenir aux besoins de financement des intermédiaires de microfinance et de les aider à atteindre le segment des bénéficiaires les plus défavorisés du microcrédit, les pouvoirs publics apparaissent comme les acteurs-clés qui permettent de fournir les subventions nécessaires au démarrage de l'activité de ces intermédiaires.
- Il existe une grande variété de bénéficiaires du microcrédit et une grande variété d'intermédiaires. Dans le cadre de projet spécifique de soutien au secteur de la microfinance, les populations cibles doivent être définies de façon suffisamment large pour ne pas limiter de manière excessive les produits de microfinance qui leur sont destinés et ainsi fournir un soutien efficace au secteur dans son ensemble. En outre, les mesures de soutien en elles-mêmes doivent être suffisamment souples pour répondre aux besoins du marché.
- Le succès de la microfinance en général et des IMFs en particulier ne dépend pas uniquement de leur approvisionnement en ressources financières mais également de la provision de services non financiers tels que la formation, l'échange des meilleures pratiques de marché, la consolidation de systèmes internes à même de répondre à une demande croissante.



## Framework

In December 2007, with the EC Communication “A European initiative for the development of microcredit in support of growth and employment” the EC has acknowledged that Europe lacks the necessary intermediaries, capital and environment to unlock the potential of microcredit in the EU.<sup>4</sup>

As the microfinance sector is not fully integrated into mainstream banking this emerging market has so far weathered the global financial storm remarkably well. However, in 2009 the market turmoil and credit crunch is hitting this sector as well. However, the situation is different from country to country and from actor to actor. Broadly speaking, the crisis is affecting microfinance mainly by:

- a) difficulties in accessing external sources of funding: many financial institutions are currently facing major problems and refocusing on their core business and less riskier market segment (liquidity tightening, rising costs of borrowing);<sup>5</sup>
- b) an expected increase in losses and defaults (higher defaults, higher indebtedness of customers, possibly exposure to foreign currency risk);
- c) an increased demand driven by “riskier bank customers” which are not served by banks anymore;
- d) deposit taking Microfinance Institutions (MFIs) report that client cash needs have gone up, causing savings to be withdrawn and sometimes straining repayments.<sup>6</sup>

As a consequence, the efficient support of this sector is not only an instrument to further develop this important market segment, but also an immediate reaction to attenuate effects resulting from crisis. This statement is further reinforced by the evidence collected for the twelve countries analysed in the annexes.

However, not only the financial support of the sector/final beneficiaries is crucial – non-financial support measures, i.e. mentoring, training and counselling are important for the microfinance sector in Europe as well. Based on a survey by the European Microfinance Network (EMN) it can be assumed that approximately 2/3 of the microfinance clients are benefiting from assistance in helping them develop their activity.<sup>7</sup>

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<sup>4</sup> European Commission (2007) 708 final; see:

[http://eur-lex.europa.eu/LexUriServ/site/en/com/2007/com2007\\_0708en01.pdf](http://eur-lex.europa.eu/LexUriServ/site/en/com/2007/com2007_0708en01.pdf).

<sup>5</sup> See e.g.: Fitch Ratings Ltd. (2009). However, in some countries there is now additional state support available.

<sup>6</sup> See e.g.: CGAP (2009).

<sup>7</sup> See: [http://www.european-microfinance.org/characteristic\\_en.php](http://www.european-microfinance.org/characteristic_en.php).

## What is microcredit?

Microcredit is the extension of very small loans (below EUR 25,000) to entrepreneurs (typically micro enterprises, see next chapter), to social economy enterprises, to employees who wish to become self employed, to people working in the informal economy and to the unemployed and others living in poverty who are not considered bankable and therefore who are lacking access to traditional sources of capital.

Financial exclusion in Western Europe is often concentrated among the people suffering from poverty and social marginalisation. But also in Eastern Europe the exclusion from traditional banking services constitutes a major obstacle to the launch of new business activities.

The average microloan in Europe is – of course – small, but increasing. In 2007, the average microloan size across an EU sample was around EUR 11k, compared to EUR 7,7k in 2005. There are wide variations from country to country – in the EU-15 the average is well above the average. For comparison with Eastern Europe, as of end of 2008 the average (outstanding) loan size in EFSE<sup>8</sup> for example was EUR 4,506.<sup>9</sup>

As policy tool, microcredit is considered to be cost effective: It is estimated that the average cost of support for microcredit schemes in Europe is less than EUR 5k per job created; hence it is typically cheaper than other labour market measures.<sup>10</sup>

Objective of microfinance is the creation or expansion of income-generating activities or micro enterprises and usually the principal need for the borrowers is working capital. The loans act as catalyst to improve the productive capacity. Hence, it is important that the borrowers are using the loans productively – if they do not, it just increases their indebtedness. This distinction between productive microcredit and undifferentiated lending needs to be kept in mind while increasing the volumes of microfinance support. Moreover, microfinance should refer to those “active poor” who prove to be technically skillful and entrepreneurial to be able to autonomously run an economic activity and to generate an appropriate cash flow (repayment of debt/savings/investment).<sup>11</sup>

It might be argued that the market share of micro enterprises that do not obtain the necessary microfinancing, would be taken over by bigger companies so that the economy overall is in the same state. However, this line of argument disregards aspects like increased competition (due

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<sup>8</sup> European Fund for South East Europe. EFSE, established in 2005, provides long-term funding to financial institutions in Southeast Europe, helping micro and small enterprises to grow and improving the quality of life for private households. EFSE is one of the largest microfinance funds worldwide and the first Public-Private Partnership of its kind. For more information see: [www.efse.lu](http://www.efse.lu).

<sup>9</sup> See: Presentation at EFSE Annual Meeting, May 2009, Novi Sad, Serbia.

<sup>10</sup> See: European Commission (2007), p. 12.

<sup>11</sup> See: Vigano, Laura; Bonomo, Luciano; Vitali, Paolo (2004).

to the market entry of new players), employment effects, and the potential for higher reaction rates of smaller entities (and hence increased potential for growth of the economy).<sup>12</sup>

Sometimes, microfinance is referred to as being a tool to improve innovation and sustained economic growth. However, in this area, the potential is rather limited. Microfinance is able to increase employment and wealth, but typically the microborrowers use their credits to create enterprises that do what others are doing as well – often in areas where there are limited economies of scale (the so called “replicative firms”). Only if these firms transform themselves later-on into innovative enterprises (new products, new services, use of innovative and productivity enhancing inputs, new modes of organisation etc.) they contribute to sustained economic growth.<sup>13</sup> However, also without being innovative, the replicative firm (and with it the microlending as source of financing) can contribute to the social-economic improvement.

As the beneficiaries of microlending are often micro enterprises (or they create micro enterprises) in the following chapter we are going to have a brief look at the SME landscape in Europe.

## The SME landscape in Europe

The European Commission defines the different enterprise categories based on the criteria headcount, turnover, and/or balance sheet total:

**Figure 1: SME definition**

Enterprise category	Headcount	Turnover	or	Balance sheet total
Medium sized	< 250	≤ EUR 50m		≤ EUR 43m
Small	< 50	≤ EUR 10m		≤ EUR 10m
Micro	< 10	≤ EUR 2m		≤ EUR 2m

Source: European Commission<sup>14</sup>

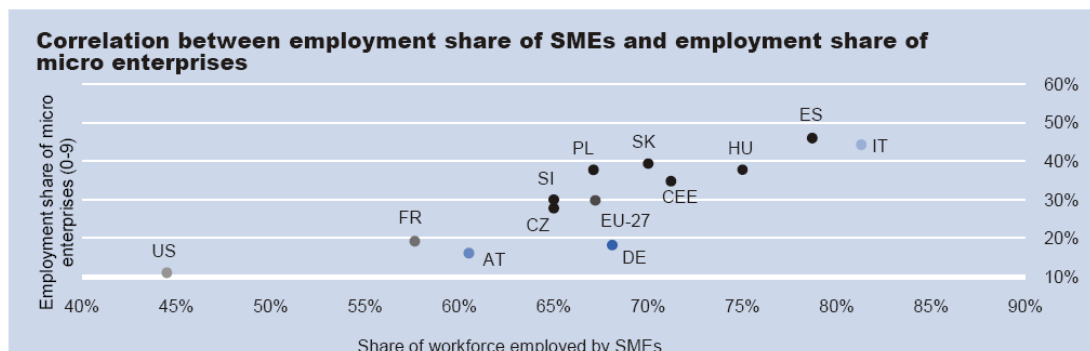
SMEs constitute the majority of all companies, irrespective of national boundaries and in most of the countries SMEs make the largest contribution to employment and value creation. In the EU-27, there are almost 20m SMEs (more than 99% of all companies), providing more than 65m jobs. The majority of the companies are micro enterprises. In the EU-27, 91% of the companies have less than 10 employees. In the Mediterranean area the average headcount is below 5; this reflects the high proportion of family-run micro enterprises in this region (see for illustration also figures 2, 3 and 4 below).

<sup>12</sup> See e.g.: Kritikos, Alexander; Kneiding, Christoph; Germelmann, Claas Christian (2009).

<sup>13</sup> See: Baumol, William J.; Litan, Robert E.; Schramm, Carl J. (2007), p. 182.

<sup>14</sup> See e.g.: [http://ec.europa.eu/enterprise/enterprise\\_policy/sme\\_definition/index\\_en.htm](http://ec.europa.eu/enterprise/enterprise_policy/sme_definition/index_en.htm).

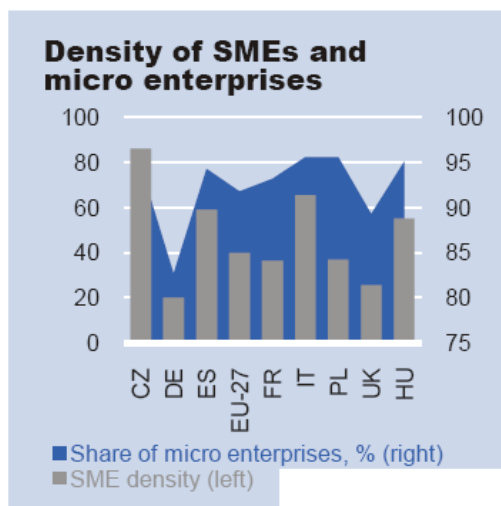
Figure 2: Correlation between employment shares of SMEs and micro enterprises.



Source: Hohmann, Katharina (2009)

These figures are as well confirmed by density statistics (SMEs per 1,000 inhabitants):<sup>15</sup>

Figure 3: Density of SMEs and micro enterprises



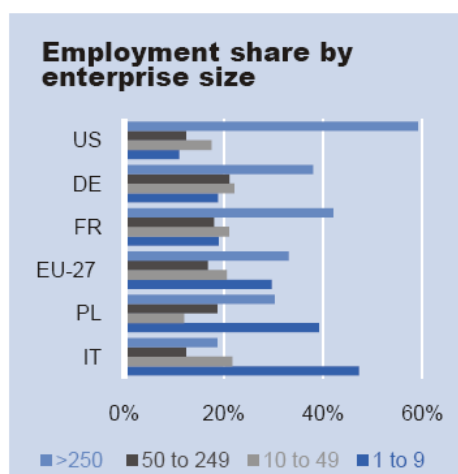
Source: Hohmann, Katharina (2009)

Typically, in European countries SMEs employ at least 50% of all people at work (in the US: around 42%). In Southern European countries, the employment contribution of SMEs is particularly high (e.g. Italy, Greece, Portugal, Spain) with 70 to 80% (for comparison: Germany 61%). In Central and Eastern Europe (CEE) the SME contribution is as well high (in the area of 70%).<sup>16</sup>

<sup>15</sup> See: Hohmann, Katharina (2009), p. 6.

<sup>16</sup> See: Hohmann, Katharina (2009), p. 5.

Figure 4: Employment share by enterprise size



Source: Hohmann, Katharina (2009)

In the EU member countries, micro enterprises are very often to be found in the sectors construction, real estate, and hospitality, as well as in wholesaling and retailing. In these sectors, more than one third of the enterprises have less than 10 employees and at least two thirds of the companies have less than 50 employees. One reason for this is that in the service sector there are often only limited possibilities for economies of scale and synergies and hence less than 50 can often represent an optimal size.<sup>17</sup>

SMEs, and i.e. micro enterprises are often called the “job-engine” of an economy and in fact the job creation/job growth rate in smaller companies is higher than in bigger companies. Micro and small enterprises represent 99% of the 2 million start-up enterprises that are created every year. One third of these enterprises are launched by unemployed.<sup>18</sup> But to give the full picture: research from several countries shows also that this goes hand in hand with higher job loss rates in smaller enterprises compared to bigger companies.<sup>19</sup> Statistics reveal that the survival of an enterprise is most difficult in the first year of operations and that the survival rate increases with the availability of microfinance.<sup>20</sup>

EMN carried out its third survey on the activity of microfinance institutions (MFI) in 21 European countries (EU and Norway) covering 2006-2007 to detail the value and volume of credits granted, actors and target population, conditions and forms of funding.

In the Eastern EU countries (Hungary, Bulgaria, Slovakia, Romania and Poland), the majority of actors have been lending since the 1990s. The sector is therefore more mature than in the Western EU, but in some cases there has been a negative trend of loans disbursed between

<sup>17</sup> See: Hohmann, Katharina (2009), p. 10.

<sup>18</sup> See: Jayo, Barbara; Rico, Silvia; Lacalle, Maricruz (2008); see also: [http://www.european-microfinance.org/characteristic\\_en.php](http://www.european-microfinance.org/characteristic_en.php).

<sup>19</sup> See: Hohmann, Katharina (2009).

<sup>20</sup> See e.g.: European Commission (2003).

2006 and 2007. As exemplified in the following tables (see figures 5 and 6), Eastern countries disbursed in 2007 a total of 15,793 loans equivalent to EUR 94m. Conversely, in the Western EU countries, the sector remains fairly young and still in an expansion process with microlenders active only since 2000. In the Western countries, the total number of loans disbursed in 2007 came to 26,957 loans equivalent to EUR 300m with nationally based lenders in France, Germany, Spain and Finland disbursed the greatest number of loans. In total, in 2007, the number of loans disbursed in the EU was 42,750 equivalent to EUR 394m. Eastern countries represented 37% of total loans and 24% of total value, whereas Western countries represented 63% of total loans and 76% of total value. On the whole, the number of active clients in the EU was 121,677 as of the end of 2007.<sup>21</sup>

**Figure 5: Evolution of microloans in European Countries**

	2005	2006	2007	Growth Rate 2007-2006
Number of loans	27,000	35,553	42,750	14%
In mEUR	210	295	394	32%

Source: Jayo, Barbara; Rico, Silvia; Lacalle, Maricruz (2008)

**Figure 6: Microloans in Europe (2007)**

2007		East EU	West EU	Number of Clients
Number of loans	42,750	15,817.5 (37%)	26,932.5 (63%)	
In mEUR	394	96.56 (24% of total value)	299.44 (76% of total value)	

Source: Jayo, Barbara; Rico, Silvia; Lacalle, Maricruz (2008)

At a European Level, the European Investment Fund is involved in the microfinance sector through the SME Guarantee Facility (SMEGF) since 2000. In addition, a number of securitisation transactions supporting microfinance have been realised on EIF's own resources and part of the resources available under the JEREMIE initiative might be used in this field. Finally, EIF is undertaking the management of the Joint Action to Support Microfinance Institutions in Europe (JASMINE) since early 2009.

<sup>21</sup> See: Jayo, Barbara; Rico, Silvia; Lacalle, Maricruz (2008); see also:  
[http://www.european-microfinance.org/characteristic\\_en.php](http://www.european-microfinance.org/characteristic_en.php).

## Microfinance Institutions as main actors

A Microfinance Institution (MFI) is an organization that provides microfinance services. In Developing Countries, during the 1970s and 1980s, the micro enterprise movement led to the emergence of nongovernmental organizations (NGOs) that provided small loans for the poor. In the 1990s, a number of these institutions transformed themselves into formal financial institutions in order to access and on-lend client savings, thus enhancing their outreach. Formal providers are sometimes defined as those that are subject not only to general laws but also to specific banking regulation and supervision (development banks, savings and postal banks, commercial banks, and non-bank financial intermediaries). Formal providers may also be any registered legal organizations offering any kind of financial services. Semiformal providers are registered entities subject to general and commercial laws but are not usually under bank regulation and supervision (financial NGOs, credit unions and cooperatives). Informal providers are non-registered groups such as rotating savings and credit associations and self-help groups.<sup>22</sup>

We showed already that the microfinance sector in Europe is still young. Moreover, most of the actors are very small, it appears that most organizations do not grant more than 100 credits per year; nearly 70% of microfinance lenders employ fewer than 5 people in their microfinance programme. Overall in Europe there is no common microfinance business model and there are different types of microfinance actors, most of which are NGOs outside the formal banking system:<sup>23</sup>

- NGOs: 28%
- Foundations: 26%
- Public institutions: 17%
- The rest (28%) is composed of banks, savings banks and other credit institutions (figures based on EMN survey).

The credit organizations can be divided into 2 groups:

- Those whose primary activity is granting microcredits (35% of all participants);
- Those for which microfinance is only a side activity (for 46% of participants it represents less than 25 % of their activity, and for 61% less than 50%).<sup>24</sup>

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<sup>22</sup> See: <http://www.cgap.org/p/site/c/template.rc/1.26.1308/>.

<sup>23</sup> See: Jayo, Barbara; Rico, Silvia; Lacalle, Maricruz (2008); see also: [http://www.european-microfinance.org/characteristic\\_en.php](http://www.european-microfinance.org/characteristic_en.php).

<sup>24</sup> See: [http://www.european-microfinance.org/characteristic\\_en.php](http://www.european-microfinance.org/characteristic_en.php).

Regionally the market participants can be distinguished: According to market surveys prepared on behalf of EIF<sup>25</sup> and according to the market information gathering conducted by EIF, at EU level, MFIs are at different stages of their life cycles and need consequentially differentiated financial support for their business and growth. MFIs in the EU are broadly characterised by:

- in EU-15 (with a few exceptions) small size, very low or inexistence profitability, microfinance institutions heavily rely on subsidies to cover costs, very limited access to external sources of funding, social lending activity mainly targeting disadvantaged groups (immigrants, unemployed, etc), operational procedures are often not standardised, very high need for seed/developing funding for MFIs;
- in CEE by larger average size of the institutions, higher profitability, lending activity more focussed towards micro-entrepreneurs, difficult access to stable external sources of funding.

In CEE there are some IFIs (EBRD, IFC, etc.) and funds providers (ProCredit, Opportunity, BlueOrchard) active in the microcredit segment, whereas in EU-15 no IFI is providing funding to MFIs. EIF appears as the only EU wide actor in this sector.

Looking at the microfinance business models in Western Europe specifically, we can distinguish 4 main types:<sup>26</sup>

1. NGOs, Microfinance driven approach: institutions with a microfinance driven approach; often they provide business support, too. Typical examples are: ADIE (France), ANDC (Portugal), Aspire (Northern Ireland, UK), or Street UK (UK).
2. NGOs with a target driven approach: NGOs, who served specific target groups (e.g. unemployed, recipients of welfare benefits, migrants) started to offer financial services, examples are the Microloan Fund of the City of Hamburg (Germany)<sup>27</sup> or Weetu (UK).
3. Support programmes initiated in existing institutions and development banks: existing institutions or development banks include support programmes for micro and small enterprises. Examples are Finnvera (Finland), KfW (Germany), BDPME-Oseo (France) or ICO (Spain).
4. Specialised units (or parts) of banks: this is still a relatively young development, examples are various caixas in Spain (e.g. Microbank La Caixa).

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<sup>25</sup> In the context of Jeremie/Jasmine, EIF has initiated Microfinance market studies. The latest studies on behalf of EIF cover 8 countries, in Western Europe as well as in CEE: Spain, Italy, UK, Germany, Czech Republic, Slovakia, Romania, Bulgaria; earlier studies cover France, The Netherlands, Poland, and Hungary.

<sup>26</sup> See: Evers, Jan; Lahn, Stefanie; Jung, Martin (2007), p. 15ff.

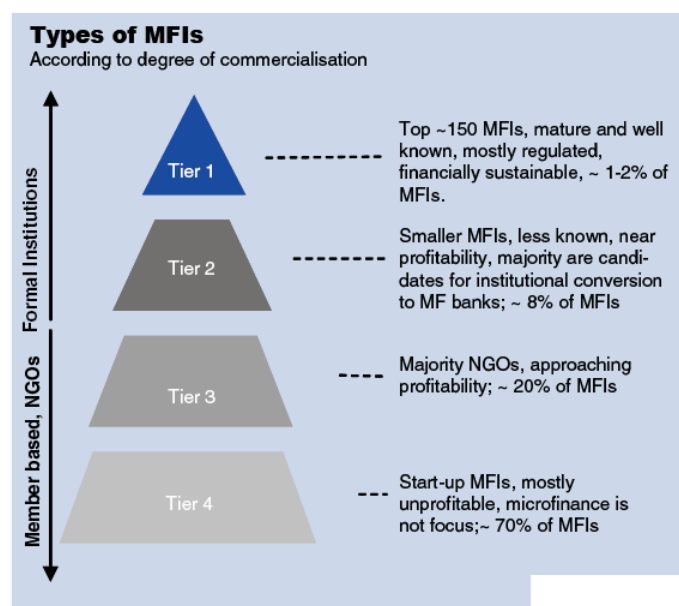
<sup>27</sup> For information: in Germany there are around 30 MFIs outside the formal banking system; see e.g.: Kritikos, Alexander; Kneiding, Christoph; Germelmann, Claas Christian (2009).



The 3 largest MFIs in Europe are currently Adie (France), Finnvera (Finland), and Fundusz Mikro (Poland). Adie was created by volunteers and works in partnerships with banks; Finnvera was set up at the initiative of the Finnish state, and Fundusz Mikro has received exceptional funding from USAID as start up aid.

Often, there is a transformation process for MFIs: they start as NGOs and finance their business via donations and/or public money. Over time they “grow” toward formal financial institutions and regulated entities.<sup>28</sup> MFIs (in general) can be classified in 4 categories:

**Figure 7: Types of MFIs**



Source: Dieckmann, Raimar (2007)

In Western European countries (i.e. Spain, Germany, UK, and Italy), microfinance has a strong focus on social inclusion and it pays limited attention to its profitability, whereas in Eastern Europe there is a larger presence of commercial intermediaries. With regard to the commercialization, we can distinguish between 4 business models:

- One alternative is the above mentioned upgrading of semi-formal MFIs (e.g. NGOs) to supervised formal financial institutions.
- A second alternative is the so called downscaling: existing banks or financial institutions enter into the microfinance business (e.g. direct lending to final beneficiaries).
- A third option is “Linkage Banking”, banks cooperate with MFIs (e.g. loans to MFIs by Citibank).
- A fourth alternative is the so called “Greenfield”: formal financial institutions specialised in microfinance business (build up from scratch).<sup>29</sup>

<sup>28</sup> See: Dieckmann, Raimar (2007), p. 7.

<sup>29</sup> See: Evers, Jan; Lahn, Stefanie; Jung, Martin (2007), p. 15.

Compared to commercial banks, MFIs have typically the following features:<sup>30</sup>

- Strong social development impact; “double return” profile (Social Return Investment (SRI) & attractive risk/return relationship);
- Granting uncollateralised loans;
- Labour-intensive delivery system and a closer relationship between lender and borrower compared to traditional banking;
- Higher cost/income ration due to a large amount of small loans on short maturity;
- Interest rates are higher due to the nature of microlending;
- Returns are relatively stable over the economic cycle;
- Lower correlation of earnings to mainstream capital markets;
- Step lending techniques: larger follow-up loans are provided if the initial loan is successfully repaid;
- Services often combined with mentoring/coaching/advisory/training;
- Credit assessment methods less standardised and not automated.

According to the market studies prepared by EMN on behalf of EIF, the main challenge for MFIs in the EU is to develop and maintain a flexible and sustainable funding model for microfinance operations that allows them to realise their individual approach towards providing microcredit (target groups, objectives) as well as to enlarge their portfolio and develop their institutional capacity. In this regard it is crucial to differentiate between different types of finance for specific MFIs need (see figures 8, 9 and 10).

The optimal funding depends mainly on the development stage of the MFI and the area of operation; they define the internal and external factors that determine the funding needs. Internal factors are e.g. the growth of the loan portfolio and the mobilisation of savings; external factors are mainly defined by the regulatory framework, but also the availability of donations or commercial lending are important. Moreover, the costs and maturity of the various funding sources play a major role.

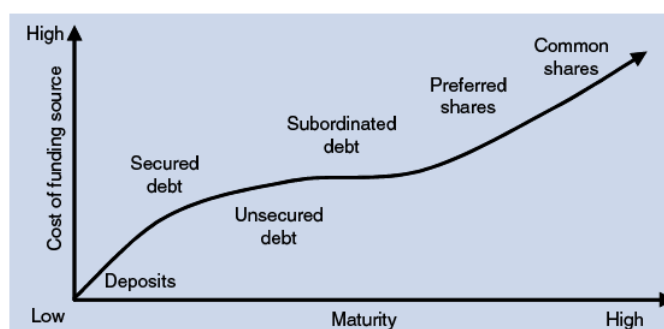
In line with the Pecking Order Theory (Myers/Majluf, 1984), the MFIs have to prioritize the various sources of financing. Typically, the issuance of equity is costly and often structurally limited considering the NGO nature of most MFIs (except grant equity or donations). Equity is followed by unsecured and subordinated debt while deposits are considered to be relatively cheap. But also the maturity plays an important role of the choice of the funding source:

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<sup>30</sup> Based on: Dieckmann, Raimar (2007), p. 15 and McDowell, Malcolm (2006).

typically equity serves as long term funding source, while deposits are more of a short(er) term nature (see figure 8).<sup>31</sup>

**Figure 8: MFI funding – costs versus maturity**



Source: Dieckmann, Raimar (2007)

The continuum of funding needs for MFIs in the EU can be structured as follows:

**Figure 9: Funding needs of MFIs**

Funding need	Description	Typical sources of funding
Start-up costs/ Institutional development	Any costs connected to the creation or substantial expansion of a MFI.	Donations and public subsidies.
Equity	Any sustainable MFI needs equity capital. Due to the special nature of its operations the equity ratio should go well beyond the one set for credit institutions in the minimum capital requirements (Basle II).	Donations and public subsidies, retained earnings, Venture philanthropy.
Refinancing loan capital	Many MFIs start their lending out of own equity. To reach scale it is necessary to find other resources to refinance the loan capital.	Capital market through partner banks, revolving loan funds set up using European structural funds (ERDF/ESF). Re-capitalisation with public funds.
Operational costs of lending operations	1. Transaction costs connected to the provision of microloans 2. Risk costs arising from defaulted loans.	Income from interest and subsidies, in some cases risk costs are at least partly covered through guarantee structures (e.g. CIP).
Operational costs of non-financial services provided	Additional non-financial services provided to microenterprises (by specialised service providers).	Donations and public subsidies, partly using existing schemes co-financing Business Development Services revenues from users of services.
Income subsidies for microfinance clients	Some of the microfinance clients need additional income subsidies in the start-up phase of their business.  In some countries schemes have been successfully established to encourage people, who receive social welfare payments, to become self-employed. People retain a certain percentage of their fare payments for some time after becoming self-employed.	Public funds.

Source: Evers & Jung in European Microfinance Network (2008/2009)

<sup>31</sup> See: Dieckmann, Raimar (2007), p. 8.

In the interviews related to the above mentioned studies, the institutions reported patchworks of funding lines for microfinance operations, with most of the funding available only of periodical nature without reliable long-term commitment from donors or alternative funding sources to replace such relationships. This is detrimental to the development of the whole sector because it does not allow MFIs to engage themselves in long-term strategies to build up capacity for efficient and sustainable lending operations and to offer additional services for their clients. In general start-ups and transforming MFIs are mostly impact-oriented and have limited risk tolerance, they are poorly interested in risk alleviation tools and more in need of grants, technical assistance, equity and long term loans. Conversely, transforming and mature MFIs have sophisticated risk management considerations and are high in demand of risk alleviation solutions. As illustrated in the following figure, different MFI beneficiaries rely on different types of investments to respond to specific risk considerations.

**Figure 10: Financing needs of MFIs in various stages**

<b>Beneficiaries</b>	<b>Investments</b>	<b>Funders</b>	<b>Risk Considerations</b>
Start-up MFI	Grants & Donations	Donor institutions	No risk considerations
Small MFI	Soft loans & grant equity	Social investors	Leveraging risk
Transforming MFI	Private placements (equity and debt)	Double bottom line investors	Limiting risk
Large Mature MFI	Market securities (stock & obligations)	Market investors	Managing risk

Source: *Symbiotics*

Ratings of MFIs are gaining importance in the microfinance arena, but currently still rather with a focus on development countries. Objective of the rating is to make the risk profiles of MFIs comparable across countries and market segments. Due to the nature of the business, the rating methodologies need to be different compared to the typical rating approaches. There are several rating agencies, covering MFIs (e.g. MicroRate, Microfinanza, Planet Rating), for the traditional rating agencies (Fitch, Moody's, Standard & Poor's) microfinance is currently only a side aspect. Typical rating criteria are (examples only):<sup>32</sup>

- Management, ownership, and governance;
- Strategy;
- Operational risk and enterprise risk (management);
- Accounting and financial reporting;
- Credit and market risk (management);
- Funding, liquidity and profitability;
- Information systems.

<sup>32</sup> Based on: Dieckmann, Raimar (2007), p. 16.

A “Rating Initiative” (with a focus on developing countries), started in September 2008. The initiative is designed to increase transparency in the microfinance sector (i.e. via co-funding of ratings and rating market studies). It was launched by ADA in collaboration with the Government of Luxembourg, and is supported by the Microfinance Initiative Liechtenstein, the Swiss Agency for Development and Cooperation, Oxfam Novib, responsAbility and Blue Orchard.<sup>33</sup>

## Detailed results from selected microfinance markets

In most parts of the world, microfinance offers people excluded from formal financial services the opportunity to obtain microloans in order to generate income and engage in productive activities, often by expanding their small businesses.

Introduced in Central and Eastern Europe (CEE) after the fall of the Berlin Wall, microcredit today is represented by a dynamic sector. In the CEE microfinance began as an economic development tool in turbulent times with i.e. the development of the entrepreneurial sector, privatisation, market entry of foreign banks etc.

Later-on, in a more benign economic environment, small companies became less risky and in addition to the involvement of MFIs and NGOs in the provision of microfinance in Eastern Europe, commercial banks started to be increasingly interested in downscaling in order to provide microloans. Within 5 or 6 years of the collapse of the Wall, microfinance institutions in Central and Eastern Europe and in the New Independent States had attracted more than 1.7m borrowers and 2.3m depositors, with an average client growth rate of 30% per year.<sup>34</sup>

In Western Europe, however, the sector’s growth has been more limited, despite increasing interest in its potential. Although microfinance has some deep roots through institutions such as the Raiffeisen and Savings Banks in Germany, lending charities in England, and the co-operative model of the “Casse rurali” in Italy, it remains a fairly recent phenomenon in this region. Microfinance is mainly perceived in Western Europe as a tool for economic growth and social cohesion. Many small businesses and families lack access to financial services in spite of the existence of a dense and competent banking network. Financial exclusion is mainly concentrated among those suffering from poverty and social marginalisation.

As noted, the vast majority of the EU lenders are not for profit organisations in the form of NGOs, foundations or government bodies. The best financially performing organizations are however located in Eastern EU countries, namely in Romania and Bulgaria, characterised by their for profit legal structure. Major actors disbursing microloans in the EU are: credit unions,

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<sup>33</sup> See e.g.: <http://www.microfinance.lu/231.html?&L=1>.

<sup>34</sup> See: [http://www.european-microfinance.org/europe-microfinance\\_en.php](http://www.european-microfinance.org/europe-microfinance_en.php).

state banks, ethical banks, savings banks and nonbank financial institutions.<sup>35</sup> The absence of profit driven market players in Western Europe (and their at least partial presence in Eastern Europe) is mainly driven by the underlying risks of the activity. Apart from economic conditions several other factors can affect the risk/return relationship of microcredit – examples are i.e. the negative impact of functioning social security systems on the default behaviour of microborrowers;<sup>36</sup> another aspect is the possibility to properly price microcredits (in some countries there are interest rate caps (ceilings)). Moreover, we mentioned the need for non-financial support (e.g. to assist borrowers in navigating the complicated business registration and tax regimes prevailing) – these services can reduce the default rates on the one hand, but on the other hand they are expensive and increase the costs of loan processing.

Currently - to our knowledge - in Western Europe not a single microlender has achieved financial sustainability and market experts doubt whether this sustainability is possible in Western Europe (subsidies of some sort are required indefinitely). Moreover, how the performance and behaviour of the profit driven microfinance actors in Eastern Europe is going to be following the financial crisis remains to be seen.

### Western Europe (UK, Spain, Germany, Italy) - Main findings<sup>37</sup>

In the 4 countries analysed, microfinance activities are still at a preliminary stage of development with roughly a decade of experience on average. It has been noted however how Western European microfinance markets are over-crowded with social support organisations.<sup>38</sup>

Given the uniform market immaturity and the similar socio-economic contexts, similar trends among European countries can be traced. The fundamental challenge for most microfinance institutions in Western Europe is achieving efficient operational models that can maximise social and financial performance. This is however complicated by the pre-existence of competitive financial service sectors along with elaborate and well-enforced legal oversight structure. Additional efforts should be made to reach higher levels of consolidation and coordination.

Target: The target of microcredit in the 4 markets varies substantially. Micro-enterprise lending exists in all 4 markets. In the UK most of the microcredit activity is micro-enterprise lending. Also in Germany, a greater volume of microcredit is focused on micro-enterprise lending; however, there are considerably more social lending focused institutions. In Italy, targeting is

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<sup>35</sup> See: Jayo, Barbara; Rico, Silvia; Lacalle, Maricruz (2008); see also: [http://www.european-microfinance.org/characteristic\\_en.php](http://www.european-microfinance.org/characteristic_en.php).

<sup>36</sup> We stress that we are not saying that the existence of a functioning social security system is negative but that the absence of such a system increases the pressure on a borrower to repay the microcredit.

<sup>37</sup> The following summaries are solely based on the market surveys by EMN and might not necessarily reflect the exact situation of microfinance in those countries.

<sup>38</sup> EMN market surveys for EIF (2008).

somewhat more evenly balanced, and the immigrant community is increasingly becoming a focus for social lending programmes. In Spain, lending is decidedly social in nature. In general, all 4 markets have grown significantly since their beginnings and potential demand is considered to be substantial.

Performance and Size: Performance has been hard to track in the 4 markets of analysis due to a number of issues. In most cases, institutions were not able to forecast future performances of loan portfolios. Research also shows how it was apparent that some of the smaller non-profits that proliferate in these markets lacked the capacity due to weak information management or to the lack of human expertise.

Additionally, the current market size is hard to measure due to poor data and different methodologies adopted when measuring number of loans and loan values.

Methodologically, the supply and demand findings from the country reports were based on surveys run by EMN research teams, in-depth analysis of more macro data, and info provided by industry associations.

Demand: Evidence shows a lack of information on potential demand in the countries of analysis. This is partly due to the markets' own incapacity to conduct intensive analysis as well as to the lack of adequate marketing programmes that could gauge the demand. Moreover, EMN studies confirm that financial institutions very rarely disclose complete information on loans and beneficiaries through surveys and interviews. It has been noted however that traditional licensing constitutes a limiting factor for most aspiring microfinance institutions as it confines these new institutions and their innovative products within the rules applied to the traditional, profit-driven financial system. Apart from the expenses of legal incorporation and compliance, aspiring microfinance institutions in these countries must operate within the range of acceptable interest rates outlined by national usury laws (this does not apply to the UK). The high operating costs inherent in microfinance, the inability to take savings and the limited existence of economies of scale due to limited demand mean that self-sustainability in this sector will not be achieved in the foreseeable future.

Another serious concern for the future of microfinance is the impact of economic crisis (both current and future) on the funding levels of microfinance activities. It is in fact unclear whether donors will continue to support microfinance in time of economic downturns, and whether demand will rise with unemployment and poverty rates. Researchers also speculate on the possibility that the demand will be limited by a crisis-induced behaviour of potential entrepreneurs vis-à-vis new risks.

## Eastern Europe (Romania, Bulgaria, Czech Republic, Slovakia) - Main findings

Differently from the Western European countries, microfinance is perceived in the eastern region as an effective tool to fight financial exclusion and has proved to be efficient in providing sustainable development. Interestingly enough, in spite of the fact that the 4 countries are located in the same region and share a common recent history, the studies revealed a diversity of approaches, methodologies, instruments and institutions engaged in providing access to financial services. In most cases, they serve the needs of entrepreneurs, micro enterprises and individuals.

An overarching problem in Eastern Europe is the lack of definition of microcredit. The EU definition of loans of under EUR 25k may not be adapted to countries that are well under the average EU per-capita GDP levels. With no clear definition of players, tools, offer and demand, it is also very difficult to gather reliable data and build statistics. Another issue is the legal and regulatory background. In the Czech Republic or in Slovakia, this is entirely non-existing and it is insufficiently developed elsewhere. In Romania, after an initial positive "Microfinance Companies Law" of 2005, recent regulatory changes have negatively impacted microfinance institutions bringing unexpected obligations for smaller actors.

Some countries, mainly in Central Europe, prioritise large company growth rather than small business development. In parallel, little is done to develop financial institutions, projects or products geared towards small and very small companies. Although mainly workforce exporters, Central and Eastern European countries do see part of their population, mainly the Roma, face exclusion problems. They have set up programmes and actions to face the issue, but microfinance has been seldom considered as a priority. The micro and small entrepreneurs tend to use fast-developing consumer credit products as a default answer to their financing needs. This is counterproductive for the entrepreneur, who gets expensive financing and no counselling or training. In the long term, this detrimental effect is also reflected in the whole financial sector.

### Social inclusion and job creation

As indicated in the figure 11 below, in 2007, 44% of microloan clients were women, 2% of clients were from ethnic minorities, 12% were immigrants, 12% were youth and less than 1% of microloan clients were disabled people. These figures are based on Jayo, Rico, and Lacalle 2008. The highest rates for women can be found in Spain (nearly 70%), Bulgaria, Portugal, the United Kingdom and Romania (more than 50% for each). When comparing the number of female beneficiaries of microloans to the proportion in the population, it is evident the extent to



which they are currently underrepresented. On the contrary, women represent 85.2% of total clients in microlending programmes. Immigrants also represent nearly 50% of microcredit clients in Spain and 25% in France. On average, they represent 12%, since they are less represented in other European countries, especially in Eastern Europe. Generally speaking, only 12% of microcredit beneficiaries are between 18 and 25 years old. But they represent a significantly higher proportion in Hungary (70% of clients) and Spain (30%).

**Figure 11: Microcredit beneficiaries in the EU (2007)**

<b>Beneficiaries (2007)</b>	
<b>Woman</b>	44%
<b>Ethnic minorities</b>	2%
<b>Immigrants</b>	12%
<b>Young</b>	12%
<b>Disabled</b>	1%

Source: Jayo, Barbara; Rico, Silvia; Lacalle, Maricruz (2008)

The relevance of other “at risk groups” such as immigrants and youth as microcredit clients is significant in some countries. For example, in Spain and France, immigrants are represented well over their proportion in the population whereas in Hungary and Spain young people are represented well over their proportion of the young entrepreneurs’ population.

The support offered for the setting up of a small enterprise is a major priority for the surveyed credit institutions, since it contributes to limiting social exclusion and unemployment. Consequently, credit is more readily granted to people starting a business than to already existing enterprises.<sup>39</sup> According to ADIE, the needs for financing at start-up are minimal in most cases: close to 60% of genuine start-ups in France are financed with less than EUR 8,000; 22% of these do not need more than EUR 2,000.<sup>40</sup> With regard to the link between microfinance and job creation, EFSE has initiated a study based on a survey among 277 urban micro and small enterprises (MSEs) in Romania, Serbia, and Montenegro (January 2005 to December 2007). One of the results was that 88% of the interviewed MSEs had either increased or sustained paid full-time positions since taking loans in 2005. 35% of the MSEs reported the creation of 1 to 9 new jobs, almost 10% of the MSEs have created more than 10 new jobs. Almost 43% of the surveyed companies have sustained the number of jobs. 12% reported lost jobs. Two thirds of the interviewees rated the loan as important or very important

<sup>39</sup> See: Jayo, Barbara; Rico, Silvia; Lacalle, Maricruz (2008); see also: [http://www.european-microfinance.org/characteristic\\_en.php](http://www.european-microfinance.org/characteristic_en.php).

<sup>40</sup> See e.g.: ADIE (2009); e.g. <http://www.european-microfinance.org/data/file/adie-fiche-anglais.pdf>.

to the creation of new jobs in their company. 18% of the MSEs even concluded that their business would have closed had they not had access to the loans.<sup>41</sup>

**Figure 12: Results from the EFSE survey**

Job category	Number of MSEs	Number of jobs	Average result
Jobs created	126	1,005	8.0
Jobs sustained	118	655	5.6
Jobs lost	33	-189	-5.7
Jobs created + sustained	244	1,660	6.8
Net jobs created (created – lost)	159	816	5.1
Net jobs (created + sustained – lost)	277	1,471	5.3

Source: EFSE (2008a and 2008b)

The microfinance industry in Europe is still young but has proven that microfinance is a tool for social inclusion and job creation. Experience shows that microlending is a business that needs to be subsidized in its initial stages. This is all the more true for Western European countries that are characterised by a more highly developed banking system.<sup>42</sup> However, various surveys and EIF's market experience show a gap between demand and supply in the microfinance arena.

## Market gap

In a perfect market situation, there would not be a market gap with regard to microcredit, and supply and demand should meet. However, there is asymmetric information and for the lender it is often difficult to get the relevant information about the borrower – it can be reduced to the simple conclusion: the smaller the borrowing enterprise, the more difficult (and the more expensive) is the collection (and analysis) of credit-relevant information for the lender.<sup>43</sup> E.g. there is typically no Balance Sheet and P&L information and no possibility to apply standardised (or even automated) rating methodologies. This results in high handling expenses (typically prohibitively high for banks) and high uncertainty/risk. This is linked with limited ability for the borrower to provide collateral.

The analysis of the potential market gap for microfinance in Europe is not trivial and depends very much on the data availability and on the analysed potential target group (e.g. SMEs only, micro enterprises only, only start-ups etc.). To our knowledge, there is no consistent analysis based on empirical data, however, there are various estimations.

<sup>41</sup> See: EFSE (2008a).

<sup>42</sup> See e.g.: Kritikos, Alexander; Kneiding Christoph (2007).

<sup>43</sup> We do not want to go here into the details of the economics of information (keywords: asymmetric information, credit rationing, signalling, screening, Akerlof's market for lemons, Stiglitz/Weiss model etc.) but refer to the related standard textbooks and articles. German speaking readers can also get a summary in: Kraemer-Eis (1998), p. 22ff.

According to the European Commission, there is a potential demand for the

- EU-15 of more than 550,000 microloans, totalling EUR 5.6bn;
- EU-12 of more than 155,000 microloans, totalling almost EUR 0.6bn;
- EU-27 of more than 700,000 microloans, totalling EUR 6.1bn.<sup>44</sup>

These figures are based on the analysis of the population aged between 15 and 64, the share of people at risk of poverty, the share of potential entrepreneurs, and assumptions about average microloan sizes. The already mentioned individual country studies refer to the supply and demand situation in the various countries. As a country specific example, in France, for the bankable segment ADIE<sup>45</sup> estimates the potential annual demand for microfinance at 113,000 start-up loans and 98,000 loans for financing during the first 3 years following establishment.

For the not-bankable segment, the figures are in the range of 48,000 loans (min) to 98,000 loans (max.) at start-up, and 42,000 loans following establishment.

This demand meets a significant smaller supply of 111,000 loans in the bankable sector (70,000 and 41,000) and only 10,000 loans in the not-bankable segment (8,500 and 1,500) and results to a significant market gap:<sup>46</sup>

**Figure 13: Gap analysis for microlending by ADIE**

		Supply	Demand	Gap
<b>Bankable segment</b>	<b>At start-up</b>	70,000	113,000	43,000
	<b>Following start-up</b>	41,000	98,000	57,000
	<b>Total</b>	111,000	211,000	100,000
<b>Not-bankable segment</b>	<b>At start-up</b>	8,500	48k to 98k	39.5k to 89.5k
	<b>Following start-up</b>	1,500	42,000	40,500
	<b>Total</b>	10,000	90k to 140k	80k to 130k

Source: *European Microfinance Network (2008/2009)*

Also for Germany, KfW concludes in the analysis of the national market that microfinance is – although it is not a mass market - of high relevance for start-ups and existing micro enterprises.<sup>47</sup>

EIF has developed its know-how in the field of microfinance over years by managing specific mandates (MAP, CIP, JEREMIE, and EIB-RCM Microcredit Pilot Facility/JASMINE) or by setting up operations on its own resources. EIF currently covers various segments of the European microfinance market, providing funding (equity and loans) and guarantees to a broad range of

<sup>44</sup> See: European Commission (2007), p. 18f.

<sup>45</sup> ADIE (Association pour le Droit à l'Initiative Economique), provides micro financing and mentoring to enable financially excluded unemployed people to access finance for setting up and/or developing their own business. It is a French nonprofit organisation created in 1989 with today 110 branches, 300 employees, and 22k active clients. A major part of the operating income of ADIE consists of subsidies from the French State, local and regional governments as well as the European Union to cover administrative costs, especially mentoring.

<sup>46</sup> See: ADIE (2009); see e.g. <http://www.european-microfinance.org/data/file/adie-fiche-anglais.pdf>.

<sup>47</sup> See: KfW (2008).

intermediaries from non bank financial institutions close to sustainability to well established microfinance banks. Under the EIB-RCM Microcredit Pilot Facility, in particular, EIF is facing significant demand from European microcredit providers, especially from greenfield initiatives, targeting both social financing (micro-entrepreneurs benefiting from social aid, ethnic minorities, women living in deprived areas...etc.) and more entrepreneurial microborrowers. This segment of the European microfinance market is particularly relevant in the old member states of the EU, where microcredit providers do not always operate on a (financially) sustainable basis. In such cases, the first objective of the microcredit provider is to promote job creation, self entrepreneurship and release pressure on public expenses related to unemployment.

Although the EIB-RCM Microcredit Pilot Facility represents one of the first attempts to provide funding to microcredit providers throughout the EU, EIF is currently only partially able to address the existing demand, mainly for 3 reasons:

- limited resources under the EIB-RCM Microcredit Pilot Facility (EUR 20m to cover EU-27 and candidate countries) and the limited investment period available, given the pilot nature of the project;
- most MFIs in the old member states are of very limited size and are subsidised by public funding, making it difficult to absorb commercial funding;
- as a co-financing facility, EIF's operations under the EIB-RCM Microcredit Pilot Facility need to present an acceptable risk profile for banks' participation and with a sufficiently commercial profile so as to address co-financer's return requirements.

The above supports the evidence that there is a potential market gap in terms of funding of microcredit providers in the EU. Addressing this gap would therefore allow microcredit providers to become sustainable and could enable them to respond to the growing demand from microborrowers.

## Final remarks

In this paper we have analysed the European market for microfinance. Starting with basic definitions we then moved to the European SME landscape and the micro enterprises' economic contribution before exploring the regional differences in microfinance markets and markets' needs.

There are wide spectra of final beneficiaries and intermediaries and there is no common microfinance business model in Europe. In addition to financial support, also non financial measures, like mentoring, training, counselling, etc. are important element of microfinance.

The objective of microfinance is the creation or expansion of income-generating activities. Microfinance provider need to focus on the potential clients that are particularly interested in the microcredit products - the productive users. These (potential) clients can be individuals, start-up companies, or existing companies. On the other hand, as shown above, also the “group” of microfinance providers is not homogenous – there are various business models and the providers are in different stages of the transformation process.

Consequently, the target groups of support measures need to be sufficiently broad in order not to unnecessarily confine the products and to provide efficient support. Moreover, the support measures themselves need to be flexible enough to fulfill the markets’ needs.

A proposal by the European Commission for a EUR 100m “Progress Microfinance Facility” to address the microfinance market gap was adopted by the European Parliament on the 02.07.2009. The proposal envisages that the facility be managed via IFI’s, and in particular the EIB and the EIF. The details of the facility and its implementation have not yet been finalised, and negotiations remain ongoing between the European Commission, the EIB, and the EIF.

## Annex 1: Country Details

The following tables exemplify the microfinance activities in the following European Countries:

1. Bulgaria
2. Czech Republic
3. France
4. Germany
5. Hungary
6. Italy
7. The Netherlands
8. Poland
9. Romania
10. Slovakia
11. Spain
12. United Kingdom

Given the different types of actors and programmes present in the countries of analysis, the following definitions have been used:

**Commercial banks** classify by engaging in the two lines of business cited in the law to define commercial banks: demand deposits and commercial loans. Binding legal requirements, transparency and rigid capital requirements differentiate banks from other microcredit actors.

**Non banking financial institutions** are mainly specialized in consumer loans and leasing. This legal form is very suitable in many legislative contexts for MFIs as it allows the institution to be self-sufficient, (i.e. they do not depend on banks for the disbursement of the loans) and flexible, even though they are quite expensive to run.

**Public Institutions** hold a key position in the microcredit sector at national, regional and local levels as they (i) promote legislation at different levels, (ii) provide microcredit both directly and indirectly.

**Microfinance Institutions** are several types of entities (i.e. cooperative, foundations, associations, NGOs, non banking financial institutions, etc.) which have microcredit as their first and foremost activity.

## Main Indicators in selected European Countries

	Economic Indicators			Microfinance Indicators				Beneficiaries		
	GDP in million EUR (Q1 2009) *	Unemployment Rate (2009) *	At risk poverty rate after social transfer (2007) *	Number of loans disbursed (2007)	Total value of loans disbursed (EUR M) (2007)	Average Loan Size EUR (2007)	Average Interest Rate (%)	Percent of loans to women	Percent of loans to immigrant	Percent of loans to Young People
Germany	591,460.00	7.70%	15%	4,625	52,276,375	11,303	6.92	43%	:	:
Italy	381,732.00	7.40%	20%	3,223	22,451,418	6,966	5.80	27%	21%	11%
Spain	267,317.00	18.10%	20%	8,773	97,800,000	9,943	5.00	67%	47%	33%
UK	382,620.70	7.50%	19%	1,252	13,420,000	10,718	13.40	55%	14%	16%
Romania	30,159.80	6.20%	25%	2,496	18,847,296	7,551	:	:	:	:
Bulgaria	:	6.80%	14%	68,348 **	432,890	6,334	:	60%	19%	17%
Czech Republic ***	33,248.90	6.30%	10%	:	:	4,500	:	:	:	:
Slovakia ***	15,466.10	11.70%	11%	982	155,000,000	157,841	6.50	80%	:	:
France	478,492.00	9.40%	13%	121,000	852,500,000	7,045	0-5	:	:	:
Poland	73,244.80	8.20%	17%	130,888	:	2,024	11.00	44%	:	:
Netherlands	:	3.30%	10%	43,508	739,636,000	17,000	:	:	:	:
Hungary ****	21,925.60	10.30%	12%	104,754	371,876,700	3,550	:	:	:	:

Data for Poland refers to 2006

- \* Eurostat retrieved 10 Aug 2009
- \*\* Microloans fm the Banking sector only
- \*\*\* No specific microfinance products
- \*\*\*\* Unavailability of Primary Data Data refer to 2006
- :

Source: Authors on Eurostat (2006) and EMN studies

**Disclaimer:** The differences in the survey methodologies of the countries of analysis together with the diverse levels of disclosure of central and local banks do not allow this table to be final or comprehensive. It could however be read as a preliminary reference benchmark which is based on secondary data surveys collected by third parties. Further data collection and rigorous harmonization of methodologies should be envisaged to enhance the meaningfulness of the results. The findings of the country details in the following tables are solely based on EMN studies and might not necessarily reflect the exact situation of microfinance in those countries.

## Country Details: Bulgaria

Active Actors	Banks	MFIs
<b>Type of Involvement</b>	<ul style="list-style-type: none"> <li>▪ Bulgarian Central Bank classifies banks in 3 groups:               <ul style="list-style-type: none"> <li>○ Group 1: Large banks (by assets) very active in supporting SME sector and provide microcredit.</li> <li>○ Group 2: Local banks. 79% of which is active in microlending.</li> <li>○ Group 3 branches of foreign banks (ING, City group etc.) not active in microlending.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ Microfinance in Bulgaria includes a group of experienced MFI who piloted projects in the past decade and are now the main providers of microcredit products covering more than 140.000 loans.</li> <li>▪ Main MFIs are:               <ul style="list-style-type: none"> <li>○ Nachala;</li> <li>○ Ustoj;</li> <li>○ Mikrofond EAD;</li> <li>○ Other cooperative unions</li> </ul> </li> <li>▪ Each MFI defines its own microcredit policy, principles and format of operation.</li> </ul>
<b>Comments</b>	<ul style="list-style-type: none"> <li>▪ There is no special law concerning microcredit. Currently the legal framework for micro-scale lending carried out by smaller institutions in Bulgaria is defined by 5 main laws: Credit Institutions Act (CIA), the Commerce Act, the Cooperative Act, the SME Act, and the Non-Profit Legal Persons Act.</li> <li>▪ MFIs in Bulgaria have adopted various legal forms and strategies such as credit union, non for profit NGO, guarantee funds, or for-profit operations enabling MFI to function in a legal environment which hold no regulatory mechanisms for microfinance.</li> </ul>	



## Country Details: Czech Republic

Active Actors	Banks	MFIs
<b>Type of Involvement</b>	<ul style="list-style-type: none"> <li>▪ The financial companies in the frame of microfinance can be grouped as:               <ul style="list-style-type: none"> <li>○ Banks (among which CMZRB)</li> <li>○ Leasing companies</li> <li>○ Consumer loan companies</li> <li>○ Capital investment companies</li> <li>○ Not for profit companies.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ There are roughly 100 leasing companies, 18 consumer loan companies, 7 not for profit companies and 22 capital investment companies.</li> <li>▪ No regulation for the micro enterprises as such nad no regulation exist to coordinate providers of microcredit</li> </ul>
<b>Comments:</b>	<ul style="list-style-type: none"> <li>▪ In Czech Republic, microfinance is not recognized as a separate division of general finance provisions. It started being active around the year 2000 when banks and MFIs started addressing SMEs.</li> <li>▪ There are no institutions on the Czech financial market that would dedicate their activities solely to the segment of microenterprises.</li> <li>▪ More data needs to be collected to assess performance indicators more rigorously: only partial results possible.</li> </ul>	

## Country Details: France

Active Actors	Banks	MFIs
<b>Type of Involvement</b>	<ul style="list-style-type: none"> <li>▪ Banking microcredit offer is estimated to be 110,000 loans with different needs and different access to credit depending on the region.</li> <li>▪ It is foreseen that within 7 to 12 years the microcredit supply will cover the market demand depending on the involvement level of external actors (EU, French Government, other institutions).</li> </ul>	<ul style="list-style-type: none"> <li>▪ Non banking microcredit is offered by Adie (Association pour le Droit a l' Initiative Economique).</li> <li>▪ Adie is presently the only authorised MFI which disbursed 10,000 microloans in 2007 addressing financial and social inclusion</li> <li>▪ Since its creation, Adie's growth rate was 25%/yr. If this trend is sustained, the demand will be met by 2020.</li> </ul>
<b>Comments</b>	<ul style="list-style-type: none"> <li>▪ Micro enterprises represent an important and growing part of the French economic environment.</li> <li>▪ Legislation has improved in the recent past but it remains an obstacle to a general access to finance.</li> <li>▪ Additional data and analysis would allow a more meaningful comparison with other EU countries.</li> </ul>	

## Country Details: Germany

Active Actors	Banks	MFIs
<b>Type of Involvement</b>	<ul style="list-style-type: none"> <li>▪ In Germany, 3 commercial banks give financial support to Microfinance Initiatives:               <ul style="list-style-type: none"> <li>○ KfW (cooperates with DMI)</li> <li>○ LfA Förderbank Bayern (supports GUM)</li> <li>○ L-Bank (cooperates with MONEX)</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ In Germany MFI are public-law institutions allowed to undertake economic promotional activities under public contracts.</li> <li>▪ Microfinance market started activities in 1984 but it remains very young with new actors entering regularly.</li> <li>▪ Dual focus of MFIs in Germany: (i) Inclusion Lending and (ii) Micro enterprise lending</li> <li>▪ Other services include: personal consumer loans, insurance, savings, money transfer, home improvements, debt counselling.</li> </ul>
<b>Comments</b>	<ul style="list-style-type: none"> <li>▪ German microfinance sector is an economically young sector with a number of microloans decreased in 2007 compared to 2004 and 2006.</li> <li>▪ The legal framework is generally unfavourable for the majority of microlending in Germany.</li> <li>▪ More data needs to be collected to assess performance indicators more rigorously: no data available about microloans supplied by the banking sectors.</li> </ul>	

## Country Details: Hungary

Active Actors	Banks	MFIs
<b>Type of Involvement</b>	<ul style="list-style-type: none"> <li>▪ Since 2001 Hungarian banks increased lending to SMEs due to stronger bank competition which led to downscaling of credit-worthiness standards.</li> <li>▪ At the end of 2006, bank credit to SME totalled HUF 3,160 with medium-sized enterprises accounting for 40.4%, small enterprises 30.7% and micro enterprises 28.8%</li> </ul>	<ul style="list-style-type: none"> <li>▪ Consumer loans utilized by single person enterprises are not viewed as microcredit.</li> <li>▪ Cooperative institutions, which are governed by bank loans, make 4 different types of loans:               <ul style="list-style-type: none"> <li>○ Retail loans to individuals</li> <li>○ SME loans</li> <li>○ Agriculture loans and</li> <li>○ loans for self governance</li> </ul> </li> <li>▪ Cooperatives provide loans to 25-30% of entrepreneurs in Hungary mainly in rural areas.</li> <li>▪ MFI developed in 2002, the <i>Szechenyi Card</i> which is an important loan product in terms of microcredit scale and reach.</li> </ul>
<b>Comments</b>	<ul style="list-style-type: none"> <li>▪ Hungary has experienced a dynamic credit growth in the commercial banking sector which has served SMEs with collaterals. High administrative and disbursement costs remain barriers to commercial bank downscaling.</li> <li>▪ No apparent distinction between microcredit and social credit, results in different target groups and in different availability of loans.</li> <li>▪ The government is not leveraging sufficiently its potential role as an enabler rather than a direct provider of financial services to the poor.</li> </ul>	

## Country Details: Italy

Active Actors	Banks	Non-Banking MFIs	Public Institutions	Microfinance Institutions
	<ul style="list-style-type: none"> <li>▪ Banking system does not provide data on loans &lt; 25,000 EUR.</li> <li>▪ As of Sept 08: credit to individual enterprises totalled: EUR 97bn.</li> <li>▪ As of Sept 08: microcredit represents 19.7% of the total credit to the productive sector. With a reduction from 2002 when it was 23.2%.</li> </ul>		<ul style="list-style-type: none"> <li>▪ Involvement of public institution with mentioned total commitment of 200m. Resources still to be disbursed.</li> </ul>	<ul style="list-style-type: none"> <li>▪ In 2007, the 24 institutions disbursed EUR 2.7m for 682 loans.</li> </ul>
<b>Comments</b>	<ul style="list-style-type: none"> <li>▪ Large difficulties in the research related to the quality of the available information; and the scarcity of data affects both banking and MFIs.</li> <li>▪ Further research would allow a more rigorous performance assessment.</li> </ul>			

## Country Details: The Netherlands

Active Actors	Banks	MFIs
<b>Type of Involvement</b>	<ul style="list-style-type: none"> <li>▪ In the Netherlands, both commercial and municipal banks offer microcredit.</li> <li>▪ They cover the needs of different target groups using different types of loans products: Business Loan (with and without collateral), personal loans, and start up loans.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Non-banking MFIs have the market intelligence and know-how to work with disadvantaged groups.</li> <li>▪ BBZ programme of the central government has been the most significant microfinance programme in the country: People depending on social welfare are offered to become self-employed as alternative to formal employment.</li> <li>▪ Other MFI and Private initiatives and special programmes are gradually emerging.</li> </ul>
<b>Comments:</b>	<ul style="list-style-type: none"> <li>▪ In the Netherlands, about 7.3% of the population is considered as low income group. The total potential demand for microcredit is more than 43,000 people.</li> <li>▪ Different initiatives offering microfinance in the Netherlands: they differ by region or target group and in most cases they are financed by the government (both at national, provincial, or municipality level).</li> <li>▪ Fragmented supply of microfinance in the Netherlands results in a striking gap between supply and demand.</li> <li>▪ Further research would allow a more rigorous performance assessment.</li> </ul>	

## Country Details: Poland

Active Actors	Public Institutions	MFIs and Non-Banking MFIs	Credit Unions (CU)	Banks
<b>Type of Involvement</b>	<ul style="list-style-type: none"> <li>▪ Polish Agency for Enterprise Development (PAED) is the governmental agency supporting microfinance through direct and indirect assistance.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Non-banking MFI have the market intelligence and know-how to work with disadvantaged groups.</li> <li>▪ Different types of loans products are: Business Loan (with and without collateral); and start up loans.</li> </ul>	<ul style="list-style-type: none"> <li>▪ In 2006, there were more than 1,500 CUs in Poland, with assets of EUR 1.8+ bn, savings of EUR 1.5+ bn and loans disbursed for a total of more than EUR 1 bn.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Market Share: 98% of values of loans.</li> <li>▪ Extensive spectrum of loans and credits offered.</li> <li>▪ Credit lines to micro enterprises.</li> </ul>
<b>Comments</b>				

## Country Details: Romania

Active Actors	Banks	MFIs
<b>Type of Involvement</b>	<ul style="list-style-type: none"> <li>▪ The financial sector includes 45 banks, 284 non banks financial institutions, 125 credit cooperative, 2991 credit unions, and 5 guarantee funds. Only a few banks and 55 non banks financial institutions develop microcredit activities.</li> </ul>	<ul style="list-style-type: none"> <li>▪ One third of the loans extended to the economy in 2007 were provided by MFIs.</li> <li>▪ Biggest constraint faced by MFIs in reaching the goal of serving the financially-excluded is the lack of funds for technical assistance and lack of dedicated funds for vulnerable groups.</li> <li>▪ Non bank microfinance organizations can be separated into 3 categories: the 5+ years old MFIs, the new MFI set up after the microfinance law entered into force, and the newly set up financial boutiques offering leasing and micro credit service.</li> </ul>
<b>Comments</b>	<ul style="list-style-type: none"> <li>▪ The number of SMEs continued to grow in 2007 despite the negative prediction after the joining to the EU.</li> <li>▪ Geographical and economic dispersion within the country, results in diverse performance figures but the microfinance sector as a whole continues its growth compared to 2005 and 2006 figures. 2007 registered an average increase of 15% in the number of clients and in the value of loans.</li> </ul>	



## Country Details: Slovakia

Active Actors	Banks	MFIs
<b>Type of Involvement</b>	<ul style="list-style-type: none"> <li>▪ High concentration of banking loans in the Bratislava region. This pattern is constant in every economic indicator and it creates problems for the expansion of microfinance across the country as a poverty alleviation tool.</li> <li>▪ SZRB is the main bank (state-owned) focusing on lending to support small business development in Slovakia. It couples the efforts of the National Agency for SME Development (NADSME).</li> </ul>	<ul style="list-style-type: none"> <li>▪ Major MFIs operates as foundations (Integra and Pontis), Rural Organization (VOKA), or NGOs.</li> <li>▪ Lending methodology of MFIs is not standardized and it differs according to the different MFI and NGO involved.</li> <li>▪ Additional MFI services support production of business plans and project proposals.</li> </ul>
<b>Comments</b>	<ul style="list-style-type: none"> <li>▪ The Microfinance market in Slovakia remains undeveloped with no MFI for which microfinance is the core activity.</li> <li>▪ Lack of reliable data does not allow sufficient information for a rigorous analysis.</li> </ul>	

## Country Details: Spain

Active Actors	Banks	Governmental Agencies	Social Microcredit Support Organization (SMSOs)
<b>Type of Involvement</b>	<ul style="list-style-type: none"> <li>▪ Spanish retail banking sector is dominated by a collection of commercial banks, saving banks and credit co-operative banks.</li> <li>▪ Presently, the Saving banks are the only financial institutions that grants microcredit.</li> </ul>	<ul style="list-style-type: none"> <li>▪ State-owned Official Credit Institute (ICO) was another primary pioneer in the Spanish microcredit market.</li> <li>▪ Other national microcredit programmes have been launched to serve the needs of Women and Youth.</li> <li>▪ Other public initiatives exist at Autonomous communities and municipal level.</li> </ul>	<ul style="list-style-type: none"> <li>▪ SMSOs act as intermediaries between the institutional credit suppliers and micro-entrepreneurs</li> </ul>
<b>Comments</b>	Difficulties in measuring the exact size of the market given the limits of available sources and reliability of aggregated data.		

## Country Details: UK

Active Actors	Banks	MFIs
<b>Type of Involvement</b>	<ul style="list-style-type: none"> <li>▪ Highly concentrated banking sector with 4 banks covering most of the market both in retail and small enterprise business banking.</li> <li>▪ No dedicated bank that caters solely to microfinance and lending EUR 25,000 is part of standard operations. Credit availability has been reduced due to financial crisis.</li> <li>▪ The average loan size for lending in deprived areas (as indication of microfinance) is EUR 53,317.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Microfinance in the UK is not recognized as an independent strand of financial provision.</li> <li>▪ In 2001 the establishment of Phoenix Fund developed community financing disbursing capital to both credit unions and Community Development Financial Institutions (CDFIs).</li> </ul>
<b>Comments:</b>	<ul style="list-style-type: none"> <li>▪ Lack of market segmentation in the CDFI sector results in difficulties in establishing main actors in microfinance. No precise data available for gender balance or disabled.</li> <li>▪ More data needs to be collected to assess performance indicators more rigorously.</li> </ul>	

## Annex 2: Acronyms <sup>48</sup>

BoD: Board of Directors  
CEE: Central and Eastern Europe  
CEECs: Central and Eastern European Countries  
CIP: Competitiveness and Innovation Programme\*  
EBRD: European Bank for Reconstruction and Development  
EC: European Commission  
EIB: European Investment Bank  
EMN: European Microfinance Network  
ERDF: European Regional Development Funds  
ESF: European Social Funds  
EU: European Union  
GIF: High Growth and Innovative SME Facility  
GS: Guarantees & Securitisation  
IFC: International Finance Corporation  
IFI: International Financial Institution  
IVCI: Istanbul Venture Capital Initiative  
Jasmine: Joint Action to Support Micro-finance Institutions in Europe  
Jeremie: Joint European Resources for Micro to Medium Enterprises  
LMM: Lower Mid Market  
MAP: Multi-annual Programme  
MFI: Microfinance Institution  
MSEs: Micro and small enterprises  
NBA: Nordic – Baltic Area  
NGO: nongovernmental organisation  
PE: Private Equity  
PVCi: Portugal Venture Capital Initiative  
RCM: Risk Capital Mandate  
SMEs: Small and medium sized enterprises  
SMEG: SME Guarantee Facility  
SRI: Social Return Investment  
TT: Technology Transfer  
TTO: Technology Transfer Office  
VC: Venture Capital

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<sup>48</sup> Please note that not necessarily all mentioned acronyms are used in this document.

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The European Investment Fund (EIF) is the European body specialised in small and medium sized enterprise (SME) risk financing. The EIF is part of the European Investment Bank group and has a unique combination of public and private shareholders. It is owned by the EIB (62%), the European Union - through the European Commission (29%) and a number (30 from 17 countries) of public and private financial institutions (9%).

The EIF supports high growth innovative SMEs by means of equity (venture capital and private equity) and guarantees instruments through a diverse array of financial institutions using either its own funds, or those available through mandates given by EIB (the Risk Capital Mandate or RCM), the EU (the Competitiveness and Innovation Framework Programme or CIP), Member States or other third parties.

Complementing the EIB product offering, the EIF has a crucial role to play throughout the value chain of enterprise creation, from the early stages of intellectual property development and licensing to mid and later stage SMEs.

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