



MICROFINANCE

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Europe

2010 for Social Inclusion

Social inclusion and microfinance – a lot to offer and a lot of potential

By Jan Evers, EVERS&JUNG •

The Debate

By Adrian Chindris, former Capa Finance and Alberto Lopez Martinez, MikroBank •

**Microfinance and social objectives:
how can MFIs demonstrate that they are socially useful?**

By Peter Ramdsen, Freiss Ltd. •

Taking microcredit to the next step: the PerMicro experience

By Andrea Limone, PerMicro S.p.a •

**Reaching out to the hard-to-reach:
A task of institutional capacity building in European non-bank MFIs**

By Michael Unterberg, EVERS&JUNG •



European
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“Microfinance Europe”

is the bi-annual EMN magazine. It provides clear insights into European microfinance programmes, with a specific focus on policy measures that could support the development of the sector. Its in-depth articles offer an up-to-date commentary on what is happening in the different European countries, how policies and practices are implemented and evolving and what recommendations can be made by practitioners, researchers and academics to promote microfinance and microenterprise development in the European Union.

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MICROFINANCE Europe

“Social inclusion and microfinance a lot to offer and a lot of potential”

Jan Evers is an expert analyst and researcher in retail banking and SME finance. He has ten years of international experience related to micro and SME finance and has published over 30 articles and five books on start-up finance, micro-lending, SME banking and regional economic development. In 2001 he founded the company **EVERS&JUNG** now seen as the leading think tank in SME finance in Germany. He is a member of the editorial committee of “Microfinance Europe”.



Reaching out to the excluded to enable them to engage in self-employed activities as a way to secure a decent livelihood is the main objective of the worldwide microfinance movement. In Europe, the outreach of microfinance to socially excluded persons is closely tied to welfare support measures and the regulation of access to labour markets; both issues of growing importance in managing the social fallout of the near-meltdown of financial markets around the globe.

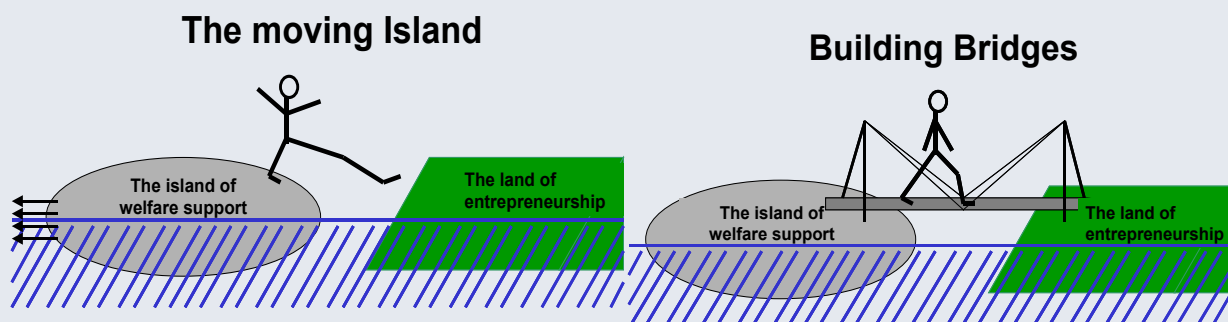
In this regard it seems fitting that the EU Commission has introduced 2010 as the European year of Combating Poverty and Social Exclusion. Together with the fact that a new Commission is now in place and the EU strategy for 2020 is in the making, it marks a crucial junction in turbulent times. The main question is: **how inclusive can European societies become in view of exploding State deficits?**

MY FIRST RESPONSE WOULD BE: IT IS NOT A MATTER OF MONEY, IT IS ABOUT METHODOLOGY.

In the upcoming years, the European welfare states and labour markets are facing an unprecedented **stress test**; it is most likely that they will not survive it unchanged. I am very aware that the situation in Eastern and Western Europe is different: the Western European welfare states are held back from making progress in social inclusion with “that is how we always did it”, the Eastern states have even more fundamental problems being held back by “how to finance it at all”.

MY MESSAGE WOULD BE: MICROFINANCE MAKES SOCIAL INCLUSION CHEAPER.

For the development of microfinance in Europe this touches a neuralgic point. Can microfinance develop into a wide-spread tool in upcoming European inclusion strategies? On the one hand, the provision of microcredit to excluded people is a cost-effective and innovative measure to foster social inclusion and more entrepreneurship at the same time. On the other hand, European welfare states have a built-in problem in supporting entrepreneurship as a way out of unemployment and inactivity. In a past study of EMN members for the Commission¹ this was illustrated by the **metaphor of the moving island**:



When a welfare recipient wants to escape the “island of welfare support” towards the “land of entrepreneurship”, the island slips away just when the entrepreneur needs it the most. One has to ask: Where are the bridges in Europe that safeguard people who take that step into an entrepreneurial future?

Microfinance has proved that it can serve as one important pillar of such a bridge, but it can rarely act as the bridge as a whole. In its response to the Commission consultation on its 2020 strategy, EMN made it clear that there is a need for “a continuous and intensified collaboration between the social assistance system, employment agencies, micro-enterprise development services and the financial system” so as to give European microentrepreneurs the support they need to flourish into livelihood building enterprises.

Let's be frank: there is a danger that the 2010 EU year of combating poverty and social exclusion ends with a déjà vu: national and European policy makers paying lip service to more inclusive and entrepreneurial societies. Therefore we must be realistic in our ambition to fulfil the promise of microfinance as a catalyst for social inclusion, welfare state reform and a more entrepreneurial spirit in Europe. We have a lot to offer regionally but are not yet there in the European mass market.

MY VISION IS A TOOLBOX AS DETAILED AS A FRANCHISE SYSTEM WHERE DIFFERENT INCLUSION METHODOLOGIES BASED ON MICROCREDIT ARE OFFERED AND EACH REGION AND COUNTRY SELECTS THE MOST APPROPRIATE.

It is quite a way to go. It will need persistency and constant innovation on our side and more open-mindedness on the side of policy makers to re-invent European societies as enabling environments for enterprises and self-employment in the 21st century.

The celebration of 2010 as the European year for combating poverty and social exclusion offers EMN and its members a unique opportunity to promote microfinance as an effective tool for social inclusion and poverty alleviation strategies in Europe, and to show ways this can happen. In this regard, the following articles shed light on different aspects of this important task.

Adrian Chindris – Former CEO of CAPA Finance (Romania) - and **Alberto Lopez Martinez** – Director of MikroBank Spain – debate the main questions regarding microfinance as a tool for social inclusion and more entrepreneurship in Europe, e.g.: How can microfinance providers support socially excluded persons

¹ « Policy Measures to promote the use of micro-credit for social inclusion”, study on behalf of the European Commission, DG Employment, 2004

to become viable entrepreneurs? What are the main risks in targeting socially excluded persons with microfinance?

Peter Ramsden presents an exciting approach to explain the social value in microfinance. In his article he introduces a simple and innovative way to measure the social added value in microfinance operations to be used by MFIs to conceptualize their target market and their growth strategy. He also informs us, that French microlender Adie has started to implement an “exclusion scorecard” that was pioneered by Prizma in Kosovo. Another wonderful example of how West learns from East in successful microfinance practice.

In Europe there still exists a widespread notion that social impact in microlending and organisational sustainability are mutually exclusive goals. This is challenged by **Andrea Limone**, who shares the experience of Per Micro in reaching low-income clients in Italy with a business model that aims at operational sustainability in five years.

When we talk about social outreach of microfinance, we also need to ask if European MFIs are yet organisationally equipped to reach excluded clients on a broad scale. My colleague **Michael Unterberg** presents findings from a recent study for the EIF that offer insights into the close interrelation between institutional capacity building efforts and social outreach of non-bank MFIs. His article is a clear call for action to install sophisticated technical assistance services for European MFIs to develop organisationally.

I wish you inspiring reading and a successful social inclusion year 2010.

Jan Evers

EVERS & JUNG, Germany



FOR THE PRESENT ARTICLE, EMN ASKED TWO PROMINENT PROFESSIONALS IN THE FIELD OF MICROFINANCE TO ANSWER QUESTIONS REGARDING THE MISSION OF MICROFINANCE IN EUROPE AS A TOOL FOR SOCIAL INCLUSION AND/OR ENTERPRISE DEVELOPMENT.

WHAT SHOULD BE THE MAIN MISSION OF MICROFINANCE PROGRAMS IN EUROPE?



Alberto López Martínez is the General Manager of MicroBank, the social bank of “la Caixa”. He has worked for the “la Caixa” Group for 27 years, 23 years in the branch network (the last nine managing business areas), and three at the “la Caixa” Foundation, where he was Assistant Deputy General Manager.

Since July 2008 he has been working for MicroBank, which he joined to strengthen the existing team and make MicroBank a benchmark for social banking with a sustainable operating model.



Adrian Chindris is a consultant/expert in MFI institutional development/transformation and strategies. For nine years he worked as CEO of CAPA Finance, the largest microfinance institution in Romania, leading it from the stage of a small foundation to the first phase of transformation into a microfinance

commercial bank. Before that he acted as Operations Manager for an MFI in Azerbaijan. Through CAPA Finance, World Vision International and MEDA, his whole career has been dedicated to microfinance and its role in economic development and financial inclusion.

Adrian Chindris. Of course there is a diversity of situations across Europe and in each case there are specific targets and strategies defined for microfinance programs. One characteristic exists across all of them: the access to financial services ensured to entrepreneurs and even private persons who are not able to access those (or similar) services within the main stream. This being the base, I would say that the mission of microfinance programs is much complex and combines the facilitation of access to finance with services that will integrate the entrepreneurs at the level of knowledge of best practices, legal environment, taxes, associative environment and so on. We need to be conscious that financial exclusion is usually the consequence of a number of factors that translate into social exclusion or large gaps between the developed society and the community where the MFI is working. Efforts should be made by the industry in order to create the necessary awareness (at the political level) and provide the necessary environment and infrastructure for excluded categories of the population (defined specifically for each country or even region) to be able to generate and/or develop profitable economic activities.

Alberto Lopez Martinez: Microfinance should contribute to promoting economic development - by providing support to microenterprises and self-employment -, job creation and to supporting families' needs and, as a result, should be a tool towards social cohesion.

In this sense, the support of microenterprises is a key factor considering their economic significance and their contribution to the creation and maintenance of employment.

Microfinance should also devote special attention to those people who have viable business projects but that, due to cultural, social or economic factors, can have greater difficulties in accessing the traditional

THE DEBATE

financial system. Among these collectives we find people that, due to the economic context, have lost their jobs or face the risk of unemployment; immigrants, youth, women...

IS IT REALISTIC TO BELIEVE THAT MICROFINANCE CAN BE AN INSTRUMENT FOR FIGHTING POVERTY AND SOCIAL EXCLUSION IN THE EUROPEAN CONTEXT?

AC. It is realistic to believe that microfinance can do that but it cannot resolve all the issues by itself. It can resolve the issue of resource availability, but not the fact that the person is socially excluded because he is an emigrant, nor the fact that, for example, the Romanian small farmer will never be a bankable person if he will not increase the productivity of his lands or activities through technology and knowhow or will not be able to sell his products if he does not have knowledge of the expected quality. Theories of development state that microfinance is one of the last activities to be implemented in a community development process. Interventions able to fight poverty and social exclusion should have microfinance as one of the components, but need to be a complex of political, social and economic actions.

ALM There are several factors that can lead to social exclusion and poverty; unemployment is one of them and, in this sense, supporting the creation of new jobs through microenterprises and self-employment projects is a way to contribute to fighting poverty and social exclusion.

HOW DO SOCIALLY EXCLUDED PERSONS BECOME REAL ENTREPRENEURS THANKS TO MICRO FINANCE? WHAT ARE THE SUCCESS FACTORS AND PITFALLS TO AVOID?

AC. It is to believe that, for an excluded person with entrepreneurial skills, it is enough to provide financial resources and he/she will manage. In most cases, especially into an overregulated environment, this is far from being enough. The entrepreneur in a European country needs to be aware of legislation, taxation, rights and obligations (even if sometimes only at a basic level). A very simple formalization of activities is mandatory for growing into a different

level of business. On the other side, microfinance is capable to open gates for entrepreneurs, who otherwise perform exclusively in the “black market”, to bring them into the formal market as tax payers and eventually as future clients of the banks.

There have been lots of discussions within the European microfinance environment regarding the difference between MFI performances in different countries. What drives the success in Bosnia, Montenegro and Romania? And how do we measure the success of a microfinance program? It is always profitability and a few “impact ratios” such as: number of jobs created, number of jobs sustained, number of start-ups, and so on? In my opinion the success of microfinance is still measured subjectively in most cases and profitability of an MFI is extremely important provided it happens with the completion of the social targets. Adaptation of business models to the local (regional or national) target market is one of the key factors, able to ensure long term success. Success can also be catalyzed by proper legislation, intelligent regulatory environment provided by the central banks, and governance systems with double bottom line interests.

Even if microfinance is a proven development instrument, we need to keep in mind that just a small number of the socially excluded persons are entrepreneurs. Overestimation of the potential number of clients in certain areas determines larger amounts in subsidies and a much later (relative to forecasted budgets) breakeven for MFIs. At the same time, focusing on “excluded” persons with a lot of advantageous services in areas where not excluded persons or entrepreneurs are present and wishing to use those services can create fraud or even other types of exclusion. We also need not to forget that the best practices and standards of microfinance from Latin America or Bosnia can hardly be applied as they are in France, Italy or even Romania, and this is mainly due to the structure of the communities targeted: in Latin America and Bosnia, the MFIs are working with a large number of clients belonging to the same community while in EU the targeted clients are most of the time scattered across a large area and just a few are within the same community. The greatest success in microfinance in Romania occurred in the rural communities with a combination of loans for agriculture and consumer finance that made the overall credit activity statistically relevant and eventually comparable with microfinance in the above-mentioned areas.

ALM. Microfinance is a tool, a decisive tool for entrepreneurs because the granting or not of the microcredit can determine the start-up of a business. However, there are several requirements to becoming a real entrepreneur: having a business plan that shows the feasibility of the project, having the appropriate competences, attitude, training...

In order to support those entrepreneurs suffering financial exclusion and who need guidance and training in matters of start-up and development of their business idea, MicroBank has a network of more than 400 partners - Local Development Agencies, Public Authorities, Non-profit Organizations, Universities ...- that provide complementary business services and assess the viability of their projects.

These partners identify the groups - they know the potential beneficiaries - make a true diagnosis on their situation and offer a coherent proposal of the tools needed in order to help them to become real entrepreneurs.

Among the business services provided by the partners there are training activities, expert advice and support for the preparation of the business plan - a key issue for both the granting of the microcredit and the future viability of the business is the preliminary analysis of the business plan and a favorable project feasibility report issued by these institutions.

THERE SEEMS TO BE AN IDEOLOGICAL CLASH BETWEEN TWO VIEWPOINTS: "ENTREPRENEURS ARE INDEPENDENT CREATORS LOOKING FOR THE MARKET NICHE" AND "WE HAVE TO HELP THE SOCIALLY EXCLUDED TO BECOME ENTREPRENEURS". WHAT IS YOUR STAND ON THIS?

AC. I doubt we can state that one of the points of view above completely excludes the other one. The typology of the socially excluded varies across Europe and a combination of the two can determine an adequate behaviour of the microfinance program. The talented entrepreneurs are usually early entry persons and a microfinance program just needs to be there in order for them to decide to apply and use those services. Meanwhile, we do need to create the necessary level of awareness and to provide the necessary assistance in order for the socially excluded to be aware of the existence of the programs and to help them to overcome the legal and technical issues.

ALM. From MicroBank, we want to help and support, through microcredit, the entrepreneurs that have viable business projects in order to contribute to economic activity, job creation and consolidation. Considering that there are collectives that, due to economic, social and cultural factors, can have

difficulties in accessing the traditional business system, MicroBank offers - among its several financial products - the social microcredit, that is a tool specially designed for those who lack guarantees, in order to help them to start a self-employment project. MicroBank provides the financial support through the social microcredit and the network of partners provides the complementary business services and assesses the feasibility of the project.

WHAT ARE THE MAIN RISKS THAT MICROFINANCE PROGRAMMES TARGETING SOCIALLY EXCLUDED PEOPLE FACE? HOW DO WE OVERCOME SUCH RISKS?

AC. There are obvious reasons for me to say that, considering the double bottom line, profit and social impact, ALL the successful microfinance programs around the world have one common characteristic: all are working with relatively large numbers of clients concentrated in the same geographical area. Talking about social exclusion in Europe, there are just a few countries where such concentrations exist and can be easily identified. It is extremely risky for European programs to define performance targets and aim as for the programs in developing countries. Inadequate program definitions and strategies, combined with unrealistic goals, are the main risks for programs targeting social excluded people. (I am tempted to say that special microfinance programs for socially excluded people are making the exclusion more obvious.) The solution becomes obvious: adapt the strategy and programs to the market segment to be served, involve other organisations to provide assistance if needed, obtain the support of the governments, value results other than profit when measuring the real value of the program and, finally, have clear plans to make it possible for excluded people to be treated the same as those who are not excluded (enhance and promote their image as reliable entrepreneurs).

ALM. Considering the survival rate of companies, financing start-ups involves a risk and in the case of those persons who have no guarantee of any kind, this risk has a greater impact.

To overcome such risks, it is important to have an active risk policy and to use appropriate scoring tools that help us to manage the risk.

Other key aspects for reducing the risk are the project analysis as a first assessment of feasibility of the project, the knowledge of the person and the environment and, finally, once the microcredit is granted, it is important to have follow-up services; in our case these services can be provided by our partners.

WHAT ARE THE MAIN DIFFICULTIES IN TRYING TO REACH THE SOCIALLY EXCLUDED ACCORDING TO YOUR OWN EXPERIENCE? HOW DO YOU ADDRESS THESE DIFFICULTIES?

AC. We have examples of many types of programs dedicated to socially excluded people, from health assistance to community development and microcredit, that failed. In most of the cases, as I have already said, the programs failed because they were built based on wishes and not on reality. On the other hand, to reach socially excluded people, an institution needs dedicated funds to be used for researching the communities and a legal environment to allow institutions to take a higher risk without higher costs being imposed. Self-exclusion and lack of trust in any kind of financial institution creates other burdens in reaching and really impacting the socially excluded people. Collaborating with community development organisations and local authorities and developing an adequate culture within the institution are some of the solutions to address difficulties in working with such a market segment. The microfinance client does not have the same characteristics as the normal banking client. Normally you cannot just apply a scoring process and approve a credit. The whole process needs to be the result of a deep understanding of the segment and acceptance of the idea that some of the credit risk can be mitigated through methods that are not usually present in the banking manuals. It also needs to be understood that the post-credit services and relationship have in many cases the same importance as the pre-money analysis. The whole process cannot be developed into an objective business line if people at all levels of the MFI are not sharing the same basic concept of it.

ALM. MicroBank targets microenterprises and the self-employed that need financial support to start up or expand a business, and operates through the network of "la Caixa" branches, a total of 5,325, which means we can offer MicroBank products and services throughout the whole of Spain and makes it possible to be close to the potential entrepreneurs. In the case of the socially excluded, most of them are referred to MicroBank through our 400 partners. These partners are committed to reaching entrepreneurs, giving special attention to those more vulnerable.

THE EU HAS DECLARED THE YEAR 2010, THE "EUROPEAN YEAR TO COMBAT POVERTY AND SOCIAL EXCLUSION IN EUROPE". WHAT IS THE MAIN CONTRIBUTION WE CAN EXPECT FROM THE MICROFINANCE SECTOR IN THIS CELEBRATION?

AC. Be able to show what the real dimensions of the microfinance industry are at the European level and what interest it has raised globally.

Be ready to measure the impact of all the microfinance interventions in all the European countries and compare it with the impact of other types of interventions that involve huge amounts from the governments.

Talk about microfinance as an integrated tool and push the EU to develop legislation that would encourage private initiatives in the direction of social and financial integration.

Be able to talk about the need for such services and show the consequences of the lack of such services for the excluded.

Be able to mobilize the recognised image leaders of such communities and have them contribute to the heightening of the impact.

Organize European and national events and awareness actions in order for the industry to be (officially) recognised as a tool for integration and development.

ALM. The microfinance sector can contribute by providing access to microcredit in order to encourage self-employment and the creation or expansion of microenterprises and therefore contribute to the creation or consolidation of employment.

On the other hand, microfinance has to continue to contribute to financial inclusion, thus promoting equal opportunity.



MICROFIN.

HOW CAN MFIs DEMONSTRATE THAT

Peter Ramsden, Managing Director of Freiss Ltd

Peter Ramsden is a leading social innovator working across Europe with cities in his role as pole manager for the EU funded URBACT programme and communities of practice focusing on inclusive entrepreneurship. He has published extensively on enterprise as a route out of social exclusion and has also focused attention on the role of micro and social enterprises in local development. He has a long standing interest in microfinance and set up Equal Credit - one of the first EU exchange programme between practitioners in the 1990s leading to a learning event in Bergen in 2001. More recently he has evaluated EMN's network activity for three years running. He is managing director of a small mission driven micro consultancy called **Freiss Ltd based in London**.



INTRODUCTION

Adair Turner the chair of the UK's financial services authority was recently quoted as saying thatsome financial activities which proliferated over the past ten years were 'socially useless'.....¹. He was referring to the authors of the financial crisis, the so-called masters of the universe, who created credit default swaps and other derivatives of such baffling complexity that it appears that even their colleagues did not understand what they were doing or that this was a bubble that would explode one day.

In this article I explore the nature of social value in microfinance and the volume of social value created.

Although our natural inclination is to think that Microfinance is on the right side of this debate it also begs the question of how much social value is produced by microfinance in Europe. Most people working in and with microfinance make the assumption that the social value is a 'given', it exists because that was the point of departure of most organisations working in the sector. However, there are a number of deeper questions that we need to address before we can be sure that there is real social value in microfinance. More specifically in the forthcoming year against poverty and social exclusion microfinance practitioners and policy makers will have to be clear about the role that microfinance can play.

Recent revelations may make you rethink some of your own assumptions. One UK microfinance organisation has doubled its interest rate to borrowers to 40%. This level of interest would be usurious in several EU Member States and which is sure to provoke active debate². Many EMN members are making fewer than 100 loans per year to start-up entrepreneurs. Can such a small number justify the considerable start-up and running costs of the small MFI? Other MFIs have gravitated upwards towards making larger loans at the €25,000 end of the EU definition that are more about SME or economic development than they are about combating social exclusion but which are good for the balance sheet and sometimes for their funders.

At a time when social exclusion and poverty appear to be growing in Europe we have to ask whether microfinance is a realistic way of dealing with these problems compared to spending higher levels of tax on traditional forms of social security. Indeed there is a risk that politicians could use arguments about microfinance as a smokescreen for a renewed assault on welfare by governments that want to reduce their deficits and argue that the poor and workless pull themselves up by their own bootstraps through self-employment.

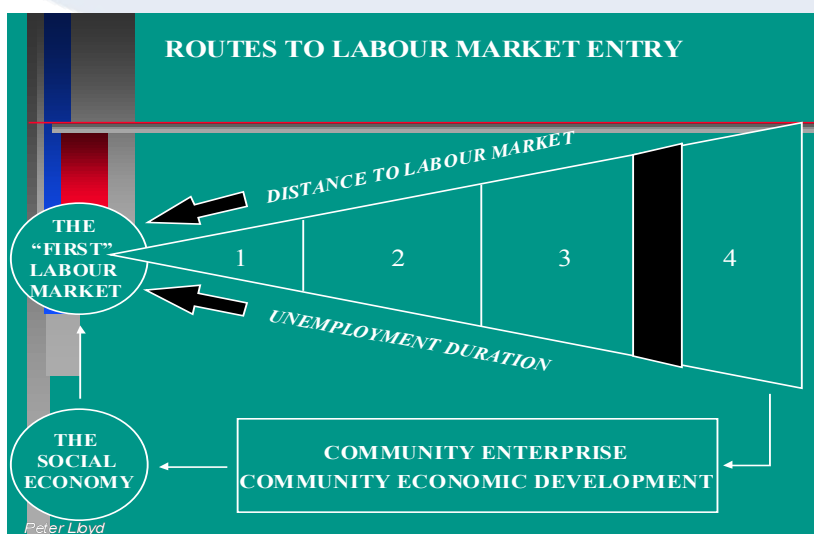
¹ Adair Turner chair of UK's Financial Services Authority: 'Well, I am sorry I spoilt his breakfast, but I do not apologise for being correctly quoted as saying that while the financial services industry performs many economically vital functions, and will continue to play a large and important role in London's economy, some financial activities which proliferated over the last ten years were 'socially useless', and some parts of the system were swollen beyond their optimal size. And if you disagree with that, you have a bone of contention not only with me, but with the Chairman of the British Bankers' Association, Stephen Green, who has said exactly the same thing in very similar words, when he argued that 'in recent years, banks have chased short-term profits by introducing complex products of no real use to humanity', and when he recognised that 'some parts of our industry have become overblown'.

² The argument over interest rates is complex but the defence in this case is that legal predatory lenders using door step techniques frequently charge more than 3-400% for loans and that the rate for informal lending by loan sharks is even higher. To produce a viable model of microfinance albeit with these rates in this market may be preferable than to have people pay these door step rates which are ten times higher.

develop and to become capable of re-entering the world of work. Where more instrumental tactics are used to activate these people the sometimes achieve short term successes but overall the situation reverts to the starting situation. For these clients most public employment services are operating a sort of 'revolving door' policy often using national and European Social Fund to finance short training programmes combined with counselling and job placement. These schemes may have high positive outcomes in the short term but over the longer term – usually after the monitoring period for performance related payments has ended - there is high drop-out. The experience of many of the long term unemployed is of a fragmented employment history with episodes of training and temporary work interspersed with longer periods of unemployment in a type of 'revolving door'. The literature talks extensively of the need for confidence building, capacities, work attitudes etc but these are often only developed when the person is really given time and support to develop. The difference in costs for society between placing someone back into work who has just become unemployed and placing someone who has become disaffected or detached from the labour market can be enormous. The difference in social added value created is equally large.

Peter Lloyd's diagram below illustrates the point about the need for transformative approaches. When he drew it in the mid 1990s he was inspired by the Dutch approach to working with long term unemployed and the Melkert plan published in 1995 which aimed to create jobs for 40,000 long term unemployed people. Unemployed people would be offered a so-called 'Melkert-job,' which was subsidized by the national government. Often these people would work in the public sector, taking a job such as a tram-conductor or high school janitor. The Dutch employment services would classify people according to their length of unemployment - as a proxy for their distance from the labour market. Intermediate labour market opportunities would be offered to those furthest away. In practice these things are not strictly linear – someone with complex problems in mental health may be much further away from the labour market than someone who is re-entering the labour market five years after having a child. All clients regardless of their 'target group' are individuals who are different and often these differences need a personalised and customised approach that large public agencies find challenging to deliver.

Figure 1 Peter Lloyd's Dutch funnel



WHAT IS SOCIAL VALUE IN MICROFINANCE?

Social value is variously defined in the literature on social impacts. Jed Emerson – the originator of the blended value concept has written that:

'Social Value is created when resources, inputs, processes or policies are combined to generate improvements in the lives of individuals or society as a whole. It is in this arena that most nonprofits justify their existence, and unfortunately it is at this level that one has the most difficulty measuring the true value created.'³

³ Jed Emerson Social Return on Investment (SROI): Exploring Aspects of Value Creation in the Nonprofit Sector <http://hbswk.hbs.edu/archive/1957.html>

Two approaches to measuring social value seem interesting for microfinance organisations. Social accounting and social return on investment (SROI) are both used within the third sector, although a critical view might argue that they are more talked about than deployed⁴. The two techniques are not mutually exclusive and can be used in combination.

Social Accounting (also known as social audit) is a reporting mechanism whereby organisations report on their social, environmental and economic performance and impact. Social accounting attempts to reconcile the problem of financial accounts which only report on the financial performance of an enterprise (balance sheet, profit and loss of an organisation) while ignoring intangible and external effects. Social reporting has been mostly driven within the corporate social responsibility movement and has also been used as greenwash by companies such as Shell that had got into reputational problems. Social accounts are increasingly used by social enterprises and some form of social reporting is a requirement of the UK's new asset lock style community interest companies. There are many organisations working within the social audit and social accounting movement. For references see Zadek et al⁵, AccountAbility⁶ and the social audit network⁷.

Social Return on Investment (SROI) started in the USA with work by REDF (formerly the Roberts Foundation) a prominent West coast social investor which uses the approach to monitor the return on its investments in the social economy.

'The core SROI analysis, as presented by REDF, does not attempt to definitively quantify and capture all aspects of the benefits and value that accrue as a result of a successful program, but rather to identify direct, demonstrable cost savings or revenue contributions that result from that intervention. And, with that documentation in place, an SROI analysis argues that the nonprofit should be at least partially compensated and/or credited for the value it creates in the marketplace. Public sector 'pay for performance' and other trends are a move in this direction, but need to be taken one step further, with social impacts being tied back to the 'investment' required to achieve such impacts.'⁸

In Europe it has been promulgated by a European SROI network⁹ and has been championed by the New Economics Foundation. SROI has been defined as 'The process of understanding, managing and reporting on the social environmental and economic value created by an organisation.'¹⁰ Whereas social reporting focuses on measuring whether an organisation achieves its desired social impact, SROI focuses on a means of revealing the missing value that is being created by an organisation. Despite being an attractive proposition there are still relatively few published SROI studies that are available online. An early European example was an SROI of alternative provision for children who had been excluded from schools carried out by NEF which is described in their SROI Primer¹¹. The book sets out six steps to implementing SROI:

- Establishing scope and identifying key stakeholders.
- Mapping outcomes.
- Evidencing outcomes and giving them a value.
- Establishing impact.
- Calculating the SROI
- Reporting, using and embedding

For the purposes of microfinance institutions (MFIs) SROI offers a model that is more likely to be relevant to external funders who are interested in the social value that is being created. This is because it enables value to be assessed in relation to what the stakeholder wants from their involvement with the MFI¹². In the same article

4 80 examples of social accounts are reported on the Social Audit network website socialauditnetwork.org.uk

5 Simon Zadek, John Pearce and Peter Raynard 1996 Social accounting for small organisations

6 AccountAbility 2006 Guidance notes on the principles of materiality, completeness and responsiveness, <http://www.accountability21.net/publications.aspx?id=380>

7 <http://www.socialauditnetwork.org.uk/>

8 Excerpt from the article "Social Return on Investment (SROI): Exploring Aspects of Value Creation in the Nonprofit Sector" in the Roberts Enterprise Development Fund Publications

9 <http://www.sroi-europe.org/>

10 Scholten, Nicholls, Olsen and Galimidi 2006 Social Return on Investment: a guide to SROI analysis and Nicholls, Mackenzie and Somers Measuring real value, a DIY guide to Social Return on Investment New Economics Foundation

11 <http://sroi.london.edu/Measuring-Social-Impact.pdf>

12 Jeremy Nicholls 2007 Why measuring and communicating social value can help social enterprise become more competitive, Office of the Third Sector UK http://www.cabinetoffice.gov.uk/media/cabinetoffice/third_sector/assets/measuring_communicating_social_value.pdf

Jeremy Nicholls makes the point that 'value is in the eye of the stakeholder'. Social Return on Investment seeks to identify a wide range of indicator of impact and then to convert these indicators into financial values. This estimation of social return can then be compared with the costs (the investment) to give a ratio. Positive ratios provide social benefit and justify the investment. This argument can be used with funders to demonstrate that their investment is good value for money.

SROI is a similar methodology in principle to cost benefit analysis which also works by calculating benefits that are converted into monetary quantities. The major difference is the way that externalities and the hidden voices of stakeholders are actively sought out in the process of calculating financial benefits and costs. The process is argued by practitioners such as Nicholls to be more complete than cost benefit analysis and to provide more equality by including the voices of those who are normally excluded from financial calculations of benefits. Indeed the determination of financial coefficients or proxies is often done as a participative stakeholder exercise.

In the context of funding from the European Union under its cohesion policy objectives the measurement of social and economic impact or value is likely to be especially important for applications for ESF and ERDF funding. It is also likely to be highly relevant to gaining support under the new European Microfinance Initiative which has its roots in the PROGRESS programme which has a strong social inclusion flavour.

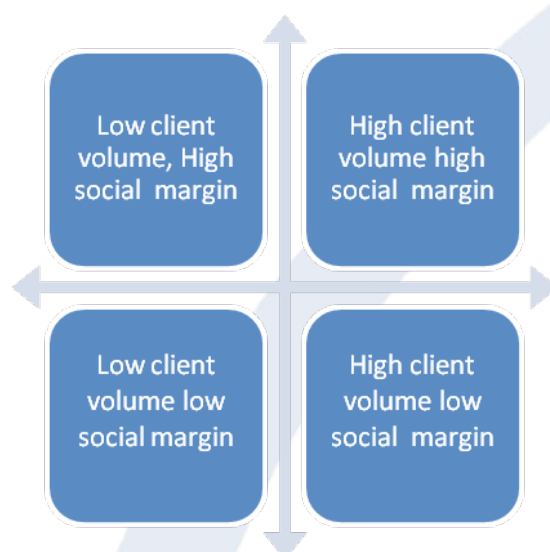
The most important social impacts for MFIs are likely to lie in employment activation of disadvantaged people both through helping people into self employment and also through entrepreneurship support programmes that increase employability even when the client has not gone into self employment¹³. Other social benefits are likely to be around financial literacy, capability and resilience. SROI is being increasingly used by social enterprises and use is becoming better understood within ESF circles including the Managing Authorities. The use of the technique by MFIs would therefore fit into this emerging framework for measuring social returns that is increasingly understood among a range of social economy players.

CALCULATING SOCIAL ADDED VALUE

This article posits a simple way of measuring social added value as a step towards doing SROI that can be used to help MFIs to conceptualise social added value and help to give focus to ideas about their target market and their client growth strategy.

It is widely accepted that : $\text{Gross profit} = \text{gross margin} * \text{volume}$

In this formulation it becomes evident that strong gross profits can be generated either by high margin, low volume businesses such as luxury goods, or by low margin and high volume businesses, such as grocery retailing.



This paper argues that an equivalent formulation can be used to help us to think about social added value in the employment field:

¹³ e.g. Princes Trust studied drop outs from their lending programme and found that their 70% of their 'failures' went from self employment to full time formal employment

Social added value = social margin * volume of people affected

In terms of the client groups that microfinance operators attempt to support there can be high volumes of low social margin people that are supported – for example people that have only recently lost their jobs and who are trying to get back into the labour market as quickly as possible. Alternatively the same social added value can be created by targeting lower numbers of people with high social margin – for instance those that have been unemployed for a long time, those with complex problems such as drug addicts or those who require multiple interventions in order to help them to access the labour market such as single parents or the disabled or the homeless. This equates to the debates that are often played out in microfinance circles in the third world about whether micro-finance should be helping the poor, the very poor or the not poor.

THE VOLUME OF LENDING BY MFIs

The other part of the equation is the volume of lending. In 2007 across the EU 2(7) 42,750 loans were disbursed with a value of €394 million. The main target groups were financially excluded individuals, women, unemployed people, ethnic minorities and migrants¹⁴. 26,957 loans were disbursed in the former EU 15 with the largest numbers being disbursed by national lenders in France, Germany, Spain and Finland. In the Eastern countries of Hungary, Bulgaria, Slovakia, Romania and Poland 15,793 loans, 37% of the total, were disbursed with a total book value of €94million.

The organisations in the EMN survey reported that they had 121,677 active borrowers at the end of 2007 (a considerable increase on the 48,000 reported at the end of 2005) and that these same organisations had made 237,495 loans since launching their programmes. This illustrates the rapid growth of the sector but also its small size.

Even in France, the Western European country in which microfinance to assist unemployed people into the labour market has made greatest progress, the numbers are relatively modest. In 2007, ADIE and France Active made 22,500 loans to assist people to start a business. The total numbers starting a business in France in that year were 320,000 meaning that the two main sources of microfinance were reaching about 7% of the start up market. At the end of 2007 before the recession really kicked in, France had an unemployment rate of 7% with 2.166million unemployed¹⁵. The figure has since risen to over 9.5%. In 2007, microfinance organisations in France were reaching about 1% of the unemployed. In France the highest levels of inactivity are in the young population where only a quarter work and in the over 55s where just over one third are working¹⁶. Does this mean that these two demographic groups should be the priority for microfinance?

However, when we compare these figures with the scale of the employment and social crisis facing Europe it is apparent that the contribution of MFIs to creating jobs is small in relation to the scale of the problem. The employment rate is the most relevant Lisbon target for microfinance. The target is to have an employment rate for men of 70% and for women of 60% and 50% for older workers. Only four countries Denmark, Netherlands, Sweden and UK had achieved the Lisbon targets by 2007 with five others not far behind. Since the crisis, the situation has worsened considerably as unemployment has risen especially for young people. Even at the high point for employment in Europe a further 22 million jobs were needed to achieve the employment rate target in all Member States. Now with growing unemployment across the Member States that figure had risen by a further 9million in November 2009.

14 These 'target groups are not mutually exclusive, clearly it is possible for the same person to be young, female, migrant and unemployed etc.

15 http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-SF-09-053/EN/KS-SF-09-053-EN.PDF

16 http://www.oecdobserver.org/news/fullstory.php/aid/1043/France_92s_employment_challenge:_Mobilising_young_and_old.html

TARGETING BY MFIs

Most MFIs are currently in the low volume left side of the graph in figure 1, they concentrate on the 'low volume, low social margin' with a few trending towards the right hand side either by chasing higher volumes or by focusing on clients with greater needs that can deliver higher social margins (e.g. migrants, women returners, banlieues/disadvantaged neighbourhoods). Few MFIs in Europe are delivering on both margins and volume although this has been achieved in microfinance programmes in some developing countries .

In terms of which groups microfinance institutions in Europe are targeting. EMN found that across Europe 44% of clients were women, 2% went to ethnic minorities 12% to immigrants, 12% to youth and less than 1% to people with disabilities. In general, these are encouraging figures with the exception of support to people with disabilities. However, it is important to note that they may tell us very little about social exclusion or poverty. To take women as an example the fact that 44% of clients are women is at first sight impressive when less than a third of enterprises in Europe are started by women. However, with such a large category making up over half of humankind, it is clearly possible that either very advantaged or very disadvantaged women might have been the client group. We simply do not know when all we record is the gender of clients.

Similarly, analysis of migrant and ethnic minority clients in the past has often failed to identify the gender dimension. In some minority ethnic groups such as those from Pakistan and Bangladesh in the UK there is a 70% male employment rate but the rate for females is below 30%. The self-employment rate for these women is less than 1% compared to 15% for the men. It follows that to support self-employment among males from these backgrounds is relatively easy, whereas the same achievement among females is much more difficult. Averaging in a single figure for 'ethnic minorities' disguises and conceals these enormous gender differences.



The state of play on microfinance metrics concerning target groups is that few microfinance organisations maintain detailed records on the characteristics of their clients. In general reporting (when it is done at all) is done by extremely broad categories covering: gender, employment status, ethnicity (in countries where this is allowed) and age. With broad groupings like these, there can be considerable variation within a category – gender being the most obvious example where approximately half the population is female. Very little analysis of clients is published which dig deeper into this data – for example looking at borrowing by young women. Not much is known about the employment status of clients after they have paid back their loans.

Only better data, deeper analysis, cross tabulations and more nuanced targeting strategies will really tell us whether such figures are impressive or average and more specifically whether helping the person has created a lot or a little of social added value.

Very few organisations have attempted to go deeper into the analysis of these more nuanced characteristics of their clients. Among Western European microfinance practitioners, ADIE is a rare exception. In 2007, they worked with Cerise an NGO specialising in the measurement of social performance in MFIs in developing countries. Together they developed an exclusion scorecard appropriate to a European setting. This scorecard produces a single score between 1 and 19 for each client (where 19 is the most excluded and 1 is the least). The score is built up from fifteen exclusion indicators following the original and more basic approach developed by Prizma in Bosnia. This analysis helps to ensure that ADIE is not drifting from its mission. The score averaged for all clients in 2008 was 8.56 compared to 8.10 in 2006¹⁷ showing a modest improvement in their outreach. It also enables more detailed analysis of the dimensions of exclusion among the clients that are supported so that gaps and trends can be properly understood for each regional office.

17 ADIE report on social impact 2007

Cerise in France has developed some methodologies for attempting to monitor the social impact. In their social performance tool, which is designed for developing countries, they identify three main strategies for targeting:

- Geographic: Selection of operating areas
- Individual: Use of targeting tools and procedures
- Pro-poor methodology :
 - Social collateral,
 - specific approach for remote areas or excluded populations,
 - transaction size

It will be critical in the future to develop tools appropriate to specific European situations and also to build capacity in each Member State for measuring social performance. Ideally in the longer term there could be moves towards the creation of some type of social rating system perhaps set within a common SROI methodology so that performance between EMN members in different Member States can be compared. This means that more groups like CERISE providing technical support to MFIs in measuring social performance will need to emerge. This creation of capacity within the MFI community allied to a common methodology could form the part of the agenda of the new Working Group on social performance established within the EMN structure. Innovation will be required to develop new metrics for measuring depth of outreach, the characteristics of and distance travelled towards the labour market and for tracking this over time. The social return on investment (SROI) techniques may need to be developed and adapted for microfinance, perhaps drawing on measurement coefficients already developed for Work Inclusion Social Enterprises, which have similar client groups and activation objectives.

To improve their performance on social value MFIs in Europe are likely to need to think more about their own strategies for outreach to their client or target groups and about creating a more detailed picture of who their clients are. In their strategies they will need to work out their own trade-off between volume and social margin in order to maximise their social added value.

MFIs will also need to collect better data on their clients in order to protect themselves against accusations of irresponsible lending by making sure that it does not happen. This is especially needed in the post crisis environment where over-indebtedness is widely seen as having contributed to both individual and societal problems. Evidence is emerging in some developing countries of the role of MFIs in contributing to the over-indebtedness. In situations where there are several lenders arrangements for sharing data on clients may be needed between MFIs.

Most importantly they need to develop tools that can enable them to prove to a wide range of stakeholders (funders, partners, clients and communities) that they are really making a significant difference for meaningful volumes of clients. It will be this combination of volume and social added value that proves to government funders, social investors, other NGOs such as EAPN¹⁸ and to the clients themselves that microfinance really does make a difference for good. SROI offers a useful framework within which to do this estimation of societal benefits. The European year for combating social exclusion and poverty offers a good opportunity to make a start.

18 European Anti Poverty Network

TAKING MICROCREDIT TO THE PER

Andrea Limone, C.E.O. PerMicro S.p.a.

PERMICRO IS THE FIRST ITALIAN COMPANY SPECIALIZED IN MICROCREDIT. IT IS A FOUNDING MEMBER OF RITMI (ITALIAN MICROCREDIT NETWORK) AND MEMBER OF EMN (EUROPEAN MICROFINANCE NETWORK). ITS ACTIVITY IS INSPIRED BY THE YUNUS MODEL. PERMICRO S.P.A RECEIVED THE ITALIAN AWARD ON GOOD PRACTICES FROM THE GIORDANNO DELL'AMORE FOUNDATION IN 2009 AT THE EMN 6TH ANNUAL CONFERENCE.

Andrea Limone became PerMicro's CEO after some experience in the Italian microfinance sector. He was responsible for European projects for Banca Popolare Etica and was a branch director at Mag2 Finance, an ethical financial cooperative. He was a researcher at the Giordano Dell'Amore Foundation, working on the publication "Microfinanza in Europa" (Giuffrè Editore, 2004). Andrea has edited publications on microcredit and the banking system: "Banche e Microfinanza" (Bancaria Editrice, 2006) and "Otto modi di dire microcredito" (Il Mulino, 2006).



There are many other stories like the ones of Julia and Ben, people that took the chance to become entrepreneurs and express themselves and their capacities. They found in microcredit the perfect ally to start their new venture. Since the actual crisis affects everyone, microcredit can really become an innovative and effective response for anybody who needs an opportunity to face momentary difficulties through exploiting his/her own capacities and abilities. It is time for the sector operators to take microcredit to the next step in order to promote further financial and social inclusion, which represents their main objective.

STORIE

Julia is a young Romanian lady who has always worked as a tailor for big clothing companies. At the beginning of this year, due to the crisis, she lost her job but she didn't lose faith in the ability of her marvelous hands. She opened a small workshop, which pretty soon became a point of reference in the area and within her community.

STORIE

Ben is a gorgeous guy who has dreamed about owning a meat shop since he was really young. When he came to Italy though, he decided that it was too risky to immediately build up his business, so he started working as a cook in several restaurants. Last year the place where he was employed closed down and he felt it was the right occasion to try his way. He put together the meat shop as in his dreams and now he has got a long list of clients not only among his community but also among the locals.

TO THE NEXT STEP: MICRO EXPERIENCE

THE ITALIAN SCENARIO

The microcredit concept is not new in today's society. In fact, Italy is considered by some people the place where the modern banking system was born and also the place where financial instruments started to be offered to low-income subjects. Among the first institutions doing this job were the "monti di pieta francescani" in the XIVth century – for them charity should help to maintain someone alive not to live, since life depends on what each person produces and charity doesn't push production. They were quite ahead of their time, already talking about issues like financial and social inclusion.

Nowadays, although competition is stressed by the global economy, which tends to privilege the big companies against the small ones, the Italian manufacturing sector is still dominated by small-scale enterprises. In 2006 in Italy, the average enterprise size was around 3.8 employees and companies with less than 10 employees corresponded to 94.9% of the total, providing jobs to 47.7% of the people in the country. In order to survive and be successful, these companies desperately need access to credit, something that in recent times has been strongly scaled down because of the "poor faith" feeling spreading among the banks. On the other hand, the same banks are asking for early reimbursement of the previous credits, supplied during the so-called bubble times. This situation leads to two consequences – on the one hand, the entrepreneur is often forced to look at unconventional ways to access credit, on the other, while unemployment is rising, the Bank of Italy registers the rate of financial exclusion for Italian families at around 10.8%. Here you understand why, in a contest where public measures will decrease more and more due to lack of funds, microcredit is such a revolutionary instrument to fuel the country again. Moreover, 90% of the potential customers are composed of immigrants and, looking at the growing rate of this segment, we can actually assume that the demand for microcredit is also growing strongly.

In Italy, there are many small institutions operating in the microfinance sector with the aim of proposing a solution to social exclusion. The business model they normally use is the following:

- A volunteer organisation does the pre-analysis of the requests to verify the ability to reimburse and the reliability of the client. Moreover, they support the client in business planning;
- A private banking foundation puts together a fund to guarantee eventual losses;
- A bank does the financing.

Most of these institutions work locally and depend on donations from private individuals and/or public funds. This way of acting has been pretty successful during recent times although it captures only partially the potential customer base due to the small size of the eventual credits and the geographical limitations. To answer the growing demand for microcredit one should accept the challenge of providing a service at the same time sustainable, with a long-term view, and largely available over the whole country.

THE PERMICRO EXPERIENCE

PerMicro decided to take up this challenge applying a new business model. The company was founded in 2007 based on the following principles as pillars:

- Putting a team of professionals on the job instead of a team of volunteers;
- Supporting a business model close to the market models vs a charity approach;
- Developing credit scoring and standardized procedures vs the fragmentation of competences and know-how
- Bearing all the risk of the credits vs using guarantee funds
- Aiming at scaling up the business as much as possible vs keeping it local;
- Organizing a capillary presence over the whole country vs an isolated offer
- Focusing on self-sustainability in the short term vs depending on donations

Today PerMicro has moved from financing through a third party bank to a direct financing model. Even if the management costs are really high, especially in the start-up phase, PerMicro aims to become self-sustainable in five years time. Since starting the activity in January 2008, the company has processed more than 4,000 applications, interviewed more than 2,000 people, and financed more than 450 projects. In 2009, the outstanding loan amount will be around over €2,3 million, the average loan being €5,800 with the highest peak reached being €15,000. Normally the reimbursement period was from 24 to 48 months and the interest rate from 8 to 12%. Around two-thirds of the microcredits were for family needs, especially household expenses (35%), medical expenses (13%), car expenses (11%), financing of past debts (11%), and education (2%). The rest was the fuel for starting around 130 microenterprises, most of them in the retail segment (41%), services (31%), hospitality (12%) and building (5%). Finally, it is interesting to note that 60% of the financed people were foreigners, and 84% involved microcredit for new ventures. PerMicro is expecting to finance 1,500 projects in 2010 for a total outstanding of €9 million.

Although it has been a success so far, something important to notice is that only 8% of the applications have been financed in the case of business credits, while it is 15% in the case of family credits. These low percentages highlight the difficulties that microcredit instruments have to face when operating in western countries, specifically:

- First of all it is very difficult to find good contacts;
- Secondly, there is lack of the minimum features required to access the instrument (i.e. belonging to a committed social network, ability to reimburse, sustainability of the proposed venture, etc.);
- The basic capital to start a business in the west is generally pretty important;
- There is a well developed banking system always offering new products;
- Finally, the presence of a welfare state stops the stimulus towards risk.

The biggest challenge for PerMicro is exactly to convert “unbankable” people into bankable people, granting them access to the traditional financial system. A wider objective is to promote the entire society through this activity based on the belief that financial exclusion, unemployment and social exclusion are strictly correlated. In fact, as highlighted in the European Commission report “Financial services provision and prevention of financial exclusion (2008)”, if social exclusion automatically leads to financial exclusion, the latter is part of a process that may cause the former. Being excluded, or feeling as such, can sometimes have its origins in a real difficulty in accessing the right channel. For this reason the product PerMicro offers is enriched by training and consulting services along all the steps prior to the financing. From the very first meeting, throughout the definition of the family balance sheet or the business plan, to the credit provision and monitoring, to the reimbursement, the PerMicro staff support the client by giving information related to legal, administrative, managerial, fiscal and marketing aspects in order to help them to get the money and manage it properly.

Even if today the statistical valuation of the impact of the activity is being defined, PerMicro can affirm it obtained significant results in terms of companies started, people employed and families helped. But one of the biggest difficulties PerMicro had to face was the lack of information on the opportunities represented by microcredit. When

talking to the network (public administration, associations, parishes, etc.) the reference people are generally surprised by the interest rate finally applied (around 9-12%) and reluctant to spread the activity of the company among their associates. Very few of them, in fact, understand that such a rate is built on the risk related to the new ventures and that the costs of management are very high when compared to the volume of the business. To conclude, if on one hand the challenge of PerMicro is to break even in five years, on the other it is clear that the rise in the cost of financed capital is almost unavoidable.

SOME CONCLUSIONS

Coming back to general thinking, microfinance and especially microcredit, in Italy as in Europe, could help social inclusion and push economic growth through the start-up and development of small businesses.

The success of a company such as PerMicro depends on its capacity to scale up the business model and achieve its social mission and on the ability to market the opportunity of microcredit. Examples of how PerMicro makes it happen are found in its everyday work, through conventions with ethnic associations, promotion of local business competitions, organization of cultural events such as exhibition for new young artists and sponsorship of multiracial sporting tournaments.

Moreover, within this context, the strengthening of a European network of microfinance institutions (such as EMN) represents an important goal to achieve. First of all, it is necessary to point out that the network should reinforce the delicate role of selecting and spreading best practices used by the various institutions operating in all the countries, pushing towards the exchange of ideas and the sharing of know-how developed.

Given the potentially growing number of adherent MFIs, the network should undertake the role of privileged interlocutor for the European institutions, in order to influence the creation of a common policy for credit regulation. This is especially true since up to now the member states can limit the activity of the local institutions according to their will. In some case this seriously penalizes the activity of MFIs through the interest rate cap fixing. The network should also support the initiatives of private and non-private players willing to develop the microfinance sector and should be the privileged channel for explaining to Europe the current difficulties they are going through, such as the lack of technical assistance and the funding issues. Finally the network should promote a better communication strategy towards potential customers in order to inform them about all the possibilities of microcredit in the fight against poverty.

Julia and Ben are showing us one way, let's connect and not waste their efforts.



REACHING OUT TO THE HARD-T A TASK OF INSTITUTIONAL CAPACITY BUI

EVERS&JUNG COMBINES RESEARCH AND CONSULTING IN FINANCIAL SERVICES. ITS WORK IS BASED ON A PHILOSOPHY OF USING FINANCIAL SERVICES TO SOLVE PROBLEMS INTELLIGENTLY. THE FOCUS IS ON RETAIL BANKING, OR MORE PRECISELY, THE QUALITY OF BANKING PRODUCTS AND ADVICE, FINANCING FOR SMALL BUSINESSES, AND FINANCIAL SERVICES TARGETED FOR SOCIAL BENEFIT. MICROLENDING IS ONE OF THE CORE ACTIVITIES OF **EVERS&JUNG**.

Michael Unterberg is a researcher in microfinance, SME finance and entrepreneurship. Since 2003 he has engaged, on behalf of **EVERS & JUNG**, in different EU-funded projects on the development of policy measures to foster microfinance in Europe. He is a member of the EMN-Working-Group on legal environment and regulation and was involved in the recent study on capability building in MFIs on behalf of the EIF.



While the availability of funds for microfinance activities in Europe is growing noticeably, the institutional capacities in the sector for transforming these funds into microcredit deliverance with measurable social impact are at best at a stalemate. This is one of the results of a series of market studies on the supply and demand of micro-credits in eight EU member states¹. They were part of a project commissioned by the European Investment Fund (EIF) to the European Microfinance Network (EMN) as one of the preparatory steps in implementing the JASMINE² facility of the European Union. The following article highlights the most important findings from this study that are related to the issue of social inclusion through microfinance. It argues that institutional capacity building of non-bank MFIs has to be regarded as a key challenge of the upcoming years in developing microfinance activities in Europe. Not only as an essential precondition for more sustainability and efficiency in the sector but also for enlarging the outreach of European MFIs to socially-excluded clients.

BACKGROUND

Every analysis of the institutional models of micro-credit provision in Europe has to start from the rather profane insight that, in Europe, the provision of microcredit has developed on a very different track from the developing world. It evolved over the past twenty years in very challenging environments characterised by:

- Post-industrial economies with highly evolved banking sectors oriented towards minimising the risk exposure of their portfolio while maximising profit rates, resulting in the financial exclusion of certain kinds of clients and entrepreneurial projects (**Western Europe**)
- Transition economies with high rates of self-employment as a result of post-communist lay-offs and lacking the financial infrastructure to finance start-ups and low-scale entrepreneurial activity. There was also an ongoing funding activity by (mostly US) foreign aid agencies with experience in microfinance in developing countries. (**Eastern Europe**)

¹ Western Europe: Germany, Italy, Spain, UK; Central Europe: Czech Republic, Slovakia; Eastern Europe: Bulgaria, Romania
² Joint Action to support microfinance institutions in Europe

O-REACH: LENDING IN EUROPEAN NON-BANK MFIs

Given these environments, a diversity of approaches developed towards the task of delivering micro-credit to financially excluded people. For analytical purposes, it is helpful to summarize these approaches into two main segments of microlending in the European Union³:

- **microenterprise lending** - lending to financially excluded microentrepreneurs and start-ups that are “nearly bankable” and can upgrade to mainstream financial services in the short to mid-term..
- **inclusion lending** - lending to financially and often socially excluded clients that are “non-bankable” and will remain excluded from mainstream financial services in the mid to long term. The loan amounts are typically lower than in microenterprise lending.

The institutional models of microcredit provision that have evolved in these two segments are equally diverse as the approaches used. Institutions that are active in the market encompass nonprofit organisations, state agencies, commercial banks, promotional banks, specialised microcredit banks and credit unions. Of these institutions, those that give out loans without a banking license⁴ can be grouped into the category ‘Non-bank MFIs’.

They are mainly active in the segment of inclusion lending, and can be regarded as the most important actors in bringing microcredit to the socially excluded. The non-bank MFI sector in Europe has been growing for some years now in pure numbers, as the annual EMN surveys have shown. But what is still unclear to most observers, is the level of institutional capacity that these organisations have reached. Do they already act on institutional levels that allow them to serve their target groups efficiently and with measurable impact? And if not, how far are they away from reaching such levels in the upcoming years? Especially for political actors on the European and national levels, this is a crucial question in the development of microfinance.

INSTITUTIONAL DEVELOPMENT OF NON-BANK MFIs IN EUROPE

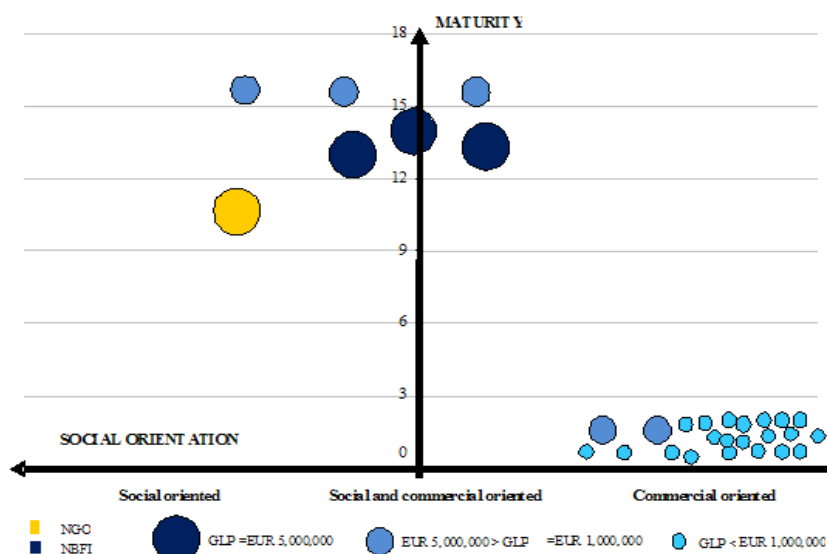
The study on behalf of the EIF showed that, for assessing the institutional capacity levels in the European non-bank MFI sector, it is crucial to acknowledge that these organisations are right now in very different stages of their institutional development. In Eastern European countries, we find many ‘mature’ non-bank MFIs that were created from 1992 on. In Western Europe, except for France and the UK, most active non-bank MFIs were only created over the last five years.

Common understanding of organisational learning would suggest that the longer an organisation is active in the market, the higher should be its institutional capacity in dealing efficiently with its clients. In this regard, a first observation can be made that in some Eastern European countries the recently established non-bank MFIs tend to be more commercially oriented than the mature ones. The following graph illustrates this finding for the Romanian market.

³ It is nevertheless important to realize that the recent financial crisis has blurred the borders between these two segments of the micro-credit market in Europe. Even start-ups and micro-entrepreneurs that would have been regarded as “bankable” in past times nowadays encounter difficulties in accessing financial means through mainstream credit institutions.

⁴ In countries in which onlending is prohibited without a banking licence, non-bank MFIs engage in microlending through cooperation models with banks, e.g. in Germany.

Graph 1: MFI Segmentation in Romania



Source: Eurom Consultancy and studies - Benchmarking Romanian MF Sector 2007

This becomes more relevant as the typical clients of many European MFIs right now are micro/small business owners and self-employed people who are on the verge of graduating to formal financial services as a result of economic development, financial sector growth and the critical support they have received through microfinance. This ‘upscaling’ in the client base of MFIs is connected to the fact that microlending to excluded, vulnerable people is a task ridden with institutional prerequisites. Excluded target groups such as migrants, disadvantaged ethnic groups (e.g. Roma people), women (especially single mothers), the disabled, long-term unemployed or welfare dependents are very diverse in their support needs and often limited in their entrepreneurial motivation, abilities and capabilities.

For micro-credit providers, this means a high risk of default when dealing with these target groups. Building up functioning financial support schemes for them is not limited to giving out and monitoring the repayment of loans but requires high levels of institutional capability in areas like screening, human resources, performance analysis and additional support services.

Examples of European MFIs that have proven successful in reaching those target groups in an efficient way include ADIE (France) and Fair Finance (UK) in Western Europe as well as Fundusz Mikro (Poland), Capa (Romania) and Prizma (Bosnia and Herzegovina) in Central and Eastern Europe. Several studies on best practice in microfinance⁵ have shown that a key success factor that those institutions share is their commitment to constant innovation in institutional routines and organisational learning. But what exactly are **the main institutional capacity aspects that enable some MFIs to serve vulnerable and excluded target groups better than others?** And, even more importantly: how can the other MFIs follow these examples and build up their capacity in efficient and sustainable inclusion lending?

DIMENSIONS OF INSTITUTIONAL CAPACITY

So far, there is only little information about what works and what does not in building institutional capacity in non-bank MFIs in Europe. In the context of a recent study commissioned by EMN, an intensive literature review was conducted by EVERS & JUNG, looking at capacity building experience in microfinance in developing countries⁶ and in different but related sectors such as non-profit organisations.⁷ The identified dimensions are

5 E.g.: Forster, S / Green, S. / Pytkowska, J (2004): The State of Microfinance in Central and Eastern Europe and the New Independent States; Evers, J. / Lahn, S. (2007): Microfinance in Germany and Europe. Market overview and best practice examples.

6 Source: CGAP (www.cgap.org)

7 Source: Venture Philanthropy Partners; McKinsey & Company.

1) vision, goals and strategy; 2) sustainable funding models; 3) human resource management; 4) organisational management; 5) systems and technical infrastructure. For each of these dimensions a set of indicators was defined, that allows MFIs to assess what they are doing already and what not.

In a perfect world, non-bank MFIs engaged in inclusion lending would display the following institutional characteristics:

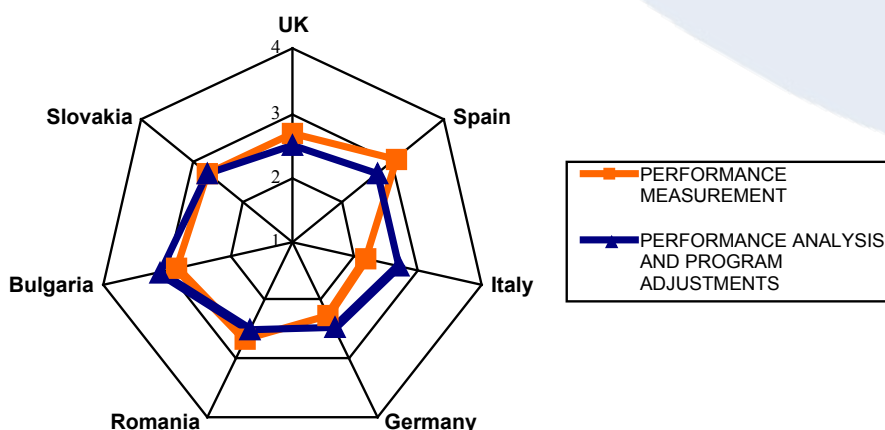
- They have a clear vision that is connected to a **strategy**, and fitting **goals and performance targets**. This is needed to inspire staff, volunteers and donors as well. Goals and social performance targets are based on quantifiable impact measures that are tightly linked to vision and strategy. This means MFIs know exactly what type and numbers of clients they want to reach and how they will realize this in the mid to long-term..
- They develop **funding models** that make use of multiple funding sources and terms to be resistant against potential market instabilities, changes in donor interest and potential withdrawals of funding. Additionally, they have developed sustainable revenue generating activities, e.g. providing support services to reduce dependency on availability of funds.
- They implement an effective **management of human resources**. This includes incentive systems, which motivate staff to 'over-deliver' in their job, and continuous training and education of staff with a dedicated budget. They are not dependent on a single person and develop resources to offer non-financial services to their disadvantaged clients.
- They make use of a full range of **organisational management skills**, from strategic planning to marketing, from fund-raising to program development. Program adjustments are not made on "gut feelings" but are clearly based on results of continuous performance measurement, in-depth performance analysis and internal and external evaluation and benchmarking.
- They have installed a **decision-making framework** that includes clear, formal lines for decisions. This is implemented within a well-developed technical infrastructure consisting of sophisticated, comprehensive electronic databases and management reporting systems for tracking clients, staff, loan figures and program outcomes.

Given the young age of the microfinance sector in Europe, it seems clear that most of the MFIs active still have a long way to go to reach such levels of institutional capacity. But how far is this away exactly? And where to start?

CAPACITY LEVELS OF NON-BANK MFIs IN EIGHT EUROPEAN COUNTRIES

To answer these questions, a self-assessment survey was carried out in eight European countries. At the end of 2008, 115 microfinance organisations filled out a questionnaire, rating their capacity levels along the five described dimensions on a scale ranging from '1- clear need for increase in capacity' to '4- high level of capacity in place'. The results of the self-assessment survey were complemented and put into perspective at country level by qualitative interviews and/or focus groups with sample non-bank MFIs.

The results of the surveys were analysed through comparisons between dimensions, indicators and countries. The following graph illustrates this for the indicators 'performance measurement' and 'performance analysis and program adjustments' in the dimension organisational management skills.



Graph2: Institutional capacity levels in performance measurement and analysis in eight European countries

Source: EMN – Microfinance Market Studies in the Framework of JEREMIE - Cross Country Studies on Western and Eastern Europe – Capacity building and policy recommendations, 2009.

The findings of the survey, with the closest reference to the institutional capacities for reaching excluded and vulnerable target groups through the provision of microcredit, were the following:

- **A lack of institutional capacity in building and maintaining adequate funding models for growth in microfinance operations.** The biggest constraints faced by most non-bank MFIs in reaching the goal of serving underserved entrepreneurs are the lack of funds, mainly for on-lending, as well as the lack of funds for technical assistance to existing and potential clients. There is a clear need for sustained funding to cover start-up and operating costs and dedicated funds for on-lending to high risk and vulnerable target groups
- **Underdeveloped systems for performance measurement and analysis.** A culture of transparency and reporting is often missing in non-bank MFIs, especially in Western Europe. This is connected to lack of awareness about the importance of this issue and a missing transfer of social visions for microfinance into viable business approaches. In Eastern Europe capacity levels in this regard are higher, but are too often limited to fulfilling reporting requirements of funding/donor organisations. Capacities to monitor the social impact of microfinance operations need to be particularly strengthened here.
- **A lack of institutional capacity for providing non-financial services to clients in a cost-effective and sustainable manner.** On the contrary, the provision of non-financial services is often a limiting factor for the programmes in scaling up their microcredit operations, since it is cost- and time-intensive, even if it is provided through affiliates with which they cooperate.

CONCLUSIONS AND RECOMMENDATIONS

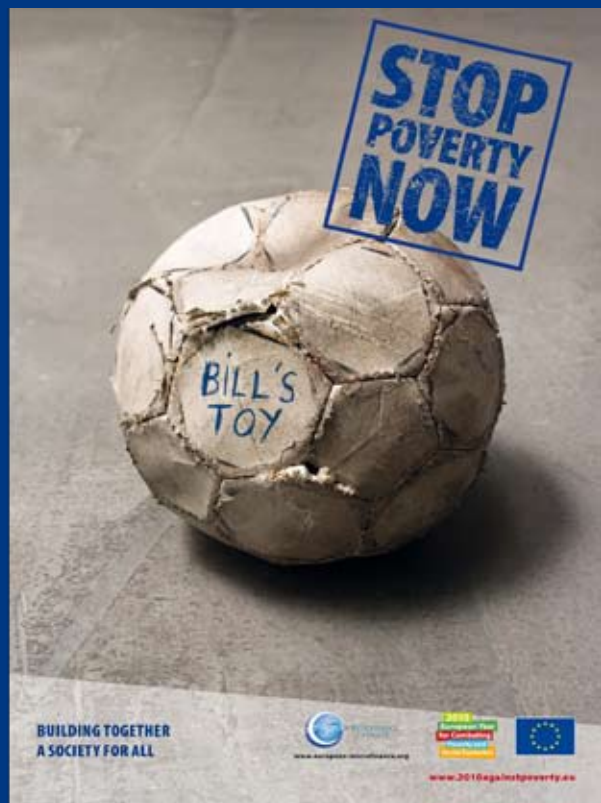
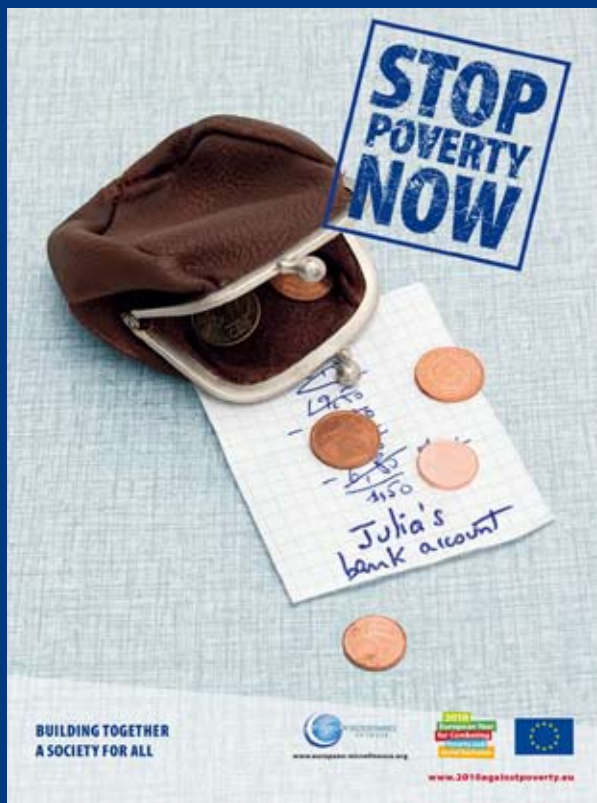
Based on the findings of the survey, recommendations for measures to strengthen the institutional capacity levels of European MFIs were deduced. Regarding the task of further developing the capacities of non-bank MFIs **for reaching excluded target groups**, the following measures should be taken into consideration by policy makers, networks like EMN and practitioners alike:

- **Funding models of non-bank MFIs need to integrate more dedicated funds to reach socially-excluded target groups.** This calls for a greater supply of dedicated funds for inclusion lending as well as more flexibility on the MFI side in integrating different funding sources into their existing funding models.
- **European support schemes for the microfinance market like JASMINE should be based on clear development objectives and targets** that need to be agreed with any MFI that receives support under these schemes. Adjusted social performance indicators need to be developed and monitored on a regular basis to measure the impact of microfinance activities on social exclusion in Europe.
- The benchmarks in terms of the **degree of (self-)sustainability** set for MFIs in the EU should be individually **adjusted according to the target groups they are serving and to the complexity of services they provide.**
- **Financial and non-financial services should be seen by all means as separate cost centres.** Even if financial operations become sustainable in the long run, business development services for disadvantaged target groups will still require subsidies.



The technical assistance branch of the Jasmine Initiative for the European Microfinance Sector will be an excellent opportunity to implement these measures and for European MFIs to make progress in institutional capacity building on a broad scale. Let's work together through EMN to make that happen and to boost the capacity of the sector to serve excluded people through microcredit in the long run.

BUILDING TOGETHER A SOCIETY FOR ALL





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