

FINAL WORKSHOP REPORT
on
“MICROFINANCE FOR SMEs
IN THE BLACK SEA ECONOMIC COOPERATION REGION”

organized by

ORGANIZATION OF THE BLACK SEA ECONOMIC COOPERATION (BSEC)
and
KONRAD-ADENAUER-STIFTUNG (KAS)

12 - 15 November 2014

Bucharest, Romania

**MICROFINANCE FOR SMEs
IN THE BSEC REGION**

**Edited by
Dr. Antal Szabó**

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ABBREVIATIONS

AIDA	Albanian Investment Development Agency
ALL	Albanian lek
AMD	Armenian dram
ANFES	Azerbaijan National Fund for Entrepreneurship Support
AZN	Azerbaijani manat
sh.a	Shoqëri Aksionare, or anonymous company in Albanian
ASC Union	Albanian Savings and Credit Union
AZHBR	Agricultural and Rural Development Agency in Albania
BDSS	business development support service
BGN	Bulgarian lev
bn	billion
BSEC	Organization of the Black Sea Economic Cooperation
CC	credit cooperatives
CEDA	Center for Entrepreneurial Education and Business Support in Moldova
CEE	Central and Eastern European countries
CIP	Competitiveness and Innovation Framework Programme
CIS	Commonwealth of Independent States
CNIPMMR	National Council of Small and Medium Sized Private Enterprises in Romania
DAX	German Stock Index (Deutscher Aktienindex)
DCFTA	Deep and Comprehensive Free Trade Agreement
DM	Deutsche Mark (German mark)
DMI	German Microfinance Institute (Deutsche Mikrofinanz Institut)
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECB	European Central Bank
EFSE	European Fund for Southeast Europe
EIB	European Investment Bank
EIF	European Investment Fund
EMN	European Microfinance Network
EPMF	European Progress Microfinance Facility
ERENET	Entrepreneurship Research and Education Network of Central European Universities
ETEAN	National Fund for Entrepreneurship and Development in Greece
EU	European Union
EUR, €	euro, official currency of the eurozone
FB	family business
FAF-DC	First Albanian Financial Development Company

FB	family business
FDI	foreign direct investment
FGCR	Rural Credit Guarantee Fund in Romania
FM	Fundusz Mikro, a Polish Microcredit Institute
FOB	free on board
FRC	Romanian Counter-Guarantee Fund
FSFS	Frankfurt School Financial Services
FX	foreign currency exchange
GDP	gross domestic product
GEEF	Groupement Européen des Entreprises Familiales, or European Family Businesses in English
GEL	Georgian lari
GNI	gross national income
GNP	gross national product
GUF	German-Ukrainian Fund
GVA	gross value added
ha	hectare
HDI	Human Development Index
ILO	International Labour Organization
INSTAT	Albanian Institute of Statistics
JASMINE	Joint Action to Support Microfinance Institutions in Europe
JEREMIE	Joint European Resources for Micro to Medium Enterprises
KAS	Konrad-Adenauer-Stiftung
KEPA	Business and Cultural Development Centre in Greece
KfW	Kreditanstalt für Wiederaufbau (German government-owned Development Bank)
LEA	Local Enterprise Agencies in Hungary
LED	local economic development in Armenia
LLC	Limited Liability Company
LSEs	large-scale enterprises
m	million
MAP	Multi-annual Programme in the EU
MAYA	Foundation for the Support of Women's Work, an MFI in Turkey
Maya Declaration	Alliance for Financial Inclusion, a network committed to financial inclusion, signed in Riviera Maya, Mexico, on 28-30 September 2011, on the occasion of the 3rd AFI Global Policy Forum
MDL	Moldavian leu
MFC	Microfinance Centre for Central and Eastern Europe and the New Independent States
MFI	microfinance institution
MFO/MO	microfinance organization

Mittelstand	SMEs in German-speaking countries
MSME	micro, small and medium-sized enterprise
na	not available
NBFI	Non-Bank Financial Institution
NBG	National Bank of Georgia
NBR	National Bank of Romania
NLC	National Licensing Centre in Albania
NLGFSME	National Loan Guarantee Fund for SMEs
NPL	non-performing loans in Romania
NRC	National Registration Center of Albania
PERMIS BSEC	Permanent International Secretariat of the Organization of the Black Sea Economic Cooperation
PLI	partner lending institution
PLN	Polish zloty
PPP	Public-Private Partnership
RAEF	Romanian-American Enterprise Fund
RMCF	Romania Micro Credit Facility
RON	new Romanian leu
RSD	Serbian dinar
RUB	Russian rouble
SBA	Small Business Act for Europe
SCA	Savings and Credit Associations
SLA	Savings and Loans Associations in Moldova
SME	small and medium-sized enterprise
SMEG	SME Guarantee Facility
SPM	Social Performance Management
SRO	self-regulatory organization
TGMP	Turkish Grameen Microfinance Project
TRY	Turkish lira
UAH	Ukrainian hryvnia
UCO	Universal credit organizations in Armenia
UK	United Kingdom
UNECE	United Nations Economic Commission for Europe
USD	United States dollar
WTO	World Trade Organization

PREFACE

Ambassador Traian Chebeleu

Deputy Secretary General,
Permanent International Secretariat (PERMIS) of the Organization of the Black Sea Economic Cooperation (BSEC)

Dear Dr. DÜRKOP,
Dear Dr. SZABÓ,
Distinguished Participants,

It is a privilege to welcome you, on behalf of the Permanent International Secretariat of the Black Sea Economic Cooperation Organization, to this Workshop on “Microfinance for SMEs”.

I will begin by extending our thanks and appreciation to the Konrad-Adenauer-Stiftung (KAS) for its long-standing support of our Organization. Since 1997, KAS has been our partner in the organization of over 40 Workshops and Seminars for the promotion and development of SMEs in the BSEC region.

I would like also to express our deep gratitude to Dr. Antal SZABÓ, Scientific Director of ERENET, for participating in a great number of these Workshops and Seminars. Through his participation, he has shared his comprehensive and outstanding professional knowledge on the ways and means through which the SME sector in the BSEC Member States could be supported.

Today’s Workshop focuses on a specific topic – Microfinance for SMEs. Microfinance is a highly important tool that helps start-ups and enables existing businesses to expand. It is a fact that microfinance plays a crucial role in the revenue and profit growth of SMEs, particularly when, for whatever reasons, SMEs have difficulties in raising funds from commercial banks. I am confident that the presentations today and their attendant discussions would help participants discover the ways through which SMEs can easily secure microfinance on reasonable terms.

Distinguished Participants,

SMEs play an important and significant role in the economic, social and political development of the BSEC Member States. The development of SMEs is essential to the economic growth of our countries. Consequently, through its activities, our Organization endeavours to develop effective policies and concrete measures supporting the sustainable development of the SME sector in our region. This is, in fact, one of the goals of the *BSEC Economic Agenda 2012*, endorsed by our Heads of State and Government.

BSEC’s Working Group on SMEs has been focusing on high technology, innovation, entrepreneurship and sustainable development, as well as technology parks and incubators. Our key objective is to help SMEs in our region improve their quality performance through innovative ideas, products, services and procedures. Our Organization also strives to bring together businesses, scientific institutions, business incubators, as well as private and state institutions from the BSEC Member States in order to develop a culture of cooperation through networking. By promoting measures to improve production efficiency, BSEC also supports the collaboration of SMEs and large companies.

Similarly, we encourage the development of concrete projects that can facilitate the implementation of our Organization’s objectives. In this spirit, the Working Group on SMEs is currently engaged in a project proposed by the Country-Coordinator of the Working Group, the Republic of Turkey, titled “Promoting Innovation and Entrepreneurial Culture in the BSEC Member States, and Exchanging Experience on Energy Efficiency Policies and Practices for SMEs”. A Workshop on Entrepreneurship and Technology Development will be organized in Istanbul, in December, as part of this project.

The conclusions and recommendations made in this Workshop today will contribute greatly to the meeting of the BSEC Working Group on SMEs, scheduled to take place on 5 December 2014.

I would like to conclude my introductory remarks by conveying my best wishes for productive exchanges and reiterating my confidence in the success of this Workshop.

Dr. Colin Dürkop

Head of the Konrad-Adenauer-Stiftung (KAS) office in Turkey

Deputy Secretary-General Ambassador Chebeleu,
Dr. Antal Szabó,
Ladies and Gentlemen,

A very good morning to all of you. It is with great pleasure and honour alike to welcome you all, on behalf of the Konrad-Adenauer-Stiftung, to the Workshop on "Microfinance for SMEs in the Black Sea Region".

Thank you all for coming to our event here in the beautiful city of Bucharest in Romania.

International workshops on SMEs, such as today's, are organized once or twice a year jointly by the Konrad-Adenauer-Stiftung, the Permanent International Secretariat of the Organization of the Black Sea Economic Cooperation, and ERENET, led by its Scientific Director, Dr. Antal Szabó.

For the past 20 years, more than 40 such workshops, aimed at providing a dialogue forum between the stakeholders and decision-makers of SME policies in the different BSEC countries, were successfully realized.

They also aimed to facilitate the exchange of experiences and information among SMEs and other NGOs, thereby contributing to better understanding among these players.

As usual, at the end of the Workshop, the findings, conclusions and recommendations generated would be submitted to the BSEC Working Group on SMEs for consideration in its next session on 5 December 2014 in Istanbul.

During our last workshop in Istanbul in 2013, *Romania* was chosen as the venue of 2014's KAS-BSEC event and *microfinance* was chosen as the main topic because it is one of the most crucial and important issues faced by SMEs.

As Dr. Szabó outlined in his concept paper for this event, we will spend the coming two days closely examining the issue of microcredit policies and programmes, various experiences in microfinance issues in the BSEC area, as well as problems and suggestions necessary for improvements. It is hoped that government authorities of the individual BSEC Member States will eventually incorporate these suggestions or take them into account in their national SME policies and programmes.

Since I am based in Turkey, please allow me to highlight one aspect of the Turkish SME financing situation. Turkey has over 2.6 million SMEs, constituting more than 95% of Turkish companies. This sizeable number underlines both the importance of this sector for employment and production, and the sector's enormous financing needs. Interestingly, SMEs seem to go for the most expensive way of financing, i.e. normal bank loans. Only less than 1% of SMEs benefit from the Republic of Turkey's Small and Medium Enterprises Development Organization (KOSGEB) grants. The remaining SMEs seem to rely on other financing tools such as leasing or factoring firms, or by obtaining a partner for the company, or trying to reach angel investors.

I will not go into further detail at this stage, as we have excellent experts and presenters on board.

To conclude, I would like to extend my thanks to:

Dr. Antal Szabó and ERENET for his intellectual input in conceptualizing this workshop, and nominating presenters and participants through its wide international network;

and

I would also like to thank our long-term partner, the Permanent International Secretariat of the Organization of the Black Sea Economic Cooperation, its

distinguished Deputy Secretary-General, Ambassador Traian Chebeleu, and Meltem Güney for their close and successful cooperation.

Without further ado, let me wish all the participants an interesting and fruitful Workshop session.

Thank you very much.

Danke schön

1. MICROCREDIT INSTITUTIONS IN THE EUROPEAN UNION

by

Dr. Antal Szabó

UN retired Regional Adviser
Scientific Director of ERENET
Budapest, Hungary

Motto:

*“Microfinance has proven its value in many countries, as a weapon against poverty and hunger.
It really can change people’s lives for the better, especially the lives of those who need it most.”*

Kofi Annan, former UN Secretary-General

ABSTRACT

The paper highlights the problems inflicted by the European economic crises on youth unemployment and poverty. It posits that microfinancing, which provides microloans and microcredit, could alleviate poverty by creating self-employment and developing microenterprises. There is a lack of both comprehensive studies and exchanges of practice in microfinancing in the Central and Eastern European (CEE) countries.

The paper defines microcredit and presents its current status in the EU. Following this, the author summarizes the main microfinance institutions in selected CEE countries. Serbia is excluded from this study due to lack of government’s recognition of the microfinance.

In the final section, the author shares his professional recommendations and puts forward a directive on the hallmarks of good microfinancing. This directive is based on the findings and conclusions of the Workshop held in 2013 in Budapest. The author will then conclude by summarizing further recommendations for the CEE countries.

Keywords: job creation, microfinance, microfinance institutions, good conduct of microfinance

JEL classification: L21, L26, L31, O52

INTRODUCTION

The world economy has yet to recover from the economic crises of 2012 and 2013. The European economy has not quite overcome the economic crises, for it has been unable to decrease the level of unemployment, especially youth unemployment. This further aggravated the youth job crises. Queues for jobs have become longer, especially for young jobseekers. According to Eurostat’s October 2013 estimate, 26.654 million men and women in the EU-28, of whom 19.298 million were in the euro area (EA-17), were unemployed.¹ This is in contrast to September 2013 where the number of unemployed persons decreased by 75,000 in the EU-28 and 61,000 in the EA-17 euro area. Of serious concern is the fact that youth unemployment rates are much higher than the unemployment rate for all ages. This reflects the general difficulties faced by young people in finding jobs. As a rule of thumb, one out of every five persons available for the labour force is unemployed. Getting a job is the safest route out of poverty for those people who are able and ready to work. Reducing unemployment is a difficult task in the face of economic crisis; however, there is no other way. If the EU could achieve a 75% employment rate by 2020, it would lift many millions of people out of poverty.

¹ See Eurostat, “Main statistical findings,” October 2013, http://ec.europa.eu/eurostat/statistics-explained/index.php/Main_Page.

See Eurostat, “EU-28 explained”, <http://ec.europa.eu/eurostat/statistics-explained/index.php/Glossary:EU-27>

See also, Eurostat, “EU-28 and EA-17 unemployment statistics”, http://ec.europa.eu/eurostat/statistics-explained/index.php/Unemployment_statistics

While many initiatives are carried out by the Black Sea Economic Cooperation (BSEC) and Central and Eastern Europe (CEE) countries, more support is needed for the employment of young people. It is very important to emphasize that encouraging the entrepreneurial spirit and supporting start-up initiatives would go a long way to alleviating unemployment too. However, the question is how, by whom and by what means? This is **the aim of this paper - to draw the attention of policymakers and entrepreneurial support institutions to the significance of microcrediting and microcredit schemes** in selected CEE countries.

YOUTH UNEMPLOYMENT

The youth unemployment rate reached a new historic high of 23.5 % in February 2013, more than twice the adult rate, with some 5.7 million young people affected. Young people who have only completed lower secondary education (early leavers from education and training) bear the highest risk of unemployment. In 2012, the average EU youth unemployment rate was 22.8%, but reached 30.3% for low-skilled youths. [1]

Table 1: Youth Unemployment Rate in BSEC countries in 2011, for population aged 15-24

COUNTRY	POPULATION in million	UNEMPLOYMENT in %	YOUTH UNEMPLOYMENT in %
Albania	3.2	13.3	n.a.
Armenia	3.3	6.2	39.1 ¹
Azerbaijan	9.2	5.4	11.0 ¹
Bulgaria	7.3	11.3	26.6
Georgia	4.5	15.1	n.a.
Greece	11.3	17.7	44.4
Moldova	3.5	6.7	n.a.
Romania	21.4	7.4	23.7
Russia	143	6.6	15.8 ²
Serbia	7.3	23.0	49.4 ³
Turkey	74.2	8.8	16.7
Ukraine	45.5	7.9	n.a.

Source: UNECE Countries in Figures, 2013

Remarks:

1. ILO data in 2010
 2. ILO data in 2012
 3. Serbian Statistical office in 2003
- n.a. means not available

Youth unemployment not only has a personal effect on each individual and their families, it also has an influence on public attitudes towards the structure of the European Union (EU) itself. Since time immemorial, migration has been the means to a better life. The principle of the free movement of peoples across the region is well-established in the EU, but there are serious economic inequalities among the constituent parts. Those countries, such as the UK, that have been able to develop welfare systems are wary of migrants coming from less generous CEE countries.

The current social and labour dimension in the EU shows that enhancement of the social dimension will strengthen employment, social inclusion and protection. It is not by chance, that the Hellenic Presidency of the Council of the EU worked toward the adoption of the proposal to strengthen the Social Summit. Strong social dialogue is the prerequisite to addressing the complex challenges of social dialogue, and this will be discussed under the Greek Presidency. The Presidency put emphasis on the **“promotion of the programme for employment and social innovation, and**

the **PROGRESS of microfinance facilities**, aiming at the retention and creation of jobs through the development of **SMEs and social entrepreneurship**." [2]

POVERTY

The first and most important target of the Millennium Development Goals, established after the UN Millennium Summit in 2000, is the eradication of extreme poverty and hunger. The main target is to reduce the rate of people living on less than USD 1 per day by half, and to reduce the proportion of people suffering from hunger by half.

24% of the European population (more than 120 million) live at risk of poverty and social exclusion. [3] This figure includes 27% of all children, 20.5% of citizens over 65 years of age, and 9% of those with jobs.

COUNTRY	RATE OF POOREST 20%	POVERTY HEADCOUNT AT USD 2.5 A DAY	POVERTY HEADCOUNT AT USD 5.0 A DAY
Albania	8.9	6.7	47.5
Armenia	8.8	29.6	79.7
Azerbaijan	8.1	5.2	40.4
Bulgaria	6.4	5.4	16.7
Georgia	5.3	42.5	77.9
Moldova	8.5	7.0	45.4
Romania	8.9	4.0	31.5
Russia	6.5	n.a.	10.7
Serbia	8.4	1.8	15.1
Turkey	5.8	21.9	41.4
Ukraine	n.a.	6.0	10.2

Source: The World Bank, Poverty and Equity, 2014,
<http://povertydata.worldbank.org/poverty/region/ECA>

While the officials and civil servants in Brussels deal with the shape of the banana and the colour of the tomato, nothing is done in the area of job creation and poverty alleviation. The European Economic and Social Committee, the European Parliament and the Council acknowledged in 2008, that more than 80 million people across the EU lived below the poverty line, that is, more than the population of our largest Member State, or 16.5% of our population. Women account for well over half of them, and 20 million are children. With the economic crises, the situation has, of course, worsened. The situation of those earning the least amount has continued to deteriorate, and they now face a greater risk of indebtedness and insolvency. This is totally unacceptable in 21st century Europe. It would only be proper to ask - is this the "gift and benefit" of joining the EU?

The European Commission has placed the fight against poverty at the heart of its economic, employment and social agenda – **the Europe 2020 strategy**. [4] According to the European Platform against Poverty and Social Exclusion: A European framework for social and territorial cohesion [5], the European Union should **lift at least 20 million people out of poverty and social exclusion in the next decade**. Complementary national targets for all 27 Member States should be elaborated. As yet, the author does not see concrete action in this field.

MICROCREDIT AND MICROFINANCE

Availability of financial instruments is of paramount importance for SMEs. Financial instruments are defined as any tools that are used by either firms or financial intermediaries to acquire or intermediate funds. Clients with negative personal factors such as illiteracy, lack of regular income

and bad credit histories face serious difficulties in getting bank loans, especially when starting a business. It is such clients who need more support.

There is a one important rule of thumb: different SME target groups need various financial schemes and lines. These vary from microcredit through public credit guarantee funds and mutual credit guarantee associations to venture capital and others. There is no unique way of financing SMEs. The need depends on the stage of maturity and size of the enterprise.

DEFINITION OF MICROFINANCE

“Microfinance” is often defined as financial services for poor and low-income clients offered by different types of service providers. In practice, the term is often used more narrowly to refer to loans and other services from providers that identify themselves as “microfinance institutions” (MFIs). These institutions commonly tend to use new methods, developed over the last 30 years, to deliver very small loans to unsalaried borrowers taking little or no collateral. These methods include group lending and liability, pre-loan savings requirements, gradually increasing loan sizes and an implicit guarantee of ready access to future loans if present loans are repaid fully and promptly.

More broadly, microfinance refers to a movement that envisions a world in which low-income households have permanent access to a range of high quality and affordable financial services offered by a range of retail providers to finance income-producing activities, build assets, stabilize consumption and protect against risks. These services include savings, credit, insurance, remittances, and payments and others. [6]

CPAG Microfinance Gateway (2014)

Microcredit addresses the fact that the self-employed, business start-ups and small enterprises need access to credit. It has a particular focus on, but is not restricted to, groups with limited access to the conventional credit market. Examples include female entrepreneurs, young entrepreneurs, entrepreneurs belonging to a minority group, entrepreneurs with a disability, sole traders, etc. Commercial banks are reluctant to give loans to the poor because they believe the poor are not bankable and will not return the loan. Special financial intermediaries created by charity organizations, socially committed helpdesks and group lending cooperatives are, in general, called Microfinance Providers. Business starters and self-employed, especially from vulnerable groups, are thus able to request modest amounts from these Microfinance Providers. The most popular microloans are less than €5,000.

MICROCREDIT is a product of MICROFINANCE, which

- consists of microcredit programmes with social orientation
- includes microsaving, microinsurance, remittance transfers
- provides training, advice, counselling, coaching

Dr. Muhammad Yunus, founder of Grameen Bank and Nobel Peace Prize Winner of 2006, believes in microcredit as a platform for job creation and poverty alleviation. His views are expressed as follows: *“There is no conflict in having microcredit, education, health, empowerment, [and] training together; they support each other. If you laid out the foundation of the financial system, it makes other interventions so much more powerful. If you come with education, health, and training, everything will make much more sense, and you get much more mileage out of your effort, **provided you have the microcredit framework already built into the system.**”*

According to an old Chinese proverb:

- **Give a man a fish, he eats for a day.**
- **Teach a man to fish, he eats for a lifetime.**

When Dr. Yunus' philosophy is applied to the Chinese proverb, you will see that a man who fishes can do so much more than eat for his whole life:

- **Provide credit and training, he opens a seafood stand, feeds the people in the surroundings, and becomes a healthy entrepreneur in the community.**

MICROCREDITING IN THE EUROPEAN UNION

In 2003, the European Commission adopted a new definition of microenterprises that came into use on 1 January 2005. [7] Enterprises will be considered microenterprises if their headcount amounts to less than ten and their turnover (or balance sheet total) does not exceed € 2 million. The EU Institutions defined microcredit as a loan below €25,000.

The European Commission Communication of 13 November 2007, "A European initiative for the development of microcredit in support of growth and employment", identified four priority areas for action:

- i. improving the legal and institutional environment in the Member States,
- ii. changing the climate in favour of employment and entrepreneurship,
- iii. promoting best practices, and
- iv. providing additional financial capital for microfinance

In 2010, in accordance with Decision No. 283/2010 of the European Parliament and the Council, the European Commission launched the **European Progress Microfinance Facility** (EPMF or Progress Microfinance) to set up and/or develop microenterprises and small businesses through the availability of microcredit – loans **below € 25,000**. [8] Progress Microfinance does not directly finance entrepreneurs, but enables **selected** microcredit providers in the EU to increase lending by:

- issuing guarantees, thereby sharing the providers' potential risk of loss
- providing funding to increase microcredit lending.

As a first step in implementing this agenda, the Commission and the European Investment Bank (EIB) created the Joint Action to Support Microfinance Institutions in Europe (JASMINE) in 2008 to provide mentoring for non-bank microcredit finance institutions and a financing window for a global amount of € 20 million offered by the EIB. The EU allocated € 25 million from the overall budget, while the European Investment Bank provided an additional € 75 million. This means a total of € 100 million was allocated for this purpose. JASMINE shall be implemented through the following types of actions, as appropriate:

- (a) guarantees and risk-sharing instruments;
- (b) equity instruments;
- (c) debt instruments;
- (d) support measures, such as communication activities, monitoring, control, audit and evaluation which are directly necessary for the effective and efficient implementation

Generally, the CEE countries deem these financial means to be outside their interest, as their policymakers are ashamed to recognize the poverty and extreme unemployment in their countries. Unfortunately, most of the CEE countries do not realize the significance of this issue. Only Poland used this instrument in the proper manner by nominating Inicytativa Micro (with the support of € 3.771 million) as a non-bank institution, and Fundusz Mikro (with the support of € 1.88 million) and Slovenia as financial intermediaries out of the 26 participating institutions from the 15 Member States.

European Parliament Decision No. 283/2010/EU emphasized that the actions financed by the EPMF should be coherent and compatible with other Union policies, in particular the financial instruments of the Competitiveness and Innovation Framework Programme (CIP), JASMINE, the European Agricultural Fund for Rural Development (EAFRD), European Regional Development Fund (ERDF), Joint European Resources for Micro to Medium Enterprises (JEREMIE) and the European Social Fund (ESF).

JASMINE is a joint initiative of the European Commission, the European Investment Bank (EIB) and European Investment Fund (EIF).² JASMINE aims to enhance the capacity of non-bank microcredit providers and microfinance institutions (MFIs) in a number of fields, so as to help them become sustainable and viable operators in the microcredit market. The European Progress Microfinance Facility (Progress Microfinance) also aims to increase the availability of microcredit loans below € 25,000 by issuing guarantees to share in any potential risk of loss.³ The facility does not, therefore, directly finance entrepreneurs, but enables selected microcredit providers in the EU to increase lending.⁴

Originally, the **JASMINE Technical Assistance (TA) Facility** provided various financial and non-financial services to MFIs, but the concept has evolved over the years. As it stands now, the **JASMINE TA Facility delivers TA** to microcredit providers, while financing microcredit providers **through the EIF-managed Progress Microfinance**.

The JASMINE HELPDESK allows one to lodge detailed information requests about JASMINE Technical Assistance, the Code of Good Conduct for Microfinance institutions / Microcredit providers, the Client Protection Principles of the Consultative Group to Assist the Poor (CGAP), market updates, European Microfinance characteristics and funding possibilities through EPMF. [9]

RESOURCE CENTRES IN EUROPE

There are two resource centres promoting microfinance in Europe, namely:

1. **Microfinance Centre for Central and Eastern Europe and Newly Independent States (MFC)**, and
2. **European Microfinance Network (EMN)**

Both share the common visions of:

- PROMOTING MICROFINANCE AS A TOOL FOR JOB CREATION, ECONOMIC GROWTH AND SOCIAL INCLUSION;
- PROMOTING ENTREPRENEURSHIP AND SELF-EMPLOYMENT

They both provide the following services:

- CAPACITY BUILDING (TRAINING, TECHNICAL ASSISTANCE, INFORMATION);
- RESEARCH (STUDIES ON LEGAL ENVIRONMENT, MODALITIES OF OPERATION, EVALUATION, COUNTRY STUDIES);
- NETWORKING (CREATION OF WEB-PLATFORMS, ANNUAL CONFERENCES, EXCHANGE OF EXPERIENCES);
- ADVOCACY AT THE EU AND MEMBER COUNTRIES' LEVEL;
- DISSEMINATION OF GOOD PRACTICES.

1. Microfinance Centre for Central and Eastern Europe and Newly Independent States (MFC)

In order to support the emerging microfinance industry, the Microfinance Centre for Central and Eastern Europe and Newly Independent States (MFC) was established in 1998 in Poland. MFC is

² For more information on JASMINE, http://ec.europa.eu/regional_policy/index.cfm/en/funding/special-support-instruments/jasmine/#1

For more information on EIB, <http://www.eib.org/>

For more information of EIF, <http://www.eif.europa.eu/>

³ For an explanation as Progress Microfinance, <http://ec.europa.eu/social/main.jsp?catId=836>

⁴ Microcredit providers in Progress Microfinance, listed according to country, <http://ec.europa.eu/social/main.jsp?catId=983&langId=en>

a regional microfinance resource centre and network. It brings together 103 organizations, including 78 microfinance institutions in 27 countries in central Europe, eastern Asia and the Caucasus region. MFC serves over 800,000 low-income clients. MFC is headquartered in Warsaw and has a regional office in Bishkek in Kyrgyzstan.

MFC aims to contribute to poverty reduction and the development of human potential by promoting a socially-oriented and sustainable microfinance sector that provides adequate financial and non-financial services to large numbers of poor families and microentrepreneurs. [10]

2. European Microfinance Network (EMN)

With valuable support of the European Commission and the French Caisse des Dépôts et Consignations (CDC), **EMN** was launched by its founding members - the Association pour le Droit à l'Initiative Economique (ADIE) from France, New Economics Foundation (NEF) from the UK, and Evers & Jung from Germany - and officially registered in Paris on 23 May 2003. EMN was created a non-governmental organization. [11]

Since **December 2012**, EMN has legally transferred its activities from France to Belgium. Under Belgian Law, EMN has been constituted as an *association internationale sans but lucratif* (AISBL) or international non-profit association.

At the end of 2013, the network had a total of 85 members from 22 European Countries. Five new members joined the organization in 2013: Microfinance Ireland (Ireland), CEEI Burgos (Spain), Micro Development (Serbia), Romcom (Romania) and SIS Credit (Bulgaria).

INSTITUTIONAL MODELS

Microcredit providers, also called **Microfinance Institutions (MFIs)**, comprise savings banks, cooperatives, credit unions, foundations, microcredit banks, different types of not-for-profit associations, microfinance banks and commercial banks. These institutions are roughly classified by their institutional models as non-banking institutions and banks. There are two types of microcredit providers.

MFIs are categorized according to their target groups as **non-bankable** and **bankable entrepreneurs**. The clients of the non-bankable groups are mainly financial and socially excluded persons. The bankable group deal with traditional start-ups and already established microenterprises. However, the two groups can take on each other's target clients.

1. Non-Banking Models

The classic model of a non-banking MFI is **GRAMEEN Bank**. This institution and model emerged from the poor-focused grassroots institution, Grameen Bank, started by Professor Mohammed Yunus in Bangladesh. It essentially adopts the following methodology: A bank unit is set up with a Field Manager and a number of bank workers, covering an area of about 15 to 22 villages. The manager and workers start by visiting villages to familiarize themselves with the local milieu in which they will be operating and identify prospective clientele, as well as explain the purpose, functions, and mode of operation of the bank to the local population. Groups of five prospective borrowers are formed; in the first stage, only two of them are eligible for, and receive, a loan. The group is observed for a month to see if the members conform to the rules of the bank. Only if the first two borrowers repay the principal plus interest over a period of fifty weeks, do other members of the group become eligible for a loan. Because of these restrictions, there is substantial group pressure to keep individual records clear. In this sense, collective responsibility of the group serves as collateral on the loan. [12]

An **Intermediary model** of credit lending is where a 'go-between' organization exists between the lenders and borrowers. The intermediary plays a critical role in generating credit awareness and education among the borrowers (including, in some cases, starting savings programmes). These activities are geared towards raising the 'credit worthiness' of the borrowers sufficiently so as to make them attractive to the lenders. The links developed by the intermediaries could cover funding, programme links, training and education, and research. Such activities can take place at various levels from international and national to regional, local and individual. Intermediaries could be individual lenders, NGOs, microenterprise/microcredit programmes, and commercial banks (for

government financed programmes). Lenders could be government agencies, commercial banks, international donors, etc.

The **National Microcredit Scheme (MCS)** is an example of the intermediary model. MCS was launched in 1991 by the European Commission and the Hungarian government as part of the Poland and Hungary: Assistance for Restructuring their Economies (PHARE) programme. The PHARE programme aimed to promote small and medium-sized enterprises. PHARE resources provided significant financial and professional help for the establishment of enterprise development foundations in the CEE countries and their capital cities, their operational organizations known as **Local Enterprise Agencies (LEAs)**, as well as the training of their staff and for the launch and operation of enterprise support programmes run by the foundations. The basic activities of LEAs, financed by PHARE, are counselling, training, infrastructure development (business incubators, industrial parks), providing microcredit as well as generating development programmes. When the programme was launched in 1992, there was no general legal framework on the microcredit activity of the individual microfinance organizations. [13] [14]

In Poland, there is a unique microfinance scheme called **Fundusz Mikro (FM)**. It was established in 1994 with a USD 20 million loan capital investment from the Polish-American Enterprise Fund. FM was registered as a limited liability company; it is also the only non-bank institution in Poland that can make interest-bearing loans. A USAID grant covered initial operating costs. FM began its lending operations in February 1995 with a one-year pilot programme in which it systematically tested different lending methodologies, locations, types of clients, types of employees and cooperation arrangements with partner organizations. Based on the results of the pilots, it has, since February 1996, built a nationwide network of 11 branches and 1 main office (Headquarters).[15]

The philosophy of Fundusz Mikro is based on mutual guarantee and continuous cooperation. The main element in crediting is preventive prevention in order to safeguard the repayment of the credit. No physical collateral is accepted by FM because they believe it would weaken borrowers' sense of personal responsibility for repayment. The "motivation" to repay is assessed in-depth, through the character of the client. A credit group generally consists of five members, and it is recommended that they have business relations among themselves. The credit society jointly opens credit and takes care of each other to ensure that they repay the credit in due time. The self-respect of the members of the group plays a positive role. By these means, the risk of the repayment decreases to the minimum. In general, the clients of FM are microenterprises like hairdressers, beauticians, locksmiths, repair shops, bakers, confectioners, restaurant keepers, cab drivers, etc. FM reached the break-even point in 1999. It also had a positive effect on the economy in that its programmes created jobs.

Micro Fund is another Polish MFI that has developed a unique form of financial cooperation with its customers. By basing its financial cooperation on the principle of partnership and mutual trust, it offers permanent access to capital in simple terms, without unnecessarily complex formalities. After more than 18 years of activity, Micro Fund has become the leading microfinance institution in Poland and is one of the largest in Central and Eastern Europe. Since its inception, the Fund has granted more than 130,000 microloans of over PLN 1 billion to 57,000 owners of micro and small businesses. 60% of Micro Fund clients are repeat customers.

According to the **French Banking Act**, only banks may engage in "credit transactions". Banks are licensed by a special committee. However, there are a few exceptions to this principle, one of which concerns microcredit. It allows voluntary associations to grant loans from their own funds and from funds borrowed from banks for the creation and development of businesses by the unemployed or people living mainly on social benefits. The Microcredit Committee, composed of members drawn from diverse backgrounds, licenses and controls these voluntary associations. [16]

The Association pour le Droit à l'Initiative Economique (**ADIE**) was created in 1989 in France. The source of inspiration was the "Banks of the Poor" that grew in developing countries in the seventies, and more particularly, Grameen Bank in Bangladesh. ADIE is a non-profit association targeting unemployed persons or persons who receive social allowances (*revenue minimum d'insertion* or RMI) in France. With its 22 regional and 112 local offices and 380 contact points, ADIE has disbursed (as of 31 December 2006) 43,747 loans and helped create 37,349 enterprises since 1989. The loss rate at the end of 2006 is 2.97 %, and 64% of businesses were still running after two years. One advantage of the introduction of the legal exemption was the simplification of the lending process. The time needed to disburse a loan has been cut by 2.2 times. Due to faster information on unpaid instalments, risk monitoring has been reduced from 10-60 days to two days. In consequence,

the cost of the back office has also decreased. ADIE was able to extend its partnerships with commercial banks. In the last three years, 20,177 loans were given, compared to 23,570 loans granted in 1990-2003.

ADIE finances the self-employed and microenterprises through a variety of products based on clients' needs. They are:

- Loans at market rate up to 10,000 €
- "Start-up grants" funded by the French government or by local authorities
- Non-interest bearing subordinated loans

Usually, the financing needs do not exceed 11,000 €

In addition, ADIE staff and volunteers provide post-loan business advice to microentrepreneurs in the fields of business management, administrative formalities, marketing and legal advice. [17]

Another noteworthy European microfinance institution is **PerMicro** in Italy. It is a financial company, according to Intermediari finanziari ex.art 106 TUB, and is supervised by the Bank of Italy. It was established in 2007 in Turin, with the aim of giving opportunity as well as social and financial inclusion to the unbankable people traditionally excluded from traditional credit instruments due to lack of financial history and guarantees.

PerMicro offers two financial schemes:

Business Microcredit for people who want to start or develop microbusiness, and even without guarantee, but they

- i. have a good business idea;
- ii. have entrepreneurial and technical skill; and
- iii. are members of a reference network that can provide modal guarantee and support them in the development of their business idea.

Personal Microcredit for individuals involved in home business, healthcare or education. These people are followed in their paths with special training and support in managing the family business.

PerMicro activity is based on network credit. **The social network to which they belong is a link between PerMicro and clients**, providing them with moral guarantee and supporting them during their credit life. PerMicro's networks are associations, churches and ethnic communities with strong interest in repaying the loans of the clients. [18]

In Slovakia, the **INTEGRA Foundation** is a notable non-profit organization. Established in 1995, its mission is to ensure the well-being of communities through the creation of opportunities for the vulnerable, and supporting personal, economic, spiritual and social development. In so doing, it contributes to the alleviation of poverty and brings justice to the poor (INTEGRA Foundation, 2014). INTEGRA supports new or already running business activities operated by women. [19]

2. Banking Models

The European Commission Expert Group agreed that the most important institutional supplier of microcredit to small firms is the banking system, with banks (savings, co-operative and commercial banks) being by far the biggest providers. The main regulations governing banks are European banking legislation and national banking laws. The trigger to fall under European banking law is to receive deposits or other repayable funds from the public and, at the same time, grant credits for its own account. [16]

Microcredit providers operating under banking laws have to fulfil all the requirements of banking legislations (regulation and supervision): transparency, minimum capital requirements, reporting to banking authorities and other supervisory regulation, etc. These requirements are justified by two overall objectives: the soundness of the financial market and the protection of banks' clients and investors.

As the EU banking directives do not relate to credit-only institutions, they therefore do not directly affect or restrict microcredit. Some Member States, however, limit the lending business to licensed banks. A few countries where only banks are allowed to lend are Austria, Germany, Italy and Turkey. Many national laws allow non-banks to engage in lending activities, as is the case in Belgium, Bulgaria, the Czech Republic, France, Romania, Sweden and the United Kingdom. Taking deposits is the determining factor for bank status, i.e. savings operations can only be carried out by accredited banks.

The two major types of the banking models are Cooperatives and Savings Banks on the one hand, and Microfinance Banks on the other.

2.2.1 Cooperatives and Savings Banks

Cooperative banks form a decentralized network governed by banking as well as cooperative legislation. Generally speaking, cooperative banks are fully-fledged banks. However, due to their history, their mission is (as well as that of savings banks') close to the provision of microcredit. Savings and cooperative banks are active in southern European countries like Greece, France and Spain, where they have partnerships with non-profit organizations, and act as business support service providers by directing customers to these credit institutions.

In Greece, for example, the credit cooperative system was established in 1993, following the creation of the appropriate legislative framework. There are two types of cooperative banks: first, where the cooperative functions as a bank, and second, where the cooperative cannot provide banking services. [20]

Savings banks are involved in microcredit operations with different business models. These business models fall into three main types:

- i. regular lending activities (balance sheet-based model),
- ii. foundations (off-balance sheet-based model) and
- iii. partnerships with financial institutions (agency-based model).

2.2.2 Microfinance Banks

A microfinance bank is devoted to extending small loans, referred to as microloans, to individuals, businesses and organizations in low-income regions, including under-developed countries where small amounts of money can go a long way. Some financial institutions are devoted entirely to microfinance, while others are part of larger companies, such as global investment banks. Ultimately, this type of bank provides credit to those who would otherwise be unable to access this form of capital.

Microfinance banks specialize in providing small loans but are regulated by banking law. Some examples of microfinance banks are ProCredit Bank in Bulgaria and Romania.

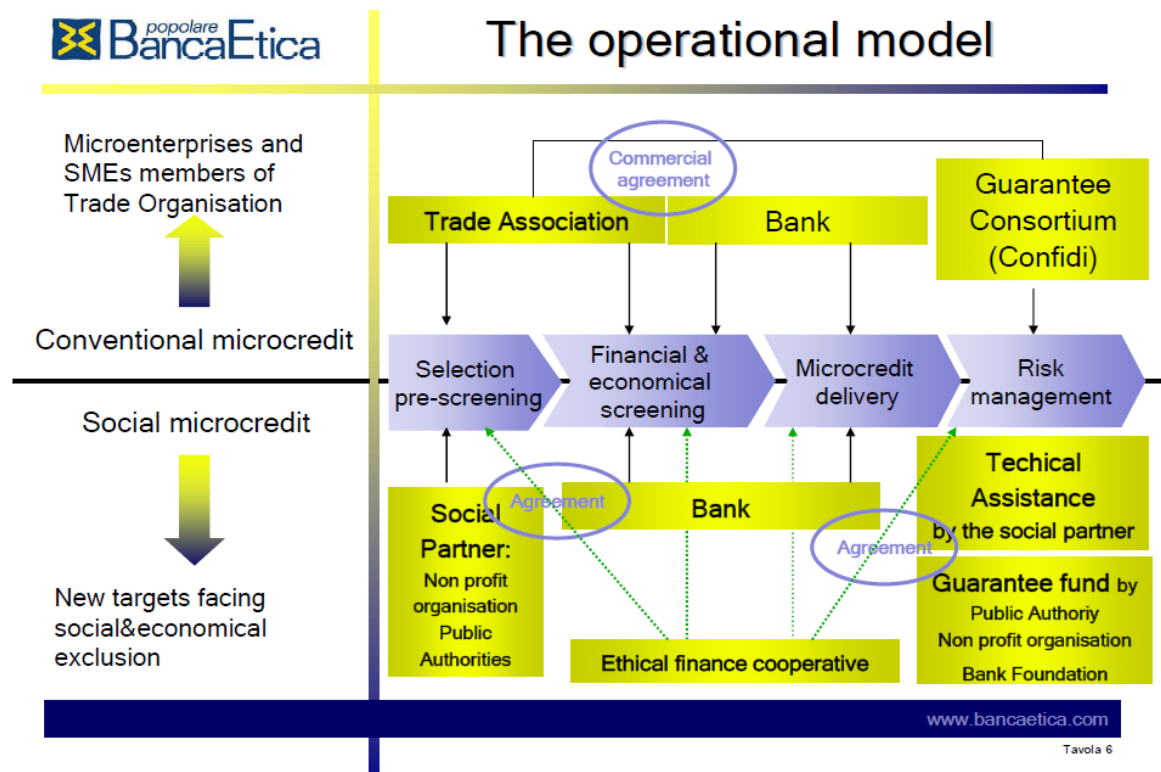
European microcredit finance is very young. This growing sector has significant potential. Microcredit practice varies from country to country, and depends on microfinance intermediaries to provide microloans. There is no single model for the promotion of entrepreneurship, as every country has to adopt its own policy mix to find the best solution. The legal framework also varies, and the practice and operation procedures differ across the different countries.

A good example of a microcredit bank in Italy is **Banca Popolare Etica**. It is the first ethical bank encouraging socio-economic initiatives in the field of sustainable human and social development. This institution was set up in 1999 in Padua. This bank introduced an ethical dimension to its banking activities. In doing this, the bank is committed to observing the following main principles:

- i. economic actions have non-economic consequences;
- ii. access to credit is a basic human right;
- iii. profit should be redistributed equally among all members;
- iv. respect the interest of all;

- v. the operation of the bank should be transparent, efficient and fulfil ethical requirements;
- vi. participation of all should be encouraged.

The operational model for provision of microcredit of the Banca Etica can be seen in the picture below [16]:



Banca Etica is rather a small bank. It has only 17 branches, about 230 staff, makes loans of less than €1 billion (\$1.3 billion), and made a profit of €1.6m in 2012. The firm mainly provides credit to the non-profit sector and green businesses. It was, for instance, the first Italian bank to lend to the cooperatives of young people farming on land confiscated from the mafia. Despite its small size, Banca Etica has attracted a broad range of shareholders. They number 38,400, of which 5,900 are firms and 83 are financial institutions. By some measures, it is among Italy's best-run banks: only 0.4% of loans are in default and only 4.9% of loans are classified as "problematic". [21]

PROFESSIONAL RECOMMENDATIONS & DIRECTIVES: CODE OF GOOD CONDUCT FOR MICROCREDIT FACILITIES AND PRACTICES

On 26 September 2013, the Hungarian Microcredit Network organized a workshop on **"The experience of the Hungarian legal framework for MF provision and its lessons in an international context, and the possible effects of the implementation of the European Code of Good Conduct for the sector"**. This Workshop was held in Budapest and was attended by the representatives of Microfinance Institutions (MFIs) involved in the regulation, Hungarian members of the European Parliament, representatives of the Ministry of Economic Affairs and the Central Bank, as well as EU experts involved in the elaboration and implementation of the European Code of Good Conduct.

In 2011, the European Commission decided to elaborate on a uniform code of conduct for microcredit provision in the EU. [22] No organizations from the Visegrád Four (V4) countries participated in the elaboration of this document. At first glance, the procedure is very bureaucratic and similar to the majority of EU procedures. Elaboration of an individual code of conduct is time-consuming, Moreover, it is unknown if these revised codes of conduct will improve microcredit practices in any given country.

The participants of the Budapest Workshop studied the current practice of Hungarian microcrediting, and unanimously suggested that international, professional recommendations and directices ought to be defined with a simplified methodology.

CONCLUSION

Microcredit is a bottom-up approach of the local economic development process, assisted by special intermediary microfinance institutions. The lack of adequate start-up finance is one of the most significant barriers to young and socially excluded persons seeking to establish their own businesses.

There is a paradigm change in the creation of economic and social activities. Through microcredit, the unemployed and the poor become creditable. The economic power engendered by microcredit creates a socio-economic power that generates income and lifts the poor out of poverty.

Micro and small enterprises play a significant role because they provide goods and services on the spot. In doing so, they create jobs, pay taxes and generate growth. Microcrediting, in accordance to EU policy, can be used to reduce poverty and encourage the entrepreneurial unemployment to return to the labour market. However, the majority of micro and small enterprises still cannot apply to financial institutions for aid, in spite of their best efforts. Government policymakers and the financial elite do not understand that microcredit facilities perform the important role of fighting poverty and fostering social inclusion through job creation and self-employment.

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2. THE GERMAN EXPERIENCE IN MICROFINANCE

by

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ABSTRACT

This paper aims to provide a complete picture of German experience in the field of microfinance. This sector has been actively developing in Germany in recent years, after the increased attention and interest from the public authorities. Thus, the purpose of this research is to describe the microfinance model characteristic for Germany, justify the correlation between microfinance and small and medium-sized enterprises (SMEs), and finally, summarize the lessons derived from the German case study. The research is based on in-depth critical analysis of the most recent works and reports on Germany's experience in microfinance as well as its actual practice.

The case of Germany is unique not only from the point of view of its historic development, which is distinguished by the present predominance of former microfinance institutions in the banking assets (approximately 50%) nowadays and having a population outreach of 90% (Seibel 2005), but also through its economic backbone represented by the *Mittelstand*.⁵ The strong SME sector and its sustainable development are due to reliable access to finance as well as solid business, tax and labour regulations. However, due to the new expanding target groups such as micro start-ups launched out of poverty or self-employed migrants, and their difficulties in obtaining finance, the forecasted access to finance is changing (Unterberg 2014).

In the context of the KAS-BSEC-Workshop "Microfinance and SMEs", which gathered representatives from the Member States of the Black Sea Economic Cooperation (BSEC) and took place in Bucharest in November 2014, this research is of particular importance and interest. This is because it provides a comprehensive overview of the microfinance experience of a western European country. Thus, this German case study broadened the participants' scope of discussion of best practice models to a regional level. It also reminded participants that it is crucial to consider best practice models at the regional level, owing to different microfinance models adopted by different European countries. In so doing, the participants discovered that a successful model in one country may not necessarily be as successful in another country.

Keywords: microfinance, microfinance model, German microfinance experience, SMEs

JEL classification: G21 Banks, Depository Institutions, Micro Finance Institutions, Mortgages

1 PROLOGUE

In order to fully understand the specifics of microfinance in Germany, the practice of microfinance formation in the European Union (EU) should be analyzed. The microfinance sector in Europe can be relatively young, and its outreach and performance need fine-tuning. The most frequently offered financial service is microcredit,⁶ while savings and microinsurance are barely introduced. According to EU definition, microloans can further be differentiated according to their purpose into microloans for business and personal consumption.

⁵ *Mittelstand* refers to small and medium-sized enterprises (SMEs) in German-speaking countries.

⁶ The European Commission (EC) defines *microcredit* as a loan of less than EUR 25,000 that addresses the need for access to credit by business start-ups, small businesses and the self-employed.

Box 1: Categories of microloans

Business microloan – a loan under EUR 25,000 with the aim of supporting the development of microenterprises or self-employment.

Personal microloan - a loan under EUR 25,000 with the aim of covering personal or consumption necessities (for example, rent, private emergencies or education).

Source: “Microcredit,” European Union website, http://ec.europa.eu/enterprise/policies/finance/borrowing/microcredit/index_en.htm.

It is important to note that due to a high level of economic development, high financial inclusion rates of population and overall favourable social welfare system, the microcredit model in the EU will differ from those applied globally. Table 1 reflects the distinctive features of microcredit loans between developing, transitional and industrialized countries.

Table 1: Overview of global microcredit loans

	Greatest prevalence	Typical average loan amounts	Number of borrowers/ country	Financial performance	Social goals
Developing countries	South America, Asia, Africa	EUR 50-500	> 2 million	Profitable, in part subsidised	Fighting poverty & promoting self-employment
Transitional countries	Eastern Europe	EUR 500-10,000	> 20,000	Profitable, in part subsidised	Financing for new self-employment
Industrialized countries	Western Europe e.g. UK, France, Germany	EUR 1,000-25,000	> 5,000	Highly subsidised	Growth financing for microenterprises & financing new self-employment

Source: Alexander Kritikos and Christoph Kneiding, “Microcredit: Is there Demand for this Type of Loan in Germany?”, German Institute for Economic Research, Weekly Report vol. 6, no. 14, (May 2010), p.106.

The table also indicates that within the EU, there are differences between the Central Eastern and Western markets in terms of loan sizes, target beneficiaries and intermediaries (Kraemer-Eis and Conforti 2009). Thus, in Central and Eastern Europe, the major purpose of the microcredit is to increase financial inclusion and sustain development. In Western Europe, on the other hand, the financial market is highly developed and banks already provide finance to the majority of population, including non-risky microcredit applications. As a result, the microfinance sector in Western Europe is mostly concentrated on the marginalized population (who bear implicitly higher risks), with emphasis on fighting social exclusion rather than making high profits. Table 2 summarizes the main differences between “East” and “West”.

Table 2: Key differences between Western and Eastern Europe microcredit market models

	Western Europe	Central & Eastern Europe
Maturity	Young	More mature
Number of loans	Fewer loans – average of 1,226 loans per institution	More loans – average of 1,575 loans per institution
Average loan size	Volume larger	Volume smaller
Social focus	Those suffering from poverty and social marginalization	Those excluded from traditional banking service, constituting major obstacle to launch of new business activities
Commercial priority, attention profitability	Grant and donor dependency, with less financial sustainability	Larger presence of commercial intermediaries with more sustainable

	Western Europe	Central & Eastern Europe
		business models
Microcredit legislation	Little specific legislation	Specific legislation exists, allowing market to be more commercially oriented and sustainable

Sources: Helmut Kraemer-Eis and Alessio Conforti, "Microfinance in Europe: A Market Overview", Working Paper 2009/001, European Investment Fund Research & Market Analysis, (November 2009). The European Commission, "Evaluation of Jasmine Technical Assistance Pilot Phase: Final Report", submitted by ICF GHK (November 2013), p.12.

2 HISTORIC ROOTS OF MICROFINANCE

The German roots of microfinance go back more than two centuries (Seibel 2005). Today, there are two large networks comprising the community-owned savings funds or banks, *Sparkassen* (German for a *savings bank*), and the member-owned cooperatives, *Volksbanken* (German for a *people's bank*) and *Raiffeisenkassen*.

- The origins of the *Sparkassen* date back to the second half of the 18th century. Based on the principle that charity alone is not sustainable and that there could be a big savings potential among the poorer population, the first institutions were established in Hamburg (as thrift societies) in 1778 and the first municipal savings bank was established in Göttingen (*Sparkasse*) in 1801. It became a role model for the savings banks, which still maintain close ties to local authorities.

With the development of the institutional network and the growth of savings deposits, the *Sparkassen* started to diversify and develop lending facilities during the 19th century. These lending facilities played an important role in financing the industrialization of Germany. At the beginning, the business conducted by the savings banks was limited. In the early 20th century, the system evolved and gained the capacity to perform cashless payments and trade in securities. Today, they form part of the universal banking system of Germany.

- The other strong movement underlining the historic dimension of microfinance started after the hunger year of 1846-1847. Starvation was spreading; many farmers lost their plots to moneylenders, and many small enterprises went bankrupt. In response to this situation, Mr. Raiffeisen created credit associations (*Darlehnskassen-Vereine*)⁷ for rural areas, later known as *Raiffeisenkassen*. Mr. Schultze-Delitzsch started a similar initiative for the urban areas, establishing savings and credit cooperatives among small entrepreneurs. These were later known as *Volksbanken*.⁸ Mr. Raiffeisen realized that doling out charity was not a sustainable solution, and established the first rural credit association in 1864. There were three stages of development: an informal start with sluggish development; regulation as special financial institutions led to rapid growth and worldwide dissemination; and consolidation under banking law, turning them into universal banks in Germany.

According to Seibel (2005), Germany's financial sector is still dominated by these former microfinance institutions (MFIs), which have continued to serve small and medium-sized enterprises (SMEs) as well as households. The Annual Report (2013)⁹ of the *Finanzgruppe Deutscher Sparkassen und Giroverband* network revealed that it comprised 20,170 branches and advisory centres in Germany, 50 million customers and uniting 590 independent institutions as of 2013. The number of customers of *Bundesverband der Deutschen Volksbanken und Raiffeisenbanken* amounted to 17.7 million; it also had 1,078 member banks as indicated in its Financial Statement for 2013.¹⁰ The two networks both comprised approximately 44% of all banking assets. Small and local banking remains profitable, as they still finance three-quarters of all SMEs and 80% of business start-ups in Germany.

⁷ Mr. Raiffeisen established a charity in 1847 where he catered grain from non-affected areas; and within a couple of months, this decreased the price of bread by 50%.

⁸ The principle on which Mr. Schultze-Delitzsch established the first urban credit association was based on a self-help mechanism without charity.

⁹ http://www.dsgv.de/en/facts/annual_report/index.html.

¹⁰ http://www.bvr.de/Press/Consolidationd_financial_statements.

3 ECONOMIC SNAPSHOT

Pursuant to the World Bank indicators, Germany is the world's fourth largest economy and the first in the eurozone in terms of gross domestic product (GDP) with EUR 2.9 trillion in 2013. German GDP growth in 2013 was 0.43%, down from 0.69% in 2012. The slowdown in GDP growth (as in the rest of the euro area) was determined by a slide in business investment due to weaker global demand and recession in southern Europe. Germany is the leader in the production of engineering products, vehicles, chemicals and pharmaceuticals, machinery and automobiles and many other sectors. In 2013, the industrial sector contributed 30.2% to GDP, while the service sector contributed 69%. A breakdown of the service sector's contribution to GDP is as follows: public services (18%), trade (16%), financial and business service (26%), information and communication (5%) and other services (4%). German agriculture is relatively insignificant, contributing to only 0.8% of the nation's GDP.

Box 2: Macroeconomic Indicators (2013)

▪ Total population:	80,621,788
▪ Urban population:	74.9%
▪ GDP (current EUR):	2.914 trillion
▪ GDP growth:	0.43%
▪ GDP per capita (current EUR):	36,146.9
▪ Persons in employment:	43.381 million (2014)
▪ Income category:	high income
▪ Unemployment rate:	6.3% (2014)
▪ People at risk of poverty or social exclusion:	16.1%
▪ Human Development Index (HDI) value:	6 out of 187 countries

Sources: The Federal Statistical Office website, <https://www.destatis.de/EN/FactsFigures/Indicators/Indicators.html>, accessed November 2014. World Bank website, <http://data.worldbank.org/country/germany>, accessed November 2014.

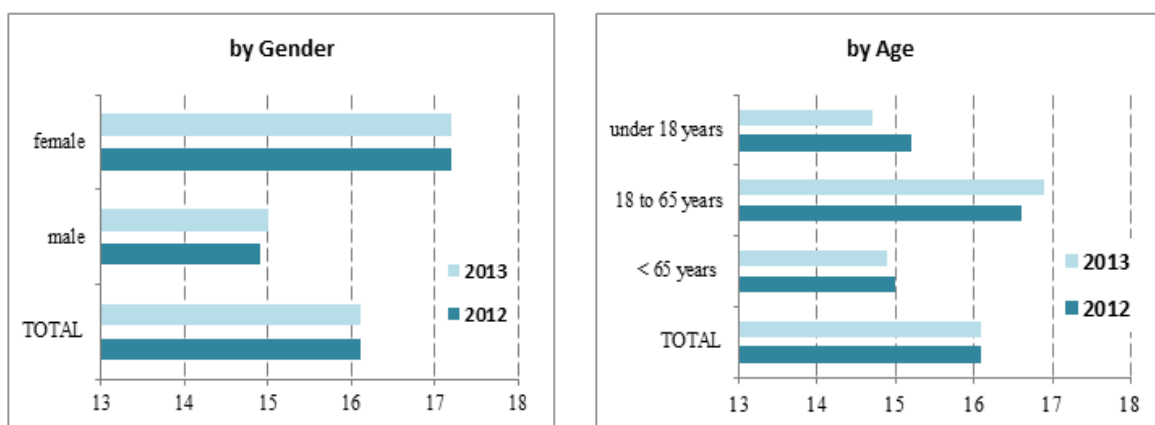
According to the Federal Employment Agency (*Bundesagentur für Arbeit*), 43.4 million German residents were employed as of October 2014, increasing from 2013's figures by 0.9%.¹¹ During the same period, there were approximately 2.7 million unemployed people, indicated by the unemployment rate of 6.3%. It marks a decrease of 0.2% from the previous month, which is usual for this time of year. Youth unemployment in Germany accounts for 7.8% (as of May 2014), the lowest among the EU member countries. The Federal Employment Agency attributes the low rate of youth unemployment to the successful implementation of vocational training.

The Federal Statistical Office stated that 16.1% of the population in Germany are at risk of poverty in 2013,¹² similar to the indicators of 2012.

¹¹<http://www.arbeitsagentur.de/web/content/EN/Press/Detail/index.htm?dfContentId=L6019022DSTB-AI700177>.

¹² According to the EU's definition, the *at-risk-of-poverty rate* is the proportion of persons, who have to make do with less than 60 % of the median income of the entire population.

Figure 1: At-risk-of-poverty rate in Germany by gender and by age
(percentage share of population)



Source: The Federal Statistical Office Web site, https://www.destatis.de/EN/FactsFigures/SocietyState/IncomeConsumptionLivingConditions/LivingConditionsRiskPoverty/Tables/EU_PovertyThresholdRisk_SILC.html, accessed November 2014.

Figure 1 shows insignificant movements in the poverty rates of 2012-2013. A detailed breakdown of the figures shows that females are more vulnerable to the risk of poverty (at over 17%, as opposed to 15% for males). People between the ages of 18-65 are most at risk of poverty, while those under 18 or over 65 are either supported by their families or receive pensions.

4 CHARACTERISTICS OF THE SME SECTOR

Germany's *Mittelstand* companies constitute a very important part of the country's economy. They are in fact the backbone of the country's economy. Based on the data provided by the Federal Statistical Office, SMEs comprised 99.6% of 3.71 million enterprises and provide employment to 60% of the working population. As a result, SMEs' value added for GDP accounted for roughly 50%.

According to the European Commission (EC), SMEs are companies that have (i) an annual turnover of less than EUR 50 million (or have balance sheet totals that do not exceed EUR 43 million) and (ii) employ less than 250 workers (see Table 3 below). They are further divided into three categories: micro, small and medium-sized enterprises (MSMEs).

Table 3: Definition of MSMEs

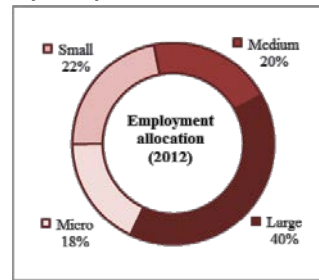
Company category	Employees	Turnover (EUR)	Balance sheet total (EUR)
Micro	< 10	≤ 2 mln	≤ 2 mln
Small	< 50	≤ 10 mln	≤ 10 mln
Medium-sized	< 250	≤ 50 mln	≤ 43 mln

Source: The European Commission Web site, http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index_en.htm.

18% of the working population work in microenterprises, 22% in small businesses and 20% in medium-sized enterprises. All of which indicates a relatively equal distribution and outstanding importance in job growth (see Box 3 for further reference).

Box 3: German SMEs at a glance (2012)

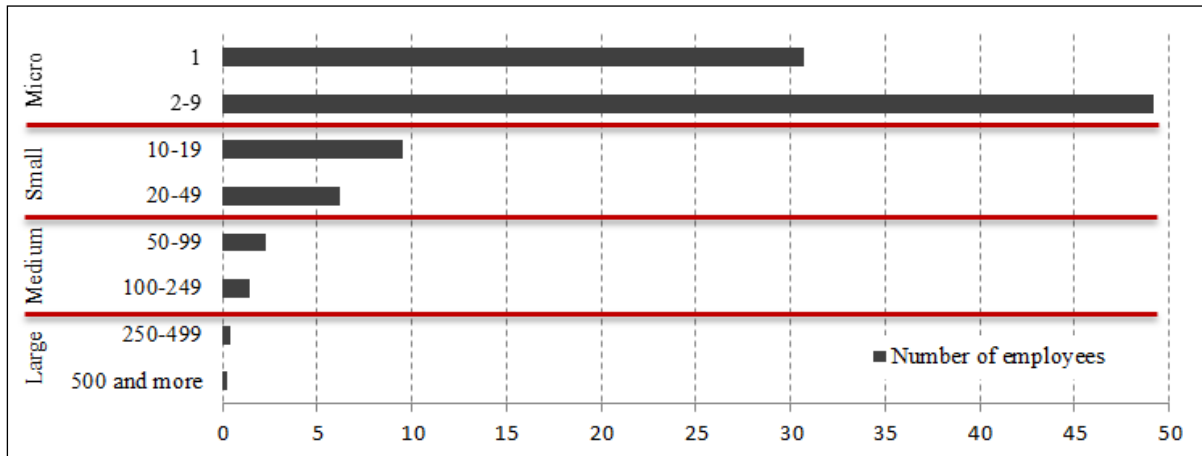
- More than 3.6 million enterprises
- Early turnover exceeding EUR 500 million
- Employment for more than 28 million people
- Microenterprises – 18% of workplaces
- 1,307 hidden champions out of 2,734 worldwide have German origins



Sources: Barbara Böttcher, “Making a Difference: German SMEs and their Financing Environment”, Deutsche Bank Research (March 2013). The Federal Statistical Office website, <https://www.destatis.de/EN/FactsFigures/Indicators/Indicators.html>. KfW Bankengruppe, Profile of the SME Sector in Germany (October 2014), <https://www.kfw.de/migration/Weiterleitung-zur-Startseite/Homepage/KfW-Group/Research/PDF-Files/The-SME-sector-in-Germany.pdf>.

When SMEs are analyzed according to the number of employees hired, it becomes evident that most prevailing enterprises (almost 80%) are microbusinesses.

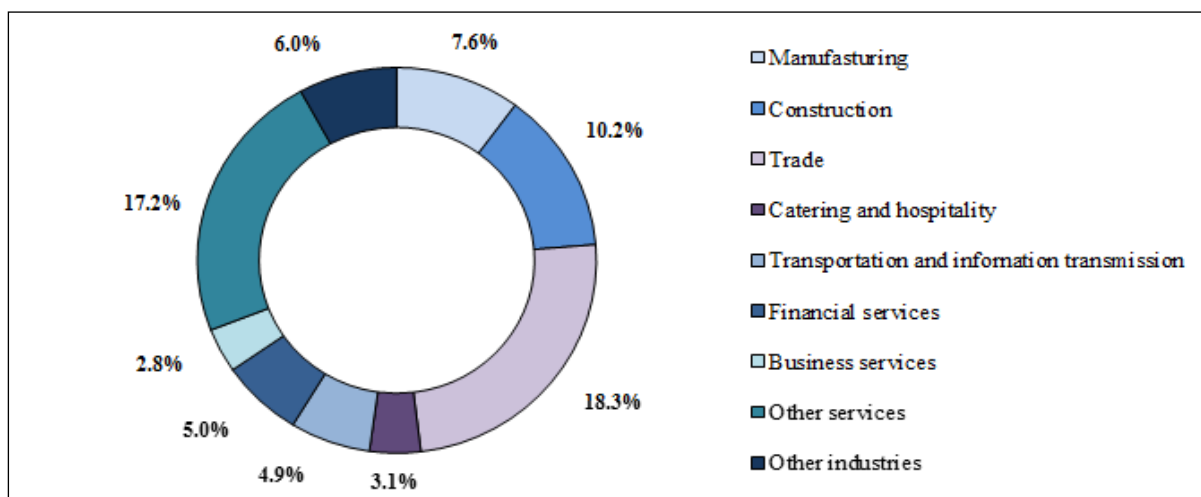
Figure 2: Allocation of companies according to number of employees (2010)



Source: Barbara Böttcher, “Making a Difference: German SMEs and their Financing Environment”, Deutsche Bank Research (March 2013), p.6.

Figure 3, below, illustrates the patterns of sectoral distribution within the SME sector. The engagement of the vast majority of enterprises in the service industries comprises more than 70%, consistent with the GDP structure in Germany (discussed in Section III).

Figure 3: Allocation of SMEs according to industry (2010)



Source: KfW (German government-owned Development Bank) Bankengruppe, "Profile of the SME Sector in Germany," October 2014, <https://www.kfw.de/migration/Weiterleitung-zur-Startseite/Homepage/KfW-Group/Research/PDF-Files/The-SME-sector-in-Germany.pdf>.

The SMEs' outline indeed bears evidence of their significance and importance in Germany. SMEs owe their success not only to the overall strength of the German economy, but also their own distinctive features. According to research conducted by Deutsche Bank in 2013 (Böttcher 2013), SMEs are innovation-driven, provide high-quality products, efficient services, and are reliable in meeting delivery deadlines. Favourable economic regulations vis-à-vis tax and the labour market have, likewise, positively impacted SME development.

However, the EC's analysis of SME performance in 2012 revealed a challenge for German SMEs in particular – that of the population ageing. The shortage of young professionals is reportedly noticeable in certain business sectors. As a consequence, this may lead to a decreasing number of entrepreneurs and start-ups, who are direct potential clients of microbanking. A few years ago, difficulty in obtaining financing was considered to be the major challenge for SMEs. However, according to the conclusions of the Deutsche Bank analyses on the financial environment in 2013 (Böttcher 2013), finance was not considered a barrier. This indicates that SMEs have, at their disposal, different banking groups offering suitable financial solutions.

5 LEGISLATIVE FRAMEWORK ON MICROFINANCE

Contrary to other countries, the German Banking Act has neither differentiated between providing standard loans or microcredit nor created a legal framework allowing non-bank institutions to provide specialized microcredit loans. Some authors call this situation as "banking monopoly" where only banks are allowed to issue loans independently of its character. In Germany, products associated to microfinance are only related to credit products.

That means German MFIs only have a limited role in screening, recommending loans to banks, and consulting with MSMEs in need of finance. Credit granting activities are exclusively the domain of commercial banks, *Sparkassen* and *Volksbanken und Raiffeisenbanken*, the state-owned national *Förderbank* (promotional bank) KfW, as well as the regional promotional banks of the different federal states. These banking institutions are either directly or indirectly providing loans to MSMEs via MFIs.

Box 4: The House Bank principle

The *house bank principle* is a widespread concept applied in Germany. The house bank in Germany refers to the bank handling all the financial transactions of its customers. SME clients usually establish a close relationship with a particular house bank. Large companies, like those belonging to the German Stock Index (DAX), use the "classic" house bank concept only in the area of cash management and payment services.

In previous years, direct lending has been especially hampered for smaller business clients and start-ups asking for loans less than EUR 20,000. Thus, the involvement of MFIs has become more important. MFIs under the umbrella of the German Microfinance Institute (*Deutsche Mikrifinanzinstitut* (DMI)) have been increasingly involved in the “linkage banking” system where the regulated banks issue loans but the MFIs take over the screening, analysis and recommendation of the client to the Bank. DMI accredits and develops MFIs to provide these services. Due to this scenario, some legal frameworks are applicable to MFIs. These are as follows:

- MFIs do not directly lend money to potential clients. Some general consumer protection standards such as the Law on the Execution of the Consumer Credit Directive and the Standard European Consumer Credit Information generally apply to MFIs.
- MFIs can be set up either as Private Partnership, Limited Liability Company or Partnership. This involves the application and adherence to general corporate and tax rules, similar to other companies with this legal form. Here, MFIs are bound by the German Limited Liability Company (LLC) Act, German Trade Code, as well as General Tax Law such as German Trade Tax Act, Corporate Income Tax Act and Value Added Tax Act.
- Usury rules for credit activity exist under Section 138 of the German Civil Code, which stipulates the ban of immoral transactions. A ceiling has been set by German case law, which defines an interest rate that is twice as much as the market interest rate as usury.
- Credit Bureau: MFIs have access to personal information and credit-worthiness data of clients. This information is provided by the *Schufa* or *Creditreform Consumer GmbH*, once the clients have a contractual relationship with MFIs. Alternatively, MFIs may require their clients to present an extract of the German General Credit Protection Agency (*Eigenschufa Auskunft*) or from their house bank.

6 GOVERNMENT PROGRAMME SUPPORTING MICROFINANCE

There are different government schemes supporting microfinance in Germany. Since microfinance (in Germany, microfinance is understood to be loans taken by businesses only) is primarily done via banks with the MFIs serving as the front-end, several different guarantee schemes have been set up as well.

The most prominent promotional programme is Microcredit Fund Germany. It is the successor of the pilot project, Microfinance Fund Germany (which was active between 2006 and 2010). The pilot project had a volume of EUR 3 million and was initiated by the Federal Ministry of Economy and Technology, Federal Ministry of Labour and Social Affairs, the European Social Fund, KfW Bankengruppe and GLS Bank.

Microcredit Fund Germany was founded and is financed by the Federal Republic of Germany in 2010 with a volume of EUR 100 million. It is a guarantee scheme as well. Here, accredited MFIs have the front-end function of analysing, recommending loans to GLS Bank and assisting the borrower from application to repayment.

There is also a three-tier German Public Promotional Banking System (mostly operating as second tier) supporting the Microfinance Sector as follows:

- KfW, the **National Promotional Bank**, has coordinated several dialogues and initiatives for microfinance; it was also one of the first (in 2000) to start a nationwide microfinance scheme (*KfW-Gründerkredit-StartGeld*) mainly for start-ups. KfW usually works as a second tier institution, providing funds to the House Banks of the client, which then passes on the money to the end-client. In the event of defaults, KfW bears 80% of the losses while the House Banks bear only 20%. Today, KfW mostly targets higher-end loans (up to EUR 100,000), since procedures have become costly and time-consuming for end-borrowers.
- The 15 **Regional Promotional Banks** of the *Länder* (Federal States) also started to establish microcredit programmes in the past decade. While they originally offered second tier services through the House Banks, there are now initiatives to directly issue loans to microenterprises through simplified procedures (as practiced by *NRW Bank*, *Sächsische Aufbaubank (ESF-Mikrodarlehen)* and *Investitionsbank Berlin* for example).

- In addition, there are **Regional Guarantee Banks** (*Bürgschaftsbanken*) in each of the Federal States, offering loan guarantees of up to 80% of the loans issued by banks.
- There are **several initiatives at the local level** where municipalities promote microfinance. One example is the “*Frankfurter Gruenderfonds*”, where Frankfurt School Financial Services (FSFS) provides the front-end functions. *Frankfurter Gruenderfonds* supports start-up companies with up to five years’ existence in Frankfurt am Main. Economic Development GmbH Frankfurt, a daughter company of the city of Frankfurt, provides financial means for guarantee funds with this purpose. The Guarantee Bank of Hesse GmbH issues the guarantee certificates. As a service provider, FSFS supports high-quality business concepts, checks potential founders that want to participate in this programme and recommends applicants for a guarantee certificate based on ratings and an additional evaluation. FSFS further coordinates the activities within the cooperating partners to support the start-up business activities in Frankfurt am Main and manages the fund.

As mentioned above, there are a number of **public guarantee schemes** in place that enable lending to microentrepreneurs via the commercial banking system. Public guarantee schemes can only be promoted through the commercial banking system. The House Banks have access to guarantee schemes in two ways: either to build it into the loan programmes as default guarantees/exemptions from liabilities or through access to separate guarantees issued by the Regional Guarantee Banks or other specialized programmes.

7 MAJOR MICROFINANCE INTERMEDIARIES AND INSTITUTIONS

According to Mikrokreditfonds Deutschland (known as Microcredit Fund Germany in English), there are 35 MFIs operating in Germany as of 2014. MFIs mostly use their specific front-end activity to target non-bankable enterprises (specifically, businesses led by young people, migrants, women and start-ups).

The example of the loan portfolio growth of the Microcredit Fund Germany (since it became operational in 2010) provides an idea of the market size of the MFI sector in Germany and its potential. The growth rate of the number of disbursed loans from 1,740 to over 17,500 by 2014 outperformed the analysts’ projections and placed Germany among the top five growing microcredit sectors in the eurozone.

Table 4: Growth of the loan portfolio of Microcredit Fund Germany

Year	2010	2011	2012	2013	2014 (accumulated till May 2014)
Number of loans distributed	1,740	4,852	5,853	4,284	17,506
Loan volume (in mln EUR)	9.78	29.57	33.61	24.90	103.25

Source: Michael Unterberg, Mirko Bendig, Martin Schellhorn and Ann-Kristin Torkler, *The German ‘Mikrokreditwunder’: Lessons Learned – Challenges Encountered*, Evers & Jung on behalf of GLS Bank (June 2014), p.7.

The overview of the major MFI players is represented below in Table 5. The first 12 microfinance providers outlined in the table received specialized technical assistance from the Joint Action to Support Microfinance Institutions in Europe (JASMINE) programme managed by the European Investment Fund.

Table 5: Comparison of German MFIs

№	MFIs	Special offers for target groups	Special features of the offers	Coverage area
1	Goldrausch	founders and entrepreneurs 45 + with an immigrant background health and social	microcredit specially for women	Berlin
2	HSZ Consulting	trade and crafts, especially furniture, kitchens, plumbing, electrical, lighting, carpentry	cooperation with different purchasing associations in the kitchen and furniture industry goods and financing for purchases, bonus pre-financing, cooperation with a leasing and factoring company	Baden-Württemberg, Rheinland-Palatinate, Hesse, Bavaria
3	Indaro Mikrofinanz	social and household-related services, other services, trade, crafts and craft related companies, gastronomy	in about 90% of requests a loan is granted, of which around 80% without collateral loan decision within 48 hours, very good accessibility	nationwide
4	Kapitalinstitut Deutschland	no special offers, general finance for entrepreneurial activities	support for financing of over EUR 10,000, on request: availability of a consultant from its network of consultants	nationwide
5	KIZ Finanzkontor	credit for women, creative loans specifically designed for self-employed in the creative and cultural industries liquidity loan specifically designed to lift potential microentrepreneurs out of unemployment	uncomplicated application procedure via mail, telephone and fax, feedback within 2 days, current approval rate from the 91%, a large network of consultants to support	nationwide
6	mikrofinanzwerk	no special offers, general finance for entrepreneurial activities	-	Southwest Palatinate region, Pirmasens, Zweibrücken (Two Bridges), County Southwest Palatinate, Kusel and Kaiserslautern
7	Mikrokredit Schleswig-Holstein	gastronomy, craftsmen, retail, service companies	microfinance for North Germany: "We finance companies and their ideas!"	Schleswig-Holstein, Hamburg, Mecklenburg-Vorpommern
8	Mozaik	companies with immigrant backgrounds	particular focus on lending to	NRW - East Westphalia-Lippe

No	MFIs	Special offers for target groups	Special features of the offers	Coverage area
			businesses with immigrant background (mainly Turkish migrants) lending to members of the cooperative	
9	pro-Unikus	Women, craftsman, restaurateurs, retailer, migrants, creative, service	sustainable financing solutions	North Rhine-Westphalia (NRW)
10	Regios	stock companies with expansion projects, companies in regional cycles, food, crafts, services, inter alia, "Networker", building a credit and savings cooperative	approved over 200 microloans in Bavaria, brought social capital to 120 cooperative members. core objective is sustainable regional development of economic cycles	Southeast Bavaria and nationwide in areas of cooperation of regional currency initiatives
11	smart Mikrokredit	no special offers, general finance for entrepreneurial activities	credit support by cooperating with local consultants	Berlin, Brandenburg
12	VS Finance	no special offers, general finance for entrepreneurial activities	-	Berlin, Brandenburg
13	Kreativ Finanz Mecklenburg	tourism and healthcare, craft, women	regional MFIs, open to all industries, many years working experience in corporate finance	Ludwigslust-Parchim, Northwest Mecklenburg, Rostock, Mecklenburg Western Lake District (Former district Müritzt), district-free cities: Schwerin, Rostock
14	GLC Glücksburg Consulting	cultural and creative industries, craftsmen, health and social sector service, trade, hospitality and transport industry	short processing time of 1-3 days; loans up to EUR 2,000 are possible without collateral; many years working experience as a business promoter	Lower Saxony, Schleswig-Holstein
15	Sportplus	entrepreneurs and start-ups in the private healthcare market as well as leisure and entertainment companies	specializing in the financing of entrepreneurs in the sports and leisure market; fast credit decision within 3 days; worked nationwide for the sports and fitness industry	nationwide
16	GfM - Gesellschaft für Mittelstandsförderung mbH	members of professional trade associations / cooperatives / partnerships and similar networks of trade and craft	focus on livelihoods and growth in appropriate networks	Greater Munich - on request, location of the composite group
17	Mikrofinanzmanager	women, persons with disabilities, persons with immigrant backgrounds	close cooperation with employment agencies and job centres, towns and cities	Lower Saxony

No	MFIs	Special offers for target groups	Special features of the offers	Coverage area
			as well as economic development agencies and chambers of commerce commitment rate of over 90%, loan approval 72 hours after the receipt of documents	
18	mein-mikrofinanzierer	services, catering and IT entrepreneurs, with Russian-speaking migrants	support for entrepreneurs in realizing their ideas - fast and unconventional	Bavaria
19	Solidarity Finance	entrepreneurs with financial problems, artisans, service providers, traders	specializing in distressed companies, many years of experience in advising and supporting the consolidation of companies	Saxony-Anhalt and Baden-Württemberg
20	Die Regionalen	health food stores, health food shops, organic supermarkets	financing offers exclusively for natural food retailer; financing of the health food store trade	nationwide - in the catchment areas of the ten natural foods wholesaler of REGIONAL
21	Mobil Mikrokredite	no special offers general finance for entrepreneurial activities	loans without collateral on a small scale are possible	Southern Lower Saxony, Northern Hesse
22	BerlinMicro	founders in the IT or the internet sector	active founding experience, strong networking	Berlin, Brandenburg, Bavaria
23	Nordhand	no special offers, general finance for entrepreneurial activities	Lending only to members of the cooperative	Dortmund
24	MFI Sachsen	no special offers, general finance for entrepreneurial activities	-	Saxony / Thuringia
25	DMK Dresdner Mikrokredit AG	no special offers, general finance for entrepreneurial activities	partner in microfinance for the city of Dresden	Saxony, Brandenburg

Source: Mikrokreditfonds Deutschland website, <http://www.mikrokreditfonds.de/de/mikrokredit-erhalten/mikrofinanzinstitute/mikrofinanzinstitut-angebote.html>, accessed November 2014.

8 MODELS OF MICROFINANCE OF SMES

While each financial institution has developed their own mission statement, target client groups and corresponding financial products and services, the conditions for providing microcredit can be summarized as follows: a business loan of a maximum amount EUR 20,000 with an 8.9% interest rate for a maximum period of 36 months (Bendig et al. 2014).

When MFIs' offers and promotional banks' direct loans are examined separately, the European Microfinance Network (EMN) study shows that the average business loan of promotional banks was approximately EUR 18,000 - varying between EUR 15,000 and a ceiling of EUR 25,000 for up to ten years. The banks additionally offered a grace period of 6 to 24 months.

The loans which were disbursed with the front-end support of the MFIs' averaged EUR 5,700 in 2013. Half the loan portfolio was distributed to existing entrepreneurs, while 32% went to those who wanted to start microbusinesses to lift themselves out of unemployment. Of the clients represented in 2010, 33% were females and 35% had migrant roots.

Table 6 summarizes the conditions for obtaining microcredit in Germany (as of November 2014).

Table 6: Microcredit “on offer” as of November 2014

	Conditions for obtaining microcredit
Interest rate	as of today, 8.9% p.a. effective
Loan term	short-term loans, maximum 3 years
Loan amounts	generally small amounts; after successful repayment of the first loan – increasing loan ceilings up to EUR 20,000 are possible
Repayment	monthly or bullet payment (at the end of the loan term)
Costs	no additional costs

Source: Mikrokreditfonds Deutschland, <http://www.mikrokreditfonds.de/de/mikrokredit-erhalten.html>, accessed November 2014.

9 CONCLUSIONS

The lessons learned from the German microfinance experience can be summarized as follows:

- General macroeconomic conditions heavily influence the positive development of microfinance and can prevent or foster its evolution.
- Sustainable development of the SME sector, which is the backbone of the economy, is only possible with reliable access to finance and solid business, tax and labour regulations.
- Strong banks with orientation towards small transactions with retail and SME customers are important for inclusive financial systems.
- When banks are the only institutions that can issue loans, a first step towards microfinance would be the application of the “linkage banking” model where MFIs fulfil the front-end function.
- Credit guarantee schemes can work well when a developed banking system exists, and thus would not have a strong impact in increasing the credit costs for SMEs.
- The more developed the economy, the less important is “commercial” microfinance. This is because the conventional financial system takes over that role and leaves “social” microfinance to close the financial gap for marginalized groups such as the unemployed, women, young or entrepreneurs with migrant roots.

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3.1 MICROCREDITING OF SMALL AND MEDIUM-SIZED ENTERPRISES IN ALBANIA

by

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ABSTRACT

Access to finance is one of the main challenges faced by Albanian small businesses in the aftermath of the latest global financial crises. The commercial banks mostly provide loans to corporations. Since they do not provide loans to start-up businesses, this poses substantial constraints on entrepreneurs. Within the BSEC region, Albania has the lowest financial leverage.

Microfinance institutions represent a good source of financing for small enterprises because they cover rural and semi-urban areas where the banking system is absent. They also provide loans to non-qualified businesses and enable them to get bank credit. But in Albania, microfinance institutions are a developing segment of the financial market and their share of total financial assets remains low. This study considers the importance of microfinance institutions for a developing country like Albania by focusing on the latest developments of microfinance institutions and their challenges for the future. This study provides detailed analysis of microfinance institutions, thereby contributing to existing literature.

Keywords: SMEs, microcredit, access to finance

JEL classification: G21, G23, G28

1. SMALL AND MEDIUM ENTERPRISES IN ALBANIA

Small and medium enterprises (SMEs) are the engine of the Albanian economy. They are essential to the creation of new jobs, promoting entrepreneurial and innovative spirit as well as increasing competitiveness and employment. Most Albanian SMEs are microenterprises with 1 to 9 employees, and they make up 94.6% of the total number of active enterprises. SMEs' contribution to employment in the private non-agricultural sector in 2012 was 81.6%, 2.4% lower than the previous year. SMEs' total export that same year was 43.7%, 3.1% lower than the previous year. The value added of Albanian SMEs in 2012 was 69.8%, increasing by 6.2% from the previous year (INSTAT 2014b). A detailed analysis of SMEs' contribution to employment, export and value added is illustrated in Table 1 below. Micro-firms contributed 45.8% to employment in the non-agricultural private sector (down by 0.4% from the previous year), 8.2% to export (increasing by 0.5% from the previous year) and 23.5% to value added (decreasing by 0.9% from the previous year). Small enterprises contributed 19% to employment (decreasing by 1.2% from the previous year), 13.3% to export (decreasing by 1% from the previous year) and 28% to value-added (increasing by 3.3% from the previous year). Medium enterprises contributed 16.8% to employment (increasing by 0.8% from the previous year), 22.2% to export (decreasing by 1.5% from the previous year) and 18.3% to value added (increasing by 4% from the previous year). While large enterprises with over 250 employees contributed 18.4% to employment (increasing by 2.4% from the year before), 56.3% to export (increasing by 3.1% from the previous year) and 30.2% to value added (decreasing by 6.2% from the previous year) (Demeti et al. 2015). These figures can be seen in Table 1.

Table 1: The contribution of SMEs in 2012

	Size of enterprises				
	Micro (1-9)	Small (10-49)	Medium (50-249)	SMEs	Large (250+)
employment	45.8%	19.0%	16.8%	81.6%	18.4%
value-added	23.5%	28.0%	18.3%	69.8%	30.2%
export	8.2%	13.3%	22.2%	43.7%	56.3%

Source: INSTAT 2014, ASN 2012 and author's calculation

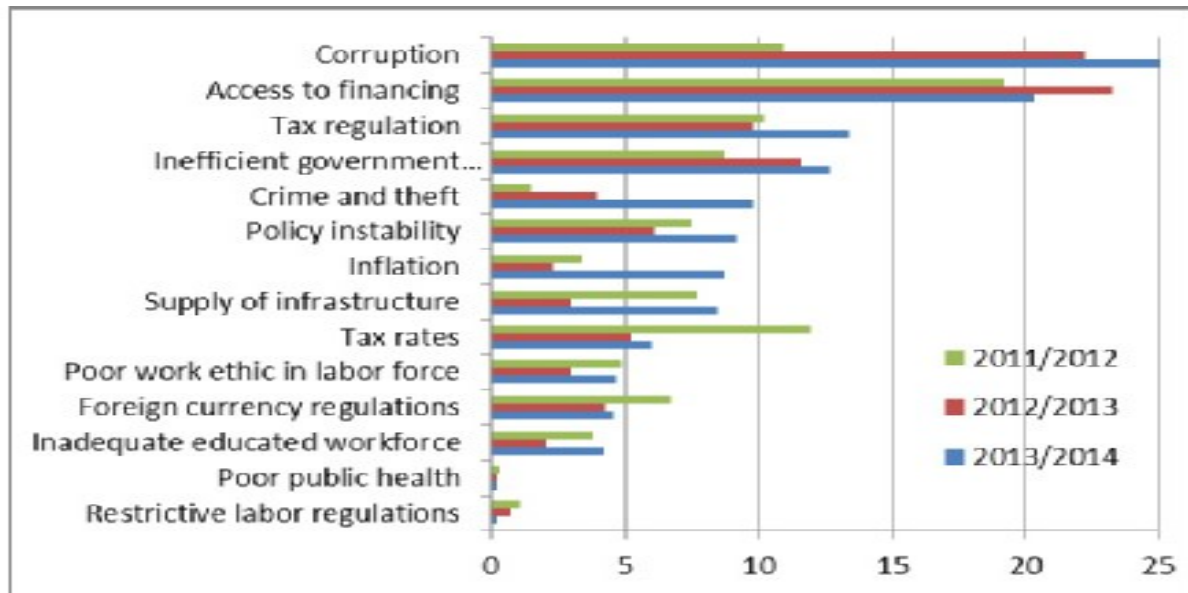
2. MAJOR OBSTACLES FACED BY SMALL, MICRO AND START-UP ENTERPRISES

The most problematic factors of doing business in Albania are corruption, access to finance and government bureaucratic inefficiency. Businesses have chosen these factors out of a list of 15 problematic elements of conducting business in Albania in 2013. As Figure 1 will demonstrate, there was a slight shift in the ranking of these problematic factors.

Corruption is in first place, up from second place in the previous year; while access to finance is second, and government inefficiency is third. More than a quarter of businesses surveyed (25.5%) deemed corruption to be a serious obstacle to business development, and 21% rated access to credit

as another major obstacle to business development. Access to finance is harder to obtain for start-ups and microbusinesses. Thus, these small enterprises and start-ups are often funded with their personal or family savings. Support from grants as well as technical assistance is almost non-existent for start-ups. Occasionally, some support is provided by various donors, especially towards development in rural areas.

Figure 1: Most problematic factors of doing business in Albania (GCI 2013/2014)



Source: Klaus Schwab, ed., *The Global Competitiveness Report 2013-2014*, WEF (2013), and authors' elaborations

Credit granted by non-bank financial institutions is quite low. As of December 2013, only 3.1% of their total financial assets and 4% of their total credit went into microcredit. Other financial instruments such as leasing and factoring are less developed in Albania; venture capital is almost absent and business angels are non-existent. The Albanian government has only begun to develop policies supporting start-up businesses in the last two years. However, these schemes have not been implemented.

Lending to small businesses and start-ups

The Albanian banking system is relatively new, comprising 16 banks. Banks dominate in financial economics and their assets make up more than 95% of the total financial assets in the country. Banks provide loans and other financial products mostly to businesses, especially large companies and some medium ones. Small and microbusinesses rarely receive loans from banks because the banks' lending standards are too rigid. Start-up businesses also have almost no access to funding from banks. Banks choose to apply a conservative lending policy, following a prudent financial screening of the would-be client's business plan requirements, investors' reputation, performance of individual sectors of the economy and so on.

There are only 2 banks focusing on microfinance. However, in the last two or three years, other banks have become more attracted by microloans. Banks are now willing to provide microfinance because the overall demand for financing has shrunk considerably after the global financial crises. As there is less demand for financing, banks are now competing with each other for quality projects and client referrals. There is also more government support for microfinancing now that large businesses are overleveraged after the global financial crises. Banks, in turn, have paid heed to this government support of the hitherto unexplored market of microfinance.

Even though banks have increased their network in the last 10 years, the rural areas do not receive much in the way of loans. The presence of the banking system in these areas is limited and the banks have very conservative views in financing the rural sector (EFSE 2009). The high

informality of the economic activity in the rural area, lack of experience in risk assessment according to the type and nature of the business, lack of strategic investments and the structural problems of the rural sector are some of the factors hindering further financial loans from banks in rural areas. Banks are more likely to finance small and medium enterprises in urban areas because there is still room to provide financial services to them. Meanwhile, financial services in rural areas are dominated by non-bank financial institutions as well as savings and loans associations.

Lending conditions

According to the Bank of Albania's lending surveys (2013), stricter lending standards have been implemented for businesses, in particular, SMEs, after 2009. Despite these stricter standards, banks are plagued by competition and the problem of ample liquidity. The tightening of credit conditions reflects the high uncertainty of the country's economic developments and the deterioration of the loans' quality. SMEs, as a developing segment of the Albanian economy, appear to be more vulnerable to economic hardship. As such, banks are reluctant to extend loans to them in the current economic climate. Likewise, the survey noted that the credit demand from SMEs has declined. The decline in demand reflects not only the weak economic activity in the country, but also the stricter credit conditions that began in the last quarter of 2008. After the Greek government debt crisis in the second half of 2011, the lending standard became more stringent, especially for SMEs. However, as in other Central, Eastern and Southeastern European (CESEE) countries, the stricter lending standard is also reflected in the deleverage policy of the European mother banks – an issue that was further addressed in the Vienna Initiatives I and II.

Cost of loan

One of the main costs of financing loans is the interest rate. The interest rate varies significantly, depending on the character of the client, the currency in which the loan is made, its maturity and if it is collateralized. Loans for businesses in foreign currency account for 62% of total loans, and business loans in euros make up the bulk of foreign currency lending. This portfolio represents about 73% of total foreign currency loans (Suljoti et al. 2013).

3. THE LEGISLATIVE FRAMEWORK ON MICROFINANCE

The microcredit sector in Albania comprises microfinance institutions as well as savings and credit associations. Institutions providing microloans are regulated by the relevant laws and supervised by the Bank of Albania (BoA, 2014b).

According to the Bank of Albania regulation, microcredit is a loan that does not exceed ALL 600,000 (approx USD 6,000) or its equivalent in a foreign currency; and a microcredit financial institution is a non-bank financial institution that fulfils all the following criteria:

- Lending and lending advisory services are the sole scope of its activities;
- The average value of a loan extended to a borrower cannot be higher than the value of the microcredit
- Microcredit makes up at least 50% of the credit portfolio.

Institutions that provide microloans are divided into:

➤ *Non-bank financial institutions* (NBFIs) are classified into two categories:

1. Institutions licensed to conduct lending operations: Besa Fund jsc., NOA jsc. (formerly Opportunity Albania), First Albanian Financial Development Company (FAF-DC) and LLC.;
2. Institutions licensed to conduct microcredit operations: Vision Fund Albania LLC. and Capital Invest jsc.

Microcredit institutions are regulated by the Laws and Regulations for Non-Bank Financial Institutions operating in lending. Their activities are governed by the following legal and regulatory frameworks:

- Law no. 9662, dated 18 December 2006, amended by law no. 18481, 17 November .2011 "On Banks in Republic of Albania".

- Regulation “*On licensing and activity of non-bank financial Institutions*”, approved by the Supervisory Council Decision No.1 of 17 January 2013.
 - Regulation “*On the supervision norms of non-bank financial entities*”.
 - The reporting system for non-bank financial institutions, approved by the Supervisory Council Decision No. 26 of 14 April 2010.
 - Regulation “*On risk management in the activity of non-bank financial institutions*”, approved by the Supervisory Council Decision No. 02, dated 17 January 2013.
 - Regulation “*On the use of information and communication technology in the entities that have been granted licenses from the Bank of Albania*”, approved with decision of Supervisory Council of the Bank of Albania no.3 2, dated 03 May 2006.
- *Savings & credit associations and their unions* are composed of:

A union of savings and credit associations (ASC Union) and Jehona Union, as well as 2 independent savings and credit associations.

Savings and Credit Associations (SCAs) are legal entities comprising voluntary unions of natural or juridical persons, who deposit their money in the company and whose funds would be later used by the company for issuing loans to members of society. While the ASC Union is a voluntary union of individual savings and credit associations, it seeks to promote the organization and development of savings and credit, as well improving its members’ internal operations. These institutions are governed by their own internal regulations. The governing bodies of a savings and credit society are: the general assembly, board of directors and supervisory committee. The regulation of credit unions, and savings and credit associations is based on the Law on Savings and Credit Associations (Law No. 8782, 3 May 2001). ASC unions are required to obtain a license from the Bank of Albania (BoA) and they must follow the strict rules put forth by the BoA supervisory board as follows:

- Regulation “*On the licensing of Savings and Credit Associations and their Unions*”, adopted by Decision No. 11, dated 27 February 2002, later amended by Decision No. 09, dated 12 February 2003, and decision No. 55, dated 12 September 2012 of the BoA Supervisory Council.
- Regulation “*On the supervision of Savings and Credit Associations and their Unions*”, approved with Decision No. 43, dated 08 June 2005 of the BoA Supervisory Council, later amended by Decision No. 68, dated 13 September 2006 and Decision No. 65, dated 29 September 2010.
- Regulation “*On the use of information and communication technology in the entities that have been granted licenses from the Bank of Albania*”, approved by the BoA Supervisory Council in Decision No. 32, dated 03 May 2006.

4. GOVERNMENTAL PROGRAMMES FOR MICROCREDIT

The state budget supports 23 different grant schemes for the promotion of SMEs, agriculture and the agroprocessing sector. Foreign donors have also contributed generously to microfinancing. The list below provides details on the different government programmes supporting microfinance in Albania.

Agriculture and Agroprocessing Fund. In order to support agricultural businesses in the areas of manufacturing and agroprocessing, the Agency for Agricultural and Rural Development (AZHBR) and ProCredit Bank provide funding schemes with loans of up to US 250,000, of which up to 70% of the interest is subsidized by the state for 5 consecutive years. The agribusiness clients who can take advantage of the AZHBR financing schemes chiefly operate in the following areas: storage and processing of agricultural products; livestock; mushrooms and medicinal plants; agricultural equipment, aggregates and milk cooling tanks; fishing and processing of aquatic products; agricultural and ecotourism activities. These schemes have been successful. In 5 years, the Agriculture and Agroprocessing Fund has mobilized and distributed almost USD 20 million in loans through ProCredit Bank. Due to AZHBR’s success with this fund, the government has decided to continue the scheme for another 7 years and cover 70% of the interest.

Interest-free Loans. In 2014, a new scheme was launched, granting loans of up to USD 250,000 and covering up to 70% of the total value of investment in the construction and reconstruction of stalls, poultry and livestock complexes. This scheme, managed by AZHBR, covers up to 80% of the investment for construction of greenhouse product processing packages.

The SME lending scheme established by the governments of Albania and Italy is for the implementation of the Italian-Albanian Programme for the Development of Albanian SMEs (PRODAPS). It was launched in January 2009. Through PRODAPS, small and medium enterprises will have access to loans as well as technical assistance. The programme has been allocated EUR 27.5 million, which is divided into two components: (i) a credit line of EUR 25 million, mainly for SME investment projects, and (ii) a guarantee fund of EUR 2.5 million to reduce the level of guarantee required by banks before they will issue loans to SMEs.

Taking into account the difficulties faced by business start-ups in obtaining loans from banks, PRODAPS approved partner banks to issue loans of EUR 15,000 to EUR 50,000 (at an interest rate that is lower than market rates) to SMEs in 2011. 10 new business start-ups were thus financed during 2011-2013.

The European Fund for Southeast Europe (EFSE) is one of the largest creditors of Albanian micro and small enterprises. EFSE's support to the Albanian financial sector does not only include financial investments, but also technical assistance, consultation and training programmes to partner lending institutions so as to increase their outreach to their target groups. EFSE has provided a loan of EUR 20 million to the National Commercial Bank (BKT). By December 2013, BKT has approved loans totalling EUR 29.3 million to 452 customers and disbursed EUR 25.6 million to 392 customers.

Fund supporting women entrepreneurs. In September 2014, the council of ministers approved of a new scheme to subsidize the interest on loans for micro, small and medium enterprises (MSMEs) owned or managed by women and operate in the following sectors: manufacture and service; textile processing (re-exporting textile merchandise); tourism; research and development; agroprocessing; design, modelling and crafts. This scheme facilitates the interest payment of loans for investment purposes in businesses run by women. Financial aid will cover 50% of the interest for four consecutive years, but not more than EUR 7,140 for a loan. The total value of the scheme is EUR 190,000 and it lasts for a period of 4 years. This fund is run by the Albanian Investment Development Agency (AIDA).

There are also some public grant schemes supporting entrepreneurs. These are:

The **Creative Economy Fund** was established following the Council of Ministers' Decision No. 954, dated 5 September 2012. It aims to increase sustainable economic activities and create jobs in the handicraft and crafts sector by addressing product development; marketing; qualification and capacity building. The Creative Economic Fund is valid in 2013-2016. The total value of the fund is ALL 40 million, or ALL 10 million per year. The fund is based on the cost-sharing approach, as it provides grants for 60-80% of allowed expenses that do not exceed ALL 500,000 per project. The fund is managed by AIDA.

Fund for start-ups. In September 2014, the Council of Ministers approved of a new scheme to support micro or small enterprise start-ups that have been active for 1-2 years in these sectors: manufacturing and service; light industry; tourism; research and development; agroprocessing; design, modelling and crafts. The fund is managed by AIDA. It is based on a cost-sharing approach, providing grants for 70% of project costs that do not exceed ALL 300,000 (approx. EUR 2,140). The start-up fund is valid in 2014-2017 and its total value is ALL 25 million (approx. EUR 178,000). Entrepreneurs may only benefit once from this fund.

The **Promoting Social Business Agency (NBS)** is a public entity created in 2011. It focuses on the social and economic development through the promotion of cohesive, balanced and stable social businesses at national level. To achieve its mission, NBS pursues environmental and social objectives, supports and promotes social and microfinancing of businesses, and offers job opportunities to vulnerable groups (such as immigrants, the poor and women) in particular.

Since mid-2012, NBS and Yunus Social Business Albania, with the support of the Government of Albania and various national and international organizations, have implemented the Social Business Movement of Albania. This movement aims to promote and support development of social businesses in various regions and sectors by tackling key social and environmental issues of

the most marginalized social groups in the country. It is not only a social business incubator, as it also performs many important activities such as consultation, coaching and network building for social business projects. It also provides a social business fund and investment for the best social business projects.

5. MAJOR MICROFINANCE INSTITUTION IN ALBANIA

Microfinance is a general term to describe financial services to low-income individuals or those without access to typical banking services.

Microfinance is also the idea that low-income individuals are capable of lifting themselves out of poverty if given access to financial services. While some studies indicate that microfinance can play a role in the struggle against poverty, it is accepted that it is not always the appropriate method, and as such, should not be seen as the only tool for ending poverty (Kiva 2014).

The microcredit sector in Albania includes microfinance institutions (MFI) as well as savings and credit associations (SCAs). These entities specifically cover rural and semi-urban areas by catering to a niche clientele and concentrating their services in locations where commercial banks are mainly absent. MFIs and SCAs are successful institutions that have significantly impacted the social and financial lives of the populations they serve. In particular, in the rural areas, they are recognized for helping farmers overcome the emergency phase and later promoting the products.

By the end of 2013, there were 6 non-bank financial institutions and 2 unions of savings and credit associations in Albania, which are licensed and supervised by the Bank of Albania. The most important institutions are:

5.1 **Besa Foundation** www.fondibesa.com

BESA Foundation was created in 1999 as a continuation of a government's urban microcredit project under the Albanian Development Fund. At its inception, BESA Fund received significant support from the World Bank, the government of Albania, and the Soros Foundation.

Besa Fund's social mission is to contribute to the promotion of micro, small and medium businesses, reduce poverty, improve clients' living conditions, empower clients, generate self-employment and create new jobs for clients, as well as support young people. Besa Fund seeks to fulfil these aims by extending loans to the self-employed and modestly limiting the tendency to migration within this segment of population. In this context, Besa Fund has developed a "Youth Loan", which subsidizes the interest on loans for young people desirous of starting businesses mainly in Tirana. In so doing, Besa Fund supports their efforts in creating self-employment. Besa Fund aims to provide financial products and services that create value for customers, improve their lives, and improve their commercial activities, manufacturing or processing activities, services, handicrafts, tourism activities. Besa Fund is also committed to supporting the prepayment of obligations. Their motto is "to be present where the need is".

Throughout 2013, Besa Fund disbursed 16,549 loans, totalling ALL 4.7 bn, 8.5% higher than in 2012. At the end of 2013, Besa Fund had 25,986 active clients with outstanding loans totalling USD 53.3 million, increasing its number of clients by 13.43% and loans issued by 8.14%. In recent years, Besa Fund has expanded its activities and currently operates 65 offices across the country. It is also becoming more present in urban and semi-urban areas.

Besa Fund has 355 employees, 246 of whom are loan officers. It is one of the leading microfinance institutions in Albania. At the end of 2007, Forbes Magazine rated BESA Fund one of 50 best microfinance institutions in the world.

5.2 **NOA Albania** www.noa.com.al

NOA Albania is part of NOA Holdings N.V., a holding company in Russia, Poland, and since 2010, in Albania. In 2010, it was constituted from its previous incarnation, the Albanian Partner in Microcredit (MHP), into NOA. The Albanian Partner in Microcredit was a member of the Opportunity International Network (Know-How Fund), which started operations in Albania in 1999 through a grant from USAID. As of December 2013, it had 17 branches in 14 cities and one agency office. It is characterized by short-term loans. NOA represents an innovative way to responsible finance, for microfinance is used to leverage the knowledge of acquiring and operating financial institutions in emerging markets. Due to its strong domain expertise, it can drive a disciplined turnaround by

implementing clear, well-defined and best-in-class business practices in the acquired businesses. This enables the NOA-operated businesses to reach their full potentials by developing and implementing scalable and game changing business models. Their motto is “through hardships to the stars”.

5.3 The First Albanian Financial Development Company (FAF-DC) www.faf-dc.com

The First Albanian Financial Development Company (FAF-DC) is a non-banking financial institution providing loans directly to individuals and SMEs in urban and rural areas of Albania that are out of reach from banks. FAF-DC mainly provides loans to profitable and stable private enterprises that have had positive impact on the development of the area by creating new jobs and markets, trying to reduce poverty and improving living conditions.

The First Albanian Financial Development Company (FAF-DC) inherited the activities of the Mountain Areas Finance Fund (MAFF). It is established to implement the strategy endorsed by the government of Albania and the International Fund for Agricultural Development (IFAD). This strategy, known as the “conversion of ‘MAFF’ into the “Financial Development Company”, was confirmed in the Decision of the Council of Ministers No. 904, dated 27 June 2008. This decision further consolidated MAFF’s mission. In accordance with the approved strategy, FAF-DC is a government-owned company that has been open to potential strategic investors with equity of nearly ALL 1 billion.

As a mission oriented company, FAF-DC has a sustainable and qualitative loan portfolio, successfully operating 26 branches and 1 office in 25 cities and 918 villages. It also provides a wide variety of financial products in almost 85% of Albania. FAF-DC has a history of effective financial self-sufficiency to an acceptable risk level. This foundation provides microloans and SME loans, with 4,225 loans averaging USD 5.109 per loan.

5.4 Micro lending programme of World Vision <http://www.visionfund.org>

Vision Fund is a microfinance institution in Albania helping families to increase their incomes through small loans to entrepreneurs without access to traditional credit opportunities. Individuals will receive vocational training for early entry into employment, and students will learn on-the-job skills at local businesses.

World Vision's microbusiness programme started operations in Lezha in 2001, and was funded by World Vision USA, the Canadian International Development Agency (CIDA) and World Vision Canada). The fund operates in urban and rural areas by providing microloans and SME loans with technical assistance. Its main objectives are to contribute to Albania's economic transition and create new jobs, especially for women, through microcredit and SME loans. The programme also provides technical assistance such as training and other services to its business customers. Credit is given for working capital, and the purchase of equipment and machinery. All kinds of activities are financed, including loans to farmers to purchase equipment, cattle and livestock. At the end of 2013, the loan portfolio was USD 2.4 million with 2,448 loans; the average disbursed loans were USD 970 at a nominal interest rate of 26.5%.

5.5 Albanian Savings and Credit Union (ASC Union) www.ascunion.org.al

The Albanian Savings and Credit Union (ASC Union) is a voluntary union of individual Savings and Credit Associations. It was created on 25 January 2002, in accordance with the Law on Savings and Credit Associations, and is licensed by the Bank of Albania. ASC Union is the product of the first microfinance programme in Albania. ASC Union has its roots in the Rural Financial Fund, which was established in 1992 by the Albanian government and the World Bank under the framework of the Albanian Development Fund. This microfinance institution has the oldest and most widespread network in Albania. ASC Union implements community support in the areas in which it operates through savings and loan associations. These associations are based on three main principles: self-help, self-responsibility and self-administration. The Albanian Savings and Credit Union and network of SCAs differ from other financial institutions in four ways: lower interest on loans as well as higher interest rates on savings and adopted lending procedures; 22 years’ experience in rural and long-term financing at the village level; the commitment of nearly 800 leaders in SCAs that are elected from, residents of rural areas, farmers and rural entrepreneurs; and providing technical assistance to members.

ASC Union aims to financially and technically support the Savings and Credit Associations, which are village financial institutions, created and managed by the members. In so doing, ASC Union is better able to promote productive activities in rural areas. Inspired by financial cooperative models,

it is based on Savings and Credit Associations (SCAs) that have strong social roots in local communities. Inhabitants of rural areas that are members of Savings and Credit Associations form the bulk of ASC Union's clients.

Savings and Credit Associations (SCA) are juridical persons composed of voluntary unions of individuals, physical or legal persons that deposit their money in the company, and which money is then used by the company to lend to members of the company. Members of Savings and Credit Associations are individuals, physical or legal persons, who wish to deposit their savings and borrow among themselves within savings and credit companies, and who accept the bylaws approved by savings and credit companies. The SCAs network has 37,000 members.

A Union Member is any established and registered SCA that carries out its activities in accordance to Law No. 8782, dated 3 May 2001. There are 97 functioning 97 SCAs that are members of the Union. ASC Union represents an SCA that offers financial services at the village level and is directed by the recipients of these services, rural residents, and members of Savings and Credit Associations. SCAs and the ASC Union are entirely owned by their members and have 100% Albanian capital.

Microcredit is the core financial product of both the ASC Union and SCA network. The credit portfolio of the SCA network amounted to USD 19.8 million at the end of 2013. While ASC Union mainly finances agricultural and livestock activities, their activities have been shrinking in the last 2 years.

6. MODELS OF MICROFINANCE FOR SMES

Table 2 presents the data of five microfinance institutions (MFIs) as of 31 December 2013. These MFIs are ranked according to the total value of their assets. Besa Fund is in the first place because of the value of its assets, loan portfolio and number of clients. As seen in Figure 3, these three indicators have increased by 55%, 29% and 129% respectively from 2008's figures. Although Besa Fund's activities and growth stagnated in 2009-2010, it has been on the upswing since 2011.

Table 2: Information on MFIs in Albania

Microfinance Institutions	BESA Fund	ASC UNION	NOA	FAF-DC*	Vision Fund
Total value of assets (in million USD)	66.7	42.9	41.5	22.2	3
Portfolio of loans disbursed (in million USD)	53.3	19.8	26.7	21.6	2.4
Savings Portfolio (in million USD)	does not have	2.5	na	na	Na
Number of borrowers	25,986	13,891	11,579	4,225	2,448
Average value of loans disbursed	4,035	2,719	2,743	3,409	
Average loan balance per borrower	2,053	1,428	3,167	5,109	970
Nominal Interest Rate	26%	10%	25.5%	19.8%	26.5%
Portfolio at risk (PAR) > 90 days	9.6%	26.9%	1.8%	17.8%	3.7%
Geographic Scope	31 cities	13 cities, 1,080 villages	14 cities	25 cities, 918 villages	

Source: www.Mixmarket.org and authors. *data are for 2012

As seen in Figures 2 and 3, the Albanian Savings and Credit Union (ASC Union) decreased in both assets and loan portfolio in 2009-2013. By the end of 2013, its assets were reduced by 15%, while the loan portfolio decreased by 51%. Also, the 2013 savings portfolio of ASC Union has had a

threefold reduction since 2008. Moreover, six savings and credit associations have had to be liquidated.

Since NOA was reorganized from the Albanian Partner in Microcredit into NOA in 2010, it has seen an 18% reduction in assets and 33% reduction in loan portfolio.

Figure 2: Assets of MFIs in years

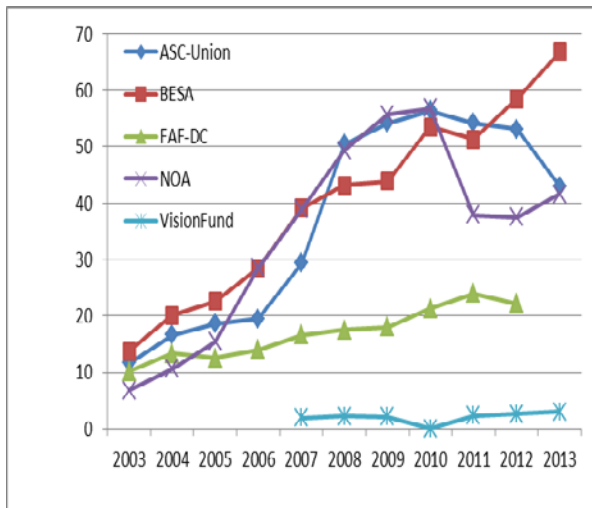
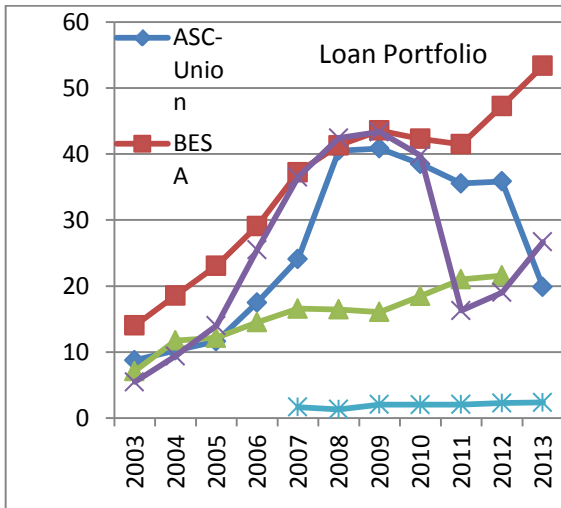


Figure 3: Loan Portfolio of MFIs in years



Source: www.Mixmarket.org and authors' calculation

The First Albanian Financial Development Company (FAF-DC) has reduced assets by 16%, while its loan portfolio has grown by 31%.

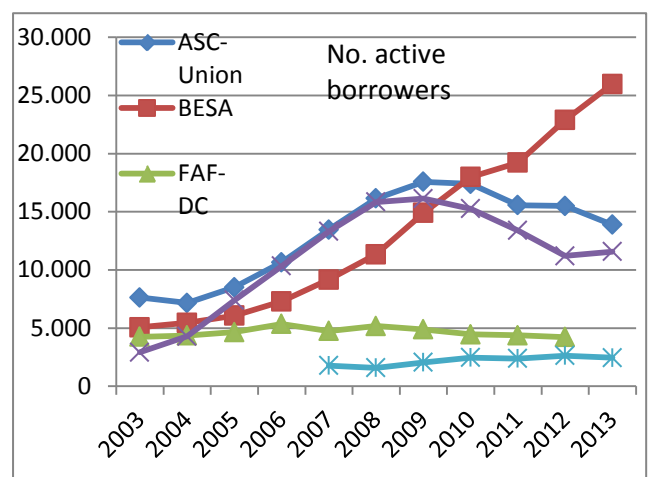
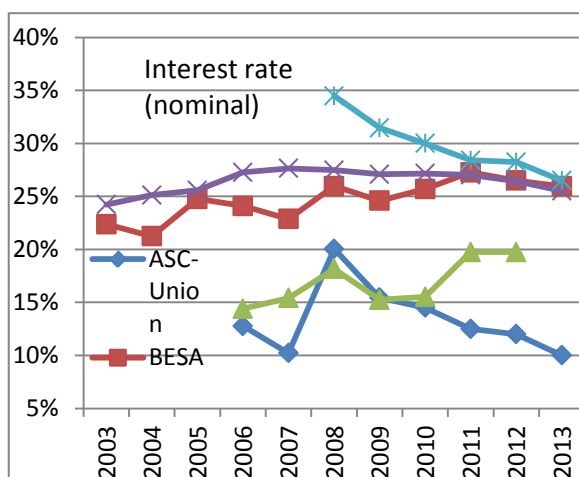
Vision Fund has had a modest loan portfolio (of USD 2-3 million), and has remained almost at the same level in the last 6 years.

As seen in Figure 4, Besa Fund had nearly twice the number of active borrowers of ASC Union at the end of 2013. As is evident in Figure 4, ASC Union had the largest number of borrowers until 2009.

Figure 5 indicates that Vision Fund had the highest interest rates in the years recorded. However, Vision Fund's interest rates have been annually reduced so much so that Vision Fund, Besa Fund and NOA have roughly the same interest rate of approximately 26% at the end of the 2013. ASC Union has the lowest interest rates in the market and its rates have continued to drop in 2008-2013 from 20% in 2008 to 10% in 2013.

Figure 4: No. of active borrowers of MFIs in years

Figure 5: Interest rate of MFIs in years



Source: www.Mixmarket.org and authors' calculation

Table 3: Main criteria of microfinance institutions for microloans

Microcredit institution	Besa Fund	ASC Union	NOA	FAF-DC
Supported activities	Production, trade, services	Trade, family tourism, machinery	Trade, family Tourism, agroloan, services, investment	Trade, Services, processing, artisan, machinery
Loan ceiling in USD	10,000	2,000 - 5,000	1,000-12,000	500-20,000
Repayment period	Max. 2 years	Max. 3 years	0.6-4 years	5-7 years
Interest rate (in lek)	21%-26%	for SCAs, 11%, for households, 15%	22%-25.5%	15%-19%
Grace period	3 months	1 year	3 months	6 months
Own contribution	min 30%	appropriate activity		min 30%
Collateral	150%, Collateral	solidarity guarantee, Collateral	100%, solidarity guarantee, movable and Collateral	150%, solidarity guarantee, Collateral
Areas	urban	rural	urban	rural and semi urban

Table 3 presents the main microloan features of the MFIs in Albania. Besa Fund has shown positive results over the years, although it has the highest cost of microloans and requires the highest value of collateral in the market. However, MFIs are important for the economic development of Albania because they focus on different target groups (rural, semi-rural and urban).

7. RECOMMENDATIONS

Albania needs to continue its reforms in improving the business environment. Albania also needs to implement new financial instruments to support SMEs, especially microbusinesses in urban, semi-urban and rural areas. Albania ought to increase its SME financial support scheme and improve on its implementation. Some recommendations to that end are listed below:

1. Promotion of new financial instruments such as leasing, venture capital, private equity funds, angel investors etc.
2. Promote incentive programmes as grant schemes for start-ups, young entrepreneurs, women entrepreneurs etc.
3. MFIs should provide financial support with acceptable costs to those who are unable to make deposits.
4. Financial support of savings and credit associations and the ASC Union providing direct funding to individual farmers in rural areas.
5. Mechanisms to finance business services in support of innovation (e.g. voucher schemes).
6. Improving domestic firms' access to finance in order to support technological innovation.

7. Strengthening MFIs' support of private companies, especially micro and small enterprises.
8. Create and/or enhance an SME portal with all information related to SMEs
9. Encouraging donors to come forward with grants and microloans in support of young people and women who wish to start microbusinesses.

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3.2 OVERVIEW AND POLICY DEVELOPMENT RECOMMENDATIONS FOR ARMENIA'S MICROLENDING INDUSTRY

by

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ABSTRACT

This paper reviews Armenian microfinance industry from the supply and demand sides, and makes recommendations to policymakers.¹³ Despite all governments recently prioritizing the development of micro, small and medium enterprises (MSMEs), there is no clear evidence suggesting development in this sector or the implementation of state supported MSME projects. There is no unified statistics on microfinance in Armenia, as the state and private decision-making processes

¹³ The views and suggestions presented in the paper are result of the author's professional activities in the field from 2003, <http://www.linkedin.com/in/haykshekyan>

have been based on perceptions and subjective assumptions. An analysis of state support of microfinance in 2003-2014 clearly shows that it has not been systemic and is insufficient for the development of the MSME sector. State microfinance development policies should be based on knowledgeable MSME sector segmentation, and they ought to depend on the nature and significance of the unmet need for financial service. We propose (a) self-employment, (b) young start-ups, and (c) repatriates as the three most obvious segments requiring different approaches and tools. The two broad groups of recommendations for the policymakers are: (a) shaping of statistical infrastructure in the field of microfinance and proactive governance, and (b) filling institutional gaps in microfinance development.

Keywords: Armenian microfinance, Small and Medium Entrepreneurship Development National Center (SMEDNC), German-Armenian Fund (GAF), policy recommendations, local currency lending, loan guarantee, start-up, self-employment, microloan, microsaving, microborrower

JEL classification: H81

Microfinance is recognized as an efficient tool for overcoming poverty, creating economic equality, stimulating economic development, decentralization and competition. The microfinance sector in Armenia emerged in the second half of the 1990s from international charity non-governmental organization (NGO) and International Financial Institution (IFI) initiatives. The Central Bank (CB) regulates the sector, and it has shaped the legal framework. This includes consumer protection rights legislation. While it does not relate directly to microborrowers, it partially covers smaller loans (up to AMD 10 million) that are disbursed to physical entities. However, there is no agreement among experts as to whether the microfinance sector efficiently resolves the above mentioned tasks. In this paper, we briefly present our vision on the state of affairs in Armenian microfinance by looking at the supply and demand sides. We ask whether the Armenian microfinance sector sufficiently covers the demand, consider the market gaps if any, examine the efficiency of market intervention and the ways that it can be improved.

1. MICROFINANCE MARKET: SUPPLY

Microfinance in Armenia comes from 21 commercial banks¹⁴ (with USD 7.3 bn in assets),¹⁵ 30 Universal Credit Organizations (UCOs, non-deposit taking financial organizations under the regulation of the CB with USD 0.6 bn in assets), and informal debt and direct investment. There are 131 pawnshops on the market that do not report their earnings or loans publicly.

With non-significant exceptions, the microloan schemes on offer can be generalized thus:

Amount	Tenure	Interest rate	Security
< AMD 1 m	3-60 months	18-24% AMD, 13-20% USD	Gold pawn
< AMD 4 m	6-36 months	20-24% AMD, 14-18% USD	Personal guarantee
AMD 4-10 m	6-84 months	18-22% AMD, 14-16% USD	Property and personal guarantee

Source: Author's compilation based on information collected from the websites of banks and UCOs.

One of the most important issues is the absence of a homogeneous statistical framework on the volume, structure and dynamics of the microfinance market. All prior studies are based on

¹⁴ The Central Bank has made a decision on 30 December 2014 to raise commercial banks' minimum capital requirement from AMD 5 billion to 30 billion from 2017, which undoubtedly will reshape the industry in the near future.

¹⁵ The statistical information and other data here and below are accurate up to the 3rd quarter of 2014. See ARKA News Agency's "Banks of Armenia" and "UCOs of Armenia" quarterly bulletins. In December 2014, the market experienced a supply shock, resulting in a significant increase of interest rates and virtually no lending in AMD.

conflicting expert judgments and cannot be used across different countries, because each country has a different definition of micro, small and medium enterprises (MSMEs). While we assume lenders do design proper products based on their demand assessments, the fact remains that:

- a.) only a few of them are capable of doing so, and
- b.) no marketing survey can replace holistic statistical information.

However, only the first can be much better elaborated and there is doubt as to the proper existence of the second. Despite several governments repeatedly declaring MSME to be a priority, their policies have been based on perceptions and subjective assumptions.

Funding is the defining factor for microfinance supply, and existing products are derived from its determinants like tenure, currency and cost. Total funding attracted by banks and UCOs comprise USD 5.9 bn. The main sources of funding are categorized below:

1. External sources.
 - a. Projects that come under the umbrella of the German-Armenian Fund (GAF). The advantages of GAF funding are long-term local currency loans and comparatively cheap funding.
 - b. Projects implemented through direct IFI funding. This source is accessible to comparatively big commercial banks (ACBA Credit Agricole, America Bank, ASHB), which as a rule, directly funds their corporate customers. Several leading UCOs are also active in this field (FINCA, Aregak, SEF International, Farm Credit). The shortcomings IFI sources are the comparatively higher cost of funds and high cost of foreign exchange (FX) risk hedging. The banks and UCOS managed to attract a total of USD 1.4 bn from external sources.

Local sources are wooed by the commercial banks as deposits. This source of funding constitutes about USD 3.7 bn. About 75% of these funds have been in foreign currency before December 2014. This should be much higher after AMD depreciated by 15% in a month. Apparently, this deficit in AMD funding for microlending puts additional FX risk on microentrepreneurs. Banks viewed funding from local sources to be of secondary priority, due to the high rate of poverty. Regardless of the growth potential, microsavings are an important long-term balancing and development factor of the national financial system. Thus, microsavings should be initiated and supported by banks and MSME policymakers.

State support for the microlending industry is realized through several institutions, the most notable of which are the German-Armenian Fund (GAF), acting under the Central Bank, and the Small and Medium Entrepreneurship Development National Center (SMEDNC) under the Ministry of Economy. The first is the major distribution channel for development funding from IFIs to commercial banks and UCOs, while the second implements state supported MSME programmes including access to finance issues and overcoming market failures through specially designed products. SMEDNC issues direct intervention tools to its beneficiaries in the form of cash-backed loan guarantees through commercial banks and UCOs. SMEDNC also offers direct preferential lending from its daughter organizations such SME Investment UCOs and so on. The loan guarantees programme has a business plan design training and mentoring programme for start-ups. The analysis of SMEDNC's activities in 2003-2014 clearly shows that its capacity and functions have not impacted development of the microfinance industry.

2. MICROFINANCE MARKET: DEMAND

From the demand side, the critical issue in regulation is partial microfinance consumer rights protection. The law prohibits non-AMD consumer lending and allows (in that it actually motivates) lending to microborrowers in foreign currencies when they have neither alternative nor proper tools to manage the foreign exchange risk. This clearly contradicts the government's declared priority to support MSMEs.

To improve policymaking, we propose the following classification of microborrowers:

1. Self-employed micro entrepreneurs, specifically people involved in family businesses, farming, retail trade activities and the service industry. This is the largest segment, as the people in this category are low-skilled as well as socially and economically excluded. They also face unmet demands for financial services in local currency and working capital lending, non-discriminatory pricing, and lack of credit history restoration (a chance to start new life). The acceptable level of risk should be established by local economic development (LED) and it should be based on social criteria rather than economic ones. While many aspects of SMEDNC's start-up support programmes deal with aspects related to this segment, they do not directly address the highlighted issues. It is not surprising that it often attracts non-start-ups due to its preferential lending terms.
2. Start-up entrepreneurs, who are just entering the market, and are well educated and ambitious. They have innovative business ideas and plans requiring venture capital resources. Policies related to these individuals should be founded by local economic development (LED) and youth policy criteria. With no venture capital supply, both MSMEs and policymakers make misleading statements on banks' and UCOs' excessive conservatism. As a result, lending (as it is defined in national regulation) is not and will not be adequate to satisfy the needs of these entrepreneurs.
3. Repatriates. Separate vision is needed for this group, due to their specific needs. Microfinance policy for these people should be founded on economic, demographic and national criteria. As these people have job experience, good education and some capital to invest, they need trust, competitive financing and good communication with financiers. They should receive support in the form of consultancy, intermediation and representation. SMEDNC has extended its start-up support programme for repatriates from Syria. This programme offers valuable experience and should be further elaborated into an independent product.

3. MICROFINANCE MARKET DEVELOPMENT INITIATIVES

Based on the analyses presented briefly above, we suggest the following actions:

1. Shaping the statistical infrastructure on microfinance and proactive governance.
 - i. Implementation of national microfinance market supply statistics.
 - ii. Elaboration and implementation of unmet microfinance needs assessment methodology.
 - iii. Segmentation/classification of microborrowers and designing proper support tools.
2. Filling institutional gaps
 - i. Design financial tools that are capable of dealing with higher risk (venture capital, private equity etc).
 - ii. Broadening the scope of microfinance funding tools (crowdfunding, microsavings etc).
 - iii. Economic assessment of the present currency regulation and control regime.
 - iv. Filling the microborrower protection gaps in regulation.
 - v. Feasibility assessment on creating microfinance intermediation channels through financial cooperatives.
 - vi. Design and implement access to finance programmes for self-employed entrepreneurs similar to start-up support programmes ("change the grade").
 - vii. Design and implementation of national access to finance programme for repatriates.

3.3 MICROCREDITING OF SMALL AND MEDIUM-SIZED ENTERPRISES IN AZERBAIJAN

by

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ABSTRACT

The paper highlights an economic snapshot of Azerbaijan by presenting the characteristics of local small and medium-sized enterprises (SMEs). This paper will also describe the legislative environment. Even though there is no specific law on microfinance, there are many laws related to microfinance. The author describes the forms of government support available and lists microfinance intermediaries in the country. Finally, the paper analyzes the model of credit issuance (including microcredit loans) used by the Azerbaijan National Fund for Entrepreneurship Support (ANFES).

Keywords: economic snapshot of Azerbaijan, characteristics of the SME sector, microfinance, legislation of microfinance, microfinance intermediaries, Azerbaijan National Fund for Entrepreneurship Support (ANFES)

JEL classification: G21

1. ECONOMIC SNAPSHOT

2013 was another year of consistent economic growth for Azerbaijan, primarily due to the extraction and export of hydrocarbon resources, and to a lesser extent, due to the development of institutions. A number of key macroeconomic indicators for 2013 are presented below:¹⁶

Indicator:	Value in AZN ¹⁷	Growth Rate %
GDP	57,708.2 m	105.8
Non-oil GDP	32,637.9 m	110.0
Volume of industrial production	33,696.7 m	101,8
Volume of agricultural production	5,244.6 m	104,9
Fixed asset investment	17,872.1 m	115.1
Nominal income of population	37,555.5 m	108.0
Average nominal monthly salary	419.0	106.6
Average annual consumption goods	-	102.4

Last year, the GDP share of the oil sector was still very high at 43.4%. In 2013, the country produced nearly 43.5 million tons of oil and 29.5 billion cubic metres of natural gas.¹⁸

However, it should be noted that the non-oil sector of the economy is growing with greater rapidity. For example, the growth rate of the non-oil sector was 10.0% in 2013, 10 times higher than the growth rate of the oil sector constituting 1% of the country's economy.

The growth rates of non-oil sector spheres are as follows: 10.7% in communications, 6.3% in transport, 23.0% in construction, 4.9% in agriculture and 9.9% in trade.

In 2013, the total volume of investment to the country's economy amounted to USD 28,010.5 million.¹⁹ At the same time, foreign investments amounted to USD 10,540.9 m. Almost half this amount (USD 4,935.2 m) went to the oil sector. In 2013, domestic investment amounted to more than 62% of total investments. Foreign investments have been increasing since the country gained independence. However, there was a decline in foreign investment in 2009, due to the global financial crisis.

Foreign investment in the oil sector allowed hydrocarbon projects to develop, which in turn generated billions of dollars of revenue. On 1 July 2014, assets of the State Oil Fund, into which

¹⁶ State Statistical Committee of the Republic of Azerbaijan, "Macro-economic indicators (January-April 2014)", <http://www.stat.gov.az/macroeconomy/indexen.php?page=9&estat=archive&topic=30>

¹⁷ According to the exchange rate of the Central Bank of Azerbaijan, USD 1 = AZN 0.7844.

¹⁸ For Azerbaijan's rate of oil and natural production in 2013, <http://new.socar.az/socar/en/economics-and-statistics/economics-and-statistics/oil-production> and <http://new.socar.az/socar/en/economics-and-statistics/economics-and-statistics/gas-production>

¹⁹ The State Statistical Committee of the Republic of Azerbaijan, "Finance and Credit", <http://www.stat.gov.az/source/finance/indexen.php>

revenue for the development of hydrocarbon resources goes, amounted to US 37,305.3 m.²⁰ A sum almost twice this amount was taken from the Fund's assets and spent on financing the budget (through annual transfers) for purposes such as:

- 1) improving the social situation of refugees and internally displaced persons;
- 2) financing Azerbaijan's part of the Baku-Tbilisi-Ceyhan pipeline;
- 3) laying the Oguz-Gabala-Baku water pipeline;
- 4) reconstruction of the Samur-Absheron channel;
- 5) construction of the Baku-Tbilisi-Kars Railway;
- 6) education of young people abroad and other projects.

Significantly, transfers from the Oil Fund to the state budget form 58.2% of budget revenues in 2014.

Azerbaijan's aggregated foreign exchange reserves (including the State Oil Fund and the reserves of the Central Bank) exceed USD 50 bn.

As of 1 January 2014, the external debt of the country is AZN 4,753.2 million, representing 8.2% of GDP.²¹ This is considerably lower than many developed countries.

Hydrocarbon exports dominate foreign trade (about 94%). Exports in 2013 amounted to USD 23,975.4 m,²² while non-oil exports only made up USD 1,615.2 m. This accounts for the very high value of foreign trade surplus.

European countries are Azerbaijan's main trade partners, with more than 54% of exports leaving for European countries and more than 57% imported from the rest of Europe.²³

According to official statistics in 2013,²⁴ 4,521.2 thousand out of a population of 9,356.5 thousand are employed. Slightly less than 5% of the population is unemployed (236.6 thousand people), of whom only 36,206 are officially unemployed because they registered with the relevant governmental bodies.

The following diagram shows the sectors in which the working population of the country are employed.²⁵

²⁰ State Oil Fund of the Republic of Azerbaijan, "Latest Figures",

http://www.oilfund.az/az_AZ/hesabatlar-ve-statistika/son-reqemler.asp

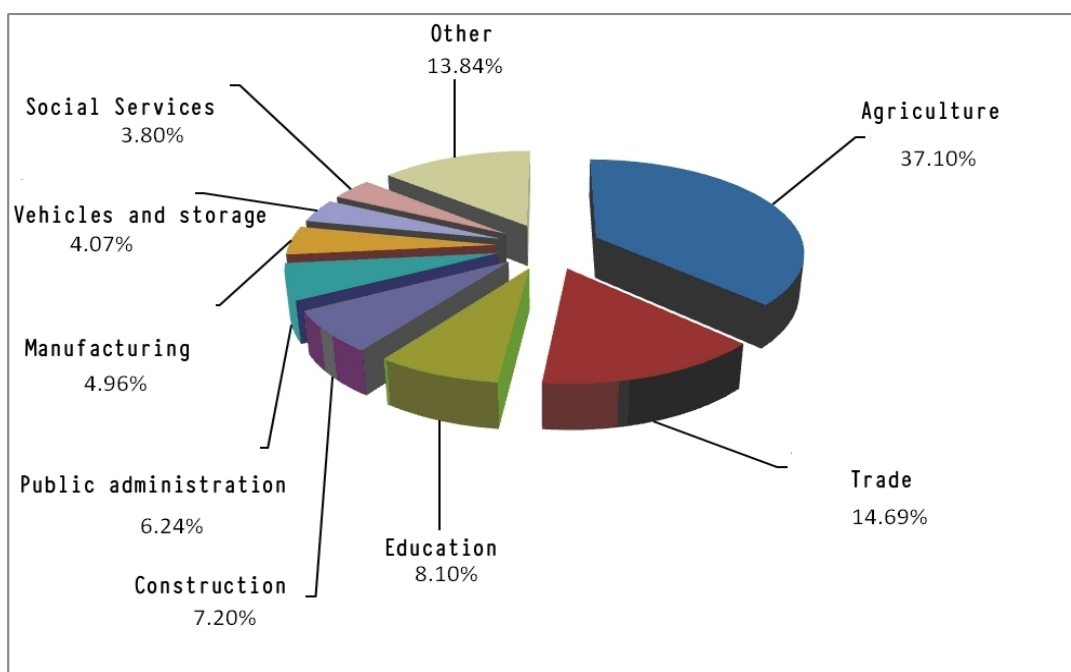
²¹ The Ministry of Finance of the Republic of Azerbaijan. "Foreign state debt of the Republic of Azerbaijan for 1 January 2014.", <http://www.maliyye.gov.az/en/node/1702>

²² The State Statistical Committee of the Republic of Azerbaijan, "Trade", <http://www.stat.gov.az/source/trade/indexen.php>

²³ The State Statistical Committee of the Republic of Azerbaijan, "Trade", <http://www.stat.gov.az/source/trade/indexen.php>

²⁴ The State Statistical Committee of the Republic of Azerbaijan, "Labour Market", <http://www.stat.gov.az/source/labour/>

²⁵ Ibid.



However, many people (especially the rural population) immigrated to other countries (Russia, Turkey, Kazakhstan, Ukraine and others) in search of work. These people are not represented in official statistics.

2. CHARACTERISTICS OF THE SME SECTOR

According to the Ministry of Economy and Industry (MEI),²⁶ the private sector accounted for 85% of GDP and 72.4% of taxes at the end of 2013. Table 1 shows the private sector's contribution to GDP in 2009-2013.

Table 1

	2009	2010	2011	2012	2013
Private sector's contribution to GDP in %	81.2	81.7	82.5	83.0	85.0

Private entrepreneurship entities operated either as legal persons (15.9% of all private sector entities) or as individual entrepreneurs (84.1%).

At the beginning of 2014, there were 86,010 registered legal entities. The growth of private entrepreneurship entities operating as legal entities in 2008-2013 is presented in Table 2.

Table 2

	2006	2007	2008	2009	2010	2011	2012	2013
Number of private companies and other organizations	74,534	79,147	85,618	89,939	93,416	75,632	78,966	86,010

On 1 January 2014, 68,642 (79.8%) of 86,010 enterprises were private enterprises based on local capital, 9,087 (10.6%) were state-owned enterprises, 4,922 (5.7%) were private companies with

²⁶ Ministry of Economy and Industry publication, <http://www.economy.gov.az/media/pdf/analitika-2013.pdf>

foreign capital, 1,601 (1.9%) were companies with mixed Azerbaijani and foreign capital, and 1,758 (2%) were municipally-owned companies. 53.4% of all private business entities operating as legal entities were concentrated in Baku, the capital of the country.

According to the Ministry of Economy and Industry, there were 454,997 persons registered as individual entrepreneurs at the beginning of 2014, only 17.9% of whom were women. 34.8% of all individual entrepreneurs operated in the capital of the country.

At the end of 2013, 80.5% of all enterprises were small businesses. Table 3 shows the growth of small businesses registered in 2007-2013.

Table 3

	2007	2008	2009	2010	2011	2012	2013
Number of small businesses	59,553	65,986	73,776	77,225	6,0223	62,899	69,219

Official criteria were defined only for small businesses in Azerbaijan. According to the Cabinet of Ministers of Azerbaijan in 2009, those companies meeting the given criteria in Table 4 were small companies.

Table 4

Sector of activity	Average annual number of employees	Annual Turnover
Industry and Construction	<50	≤ 500 thousand AZN
Agrarian	<25	≤ 250 thousand AZN
Wholesale Trade	<15	≤ 1 million AZN
Retail trade, Transport, services and other activities	<10	≤ 250 thousand AZN

Therefore, there is currently no formal definition of micro and medium enterprises in Azerbaijan.

Table 5 presents data on the number of small businesses operating in the country.²⁷

Table 5

	2007	2008	2009	2010	2011	2012	2013
Total economy	196,972	204,960	205,028	207,120	223,547	248,288	260,563
Individual entrepreneurs	182,268	186,491	186,765	192,588	210,643	234,634	246 ,02

Table 6 presents a number of key macroeconomic indicators for small businesses (including legal entities and individuals, but excluding farms).²⁸

Table 6

	2007	2008	2009	2010	2011	2012	2013
Value added, million	449.2	718.7	844.8	1,120.0	1,227.0	1,346.5	1,620.0

²⁷ The State Statistical Committee of the Republic of Azerbaijan, "Small Entrepreneurship in Azerbaijan", <http://www.stat.gov.az/source/entrepreneurship/indexen.php>

²⁸ Ibid.

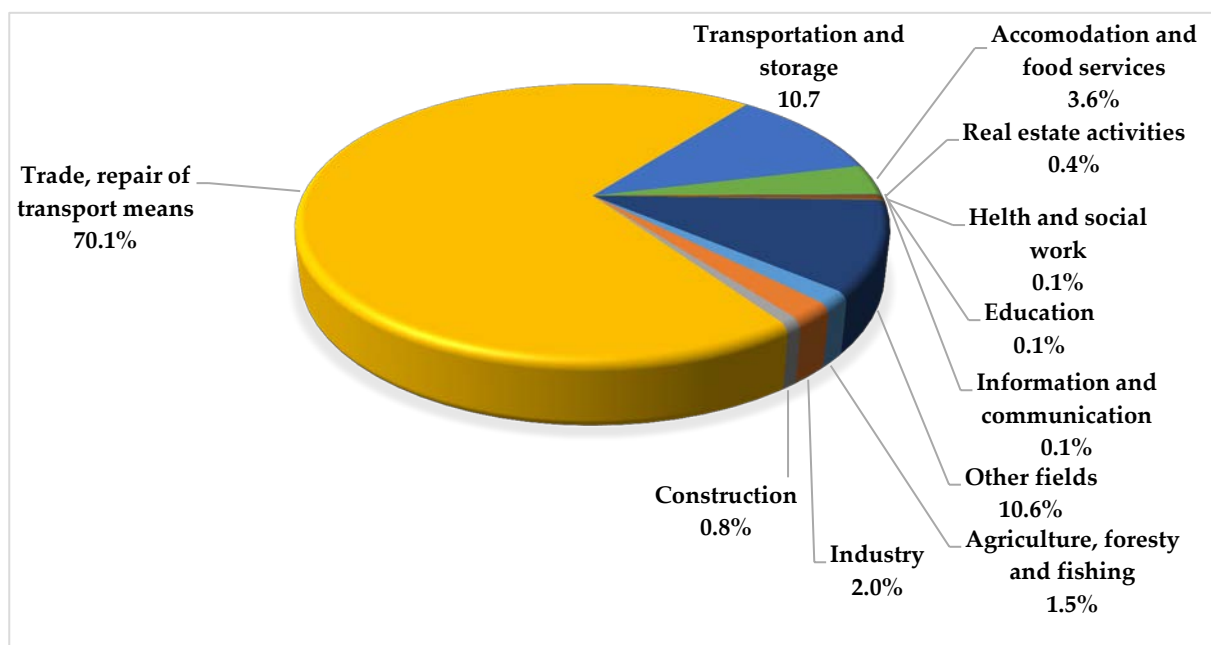
AZN							
Gross surplus, million AZN	41.7	51.9	65.8	78.3	85.3	122.8	165.4
Average annual number of employees, thousands of persons	92.1	103.2	105.9	93.2	90.2	95.5	109.0
Average monthly nominal wages, AZN	170.7	182.1	195.2	207.0	222.2	263.3	303.5
Investments directed to fixed capital, million AZN	289.4	371.2	289.3	276.3	737.6	531.6	486.5
Turnover, million AZN	1,653.5	2,475.7	2,910.1	3,835.5	4,208.5	5,100.6	6,072.6

Table 7 shows the share of small business in Azerbaijan's economic indicators in 2007-2013.²⁹

Table 7 %

	2007	2008	2009	2010	2011	2012	2013
Value added,	1.6	1.8	2.6	2.8	2.6	2.7	3.0
Average annual number of employees	6.7	7.3	7.6	6.7	6.5	6.4	7.9
Investments directed to fixed capital	3.9	3.7	3.7	2.8	5.8	3.5	2.7
Turnover	4.2	4.5	6.1	8.6	8.1	9.6	10.5

The diagram below shows entrepreneurship according to the sectors of the economy.³⁰



²⁹ Ibid

³⁰ Ibid

Table 8 presents data on the number of employees in small business entities.³¹

Table 8

	2007	2008	2009	2010	2011	2012	2013
Average annual number of employees of small enterprises	92,108	103,246	105,902	93,205	90,182	95,503	108,976

According to the report, *Doing Business*, the most problematic factors for businesses in Azerbaijan are the following: 1) those connected to electric networks, 2) those conducting foreign trade, and 3) obtaining construction permits. All this is also true for SMEs. Problems such as hard conditions for obtaining credit (high interest rates and collateral requirements) must be added to this list.

3. LEGISLATIVE FRAMEWORK ON MICROFINANCE

There are no special laws on microfinance in Azerbaijan. However, there are many laws regulating the activities of credit institutions. The most important normative acts for microfinance institutions in the country are:

1) Laws:

- “On the Central Bank”;
- “On Banks”;
- “On credit unions”;
- “About non-bank credit institutions”;
- “On Currency Regulations”;

2) Regulations of the Central Bank include:

- “Rules of bank loans”;
- “Prudential regulations of non-bank credit institutions”;
- “Procedures for appeal of non-bank credit institutions in order to obtain licenses for the issuance of loans”;
- “Rules for issuing licenses to the credit union for its banking activities”;
- “Rules of management and use of the Central Credit Register”;
- “Rules of the economic regulation of the credit union”;
- “Rules of the organization and implementation of cash transactions in credit institutions”;
- “Rules of the risk management in banks”.

In addition to these normative acts, there are many other acts of the Central Bank regulating the activities of institutions that provide loans, in particular, microcredit.

4. GOVERNMENT PROGRAMME SUPPORTING MICROFINANCE

Although special government programmes for the provision of microcredit do not exist, there are a number of governmental development programmes such as the State Programme on “Socio-

³¹ Ibid.

economic development of regions” for the period 2014-2018,³² State Programme on “Socio-economic development of Baku and its regions” 2014-2016,³³ State Programme on “Reliable Food Supply to the population” for the period 2008-2015,³⁴ and the State Programme on “Poverty Reduction” 2008-2015.³⁵ To actualize each programme, the government allocates loans to small businesses, mainly in the regional areas of the country. This is done through the Azerbaijan National Fund for Entrepreneurship Support (ANFES).³⁶

ANFES activities are regulated by a special normative act, the "Regulations on the National Fund for Entrepreneurship Support,"³⁷ approved by the Decree of the President of Azerbaijan, as well as the “Rules on use of ANFES funds”.³⁸ According to Article 5 of these rules, entrepreneurship entities are provided with soft loans in the following amounts:

- Small loans AZN 5,000 – AZN 50,000;
- Average loans AZN 50,001 – AZN 500,000;
- Large loans AZN 500,001 – AZN 10,000,000.

Once ANFES decides to grant a loan, loans are granted through special agents such as authorized banks or non-bank credit institutions. ANFES has a list of these institutions that act in accordance with the criteria established by the ANFES Supervisory Board. The Supervisory Board, in accordance with the directions of socio-economic development of the country, decides the allocation of ANFES funds to various entrepreneurship projects.

Loans are granted for the following periods:

- Small loans – up to 3 years;
- Average loans – up to 5 years;
- Large loans – up to 10- years.

Interest rates on ANFES loans:

- For media development projects – 0.5%;
- For other projects – 1%.

Authorized credit institutions can add their margins to ANFES interest rates, but they should not exceed 3% for media projects and 5% for other projects.

In 2013, ANFES issued loans amounting to AZN 275 m. 19.2% of them were small loans, 1.6% were medium-sized loans and 79.2% were large loans.

5. MAJOR MICROFINANCE INTERMEDIARIES AND INSTITUTIONS

³² Ministry of Economy and Industry, “State Programme on Socio-Economic Development of Regions of the Republic of Azerbaijan for 2014-2018”, http://www.economy.gov.az/index.php?option=com_content&view=article&id=2097:dovlet-proqrami-2014-2018&catid=116:2014-2018-dp-reg&lang=az

³³ Ministry of Economy and Industry, “Socio-economic development of Baku and its regions 2014-2016”, http://www.economy.gov.az/index.php?option=com_content&view=article&id=1913:dp-2014-2016&catid=114:2014-2016-ci-iller&lang=az

³⁴ Ministry of Economy and Industry, “State Programme on “Reliable Food Supply to the population” for the period 2008-2015”, http://www.economy.gov.az/index.php?option=com_content&view=article&id=255:dp-with-a-reliable-supply-of-food&catid=30:C9%99halinin-C9%99rzaq-m%C9%99hsullar%C4%B1-il%C9%99-etibar%C4%B1-t%C9%99minat%C4%B1na-dair-dp-2008-2015&lang=az

³⁵ Ministry of Economy and Industry, “State Programme on “Poverty Reduction 2008-2015”, http://www.economy.gov.az/index.php?option=com_content&view=article&id=249:state-programme-on-poverty-reduction&catid=29:poverty-reduction&lang=az

³⁶ Azerbaijan National Fund for Entrepreneurship Support, “About Fund”, <http://anfes.gov.az/en/>

³⁷ <http://anfes.gov.az/az/pages/e1fb4c3a-1f0d-11e0-abe4-2f80f755c2ce/Esasname.html#submenu>

³⁸ <http://anfes.gov.az/az/pages/b07b11a6-1f0e-11e0-abe4-2f80f755c2ce/Qaydalar.html#submenu>

In the previous section, we described the activities of ANFES. Loans and microcredit in Azerbaijan can also be issued by commercial banks (CB) and non-bank credit institutions. According to the Central Bank, there were 44 commercial banks and 160 non-bank credit institutions in Azerbaijan at the end of September 2014. Out of all the non-bank credit institutions, 113 were credit unions (CUs), 46 were credit institutions financed by international humanitarian organizations, and one is the Limited Liability Company «AZƏRPOÇT».

Some of the international organizations financing credit institutions in Azerbaijan are:

- ACDI/VOCA;
- Adventist Development and Relief Agency International (ADRA) Azerbaijan;
- FINCA Azerbaijan;
- Norwegian Humanitarian Enterprise (NHE);
- Norwegian Refugee Council (NRC);
- Mercy Corps (through other International NGO)s;
- OXFAM, Great Britain;
- International Organization for Migration (IOM);
- Save the Children;
- World Vision International (WVI).

The 46 credit institutions financed by international humanitarian organizations have 209 branches across the country. Credit unions do not have branches in the regional areas of Azerbaijan.

6. MODELS OF MICROFINANCE FOR SMEs

The model of credit issue (including microcredit loans) provided above are by ANFES. Models microcredit issue of other institutions (banks, credit unions, credit institutions financed by international humanitarian organizations) are not the same but similar enough. For example, the amount of microcredit issued by AccessBank ranges from USD 100 to 30,000.³⁹ Credit is issued for up to 60 months. Monthly interest rate is in the range of 1.58-2.75%. Real estate (house, apartment, residential premises, land), vehicles, equipment are used as collateral. According to the MIX Market organization,⁴⁰ AccessBank' issued loans totalling USD 1,047,258,959 to over 157,000 creditors in 2014. According AccessBank:⁴¹

	Amount	Clients
	USD m	
▪ Micro Portfolio	459	124,501
▪ SME Portfolio	447	2,618
▪ Retail Portfolio	95	27,830
▪ Mortgage Loan Portfolio	38	1,052

Another popular bank in Azerbaijan is the Bank of Baku. It issues microcredit to businesses in amounts ranging from USD 500-30,000⁴² for a period of 9-36 months at a monthly interest rate of 1.83-2.67%.

Amrahbank offers microloans between AZN 100 and 20,000 with an annual interest rate of 25% for up to 36 months.

³⁹ http://www.accessbank.az/az/page/micro_loans/#contentLeft

⁴⁰ <http://mixmarket.org/about>

⁴¹ AccessBank, "Investor Presentation on the FY 2014 result", <http://www.accessbank.az/uploads/pdf/p19densfdu1o7i1p4o1bfq1h4i1i0o4.pdf>

⁴² <http://www.bankofbaku.com/az/loans/business-loans/kredity-do-30-tysiach/srochnye-kredity-dlia/>

Unibank offers microbusinesses AZN 200-30,000 AZN. These loans are for a period of up to 36 months, with an interest rate of 2% per month.

A credit institution, FINCA Azerbaijan, issues microcredit to businesses ranging from USD 50,000 to 100,000 for a period of 4-18 months at an annual rate starting from 33%.

Credit union, Agroinvest, offers loans for agriculture. Depending on business project, the loan should not exceed AZN 5,000 AZN and annual interest rate is 7-36%. The loan period ranges from 6-60 months, depending on the project plan.

As a rule, borrowers need to meet the following requirements for loans: 1) identity card; 2) business plan; 3) income statement, and 4) collateral.

According to the research of **responsAbility Investments AG**, the average amount of microcredit in Azerbaijan is USD 3,276.⁴³ When the amount of microcredit is USD 4,000, average profitability is 27.7%.⁴⁴

3.4 MICROCREDITING OF SMEs IN BULGARIA

by

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ABSTRACT

This paper investigates the state of SME microcrediting in Bulgaria. After reviewing relevant literature and primary data, this research examines the overall economic situation, the characteristics of the SME sector, the legislative framework on microfinance, major microfinance intermediaries and institutions, and models of SME microfinance in Bulgaria. The key findings reveal that the present

⁴³ "Microfinancial climate: Global Experience and Azerbaijan." Presentation: Responsibility Investment AG at the 7th Microfinance Conference, 9-10 October 2014, Baku, Azerbaijan.

⁴⁴ Ibid.

economic and business situation in Bulgaria bears the marks of the global financial and economic crisis of 2008. SMEs play an important role in the Bulgarian economy, but their development is hampered by their low access to finance. Although there is no special law or regulation governing microcredit in Bulgaria, there is microcredit support of SMEs at both the national and EU levels. There is a great diversity of banking and non-banking institutions providing microfinance to SMEs, and there are also models of microfinance available to SMEs.

Keywords: microfinance, legislation, institutions, SMEs, Bulgaria.

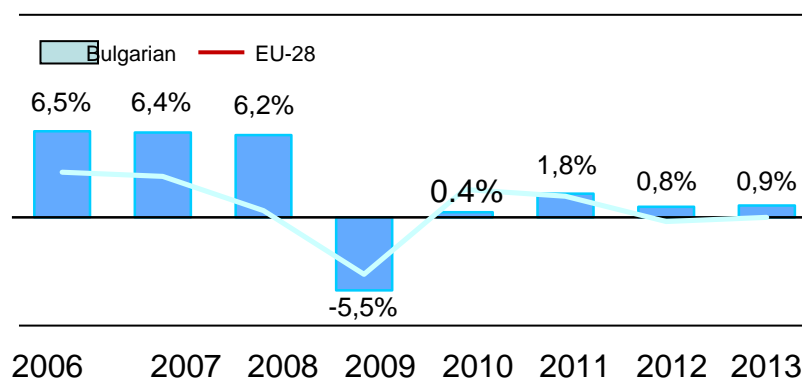
JEL classification: G21, G23.

1. ECONOMIC SNAPSHOT

In 1989, Bulgaria began profound political, economic and social reforms. After more than a decade of reforms, the European Union (EU) recognized the Bulgarian economy as a functioning market economy in 2002. The preparation of the accession of Bulgaria to the EU exercised a positive influence on the environment for enterprise development. Between 2004 and 2008, the Bulgarian economy registered an average growth of more than 6%, which was in turn driven by significant amounts of bank lending, consumption and foreign direct investment. After fulfilling all economic and political criteria, Bulgaria joined the EU in 2007. The present economic and business situation in Bulgaria bears the marks of the global financial and economic crisis of 2008. During the economic and financial crises of 2007–2010, Bulgaria marked a decline of 5.5% in GDP in 2009 and stagnated in 2010 despite a significant recovery in exports (Eurostat 2012, 41). GDP growth was 1.8% in 2011, 0.8% in 2012, and 0.9% in 2013. While internal consumption played a positive role in GDP growth in 2012, external demand was the driving force of GDP growth in 2013. The only economic sectors to register growth in 2012 were industry and agriculture, which grew by 0.8% and 3.5% respectively.

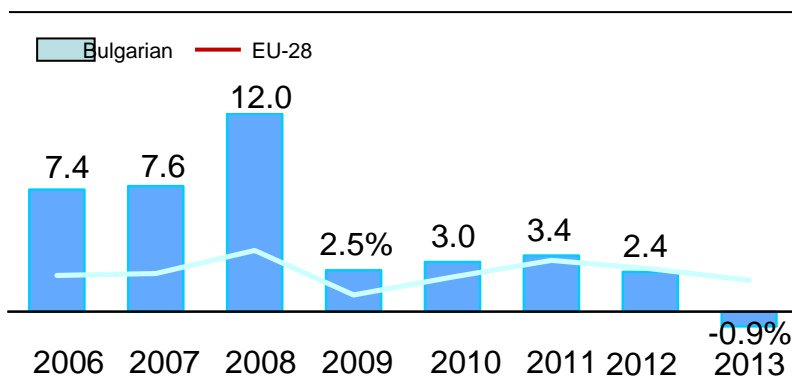
The stabilization of prices in the international oil and food markets led to a moderation of the country's inflation rate in the middle of 2011 (Figure 2). Prior to mid-2011, prices were relatively high. The moderation of prices after 2011 contributed to the weaknesses in domestic demand (especially, consumption and investment). It also led to the stagnation of the labour market, which saw no increase of wages due to high unemployment.

Between 2001 and 2009, Bulgaria managed to attract considerable foreign direct investment. When the inflow of foreign direct investment weakened after 2009, the economic development of Bulgaria slowed down significantly. In 2010-2013, net foreign direct investment averaged EUR 1.2-1.5 bn, which is considerably reduced from the averages before the global economic and financial crises (Figure 3).



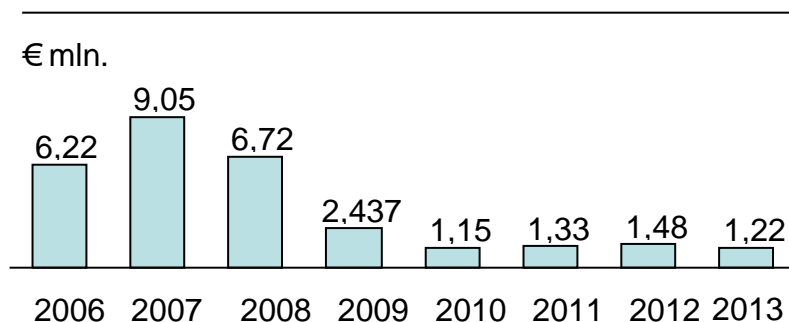
Source: Author's elaboration based on macroeconomic statistics (National Statistical Institute 2014a)

Figure 1: Real GDP growth in Bulgaria



Source: Author's elaboration based on data about inflation and consumer price indices (National Statistical Institute 2014b)

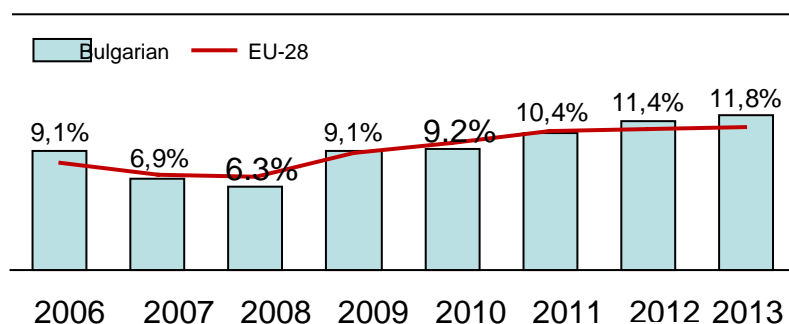
Figure 2: Inflation in Bulgaria



Source: Author's elaboration based on data about foreign direct investments (National Statistical Institute 2014c)

Figure 3: Foreign Direct Investment in Bulgaria

In comparison with the other EU Member States, the Bulgarian economy emerged from the global economic and financial crises with significantly reduced public debt. However, this was achieved at a serious social cost for it resulted in high rates of poverty, rising inequality and an increase in school dropout rate. Small and medium-sized enterprises (SMEs) and their main trading partners suffered the brunt of the economic crisis in Bulgaria. Although the decrease of real GDP stabilized in early 2010, employment figures continued falling. Until 2012, the Bulgarian economy registered slight increases in income rates, but the unemployment rate continued to rise (Figure 4).



Source: Author's elaboration based on data about unemployment (National Statistical Institute 2014d)

Figure 4: Unemployment in Bulgaria

Over the last decade, the labour market in Bulgaria went through a complete cycle of development. Until 2008, employment was continuously growing and unemployment was decreasing. However, 2009 marked the reversal in prevailing labour market trends. Since 2009, the Bulgarian market has been characterized by decrease employment and increasing unemployment. Within four years, the number of employed persons fell significantly. In 2012, employment fell by 2.5%, while unemployment increased to 11.4%. In 2013, employment decreased by 0.4% and unemployment reached 11.8%.

Close to half (49.3 %) the Bulgarian population are at risk of poverty or social exclusion in 2012, the highest rate among EU Member States (Table 1). The population at risk of poverty in 2011 decreased by 1%, while the poverty line decreased by 1.5% in 2012. The social protection system contributes significantly to the decrease in poverty. The main factors influencing risk of poverty are economic activity and participation in the labour market. For the observed period, 48.5% of the unemployed were living below the poverty line and the risk of poverty for unemployed men is 4.5% higher than unemployed women.

Indicators	2009	2010	2011	2012
Poverty line (BGN)	276.5	295.0	283.8	279.7
Number of people below the poverty line (thousand)	1657	1565	1672	1559
Share of poor population	21.8	20.7	22.2	21.2
Proportion of the total population at risk of poverty and social exclusion (%)	46.2	49.2	49.1	49.3
Number of persons at risk of poverty and social exclusion (thousand)	3511.2	3718.7	3693.2	3621.1

Source: National Statistical Institute (2013, p. 1)

Table 1: Population at risk of poverty and social exclusion

Despite the steady economic growth in the recent past, Bulgaria still remains one of the least developed countries in the EU. As indicated by the World Bank's reports, *Doing Business* 2006–2014, Bulgaria has significantly improved its business environment. However, it is easier to do business in most EU countries than in Bulgaria. In the Global Competitiveness Index, Bulgaria lags behind the majority of EU Member States. Factors impeding the competitiveness of the country include corruption, access to financing, inefficient government bureaucracy, policy instability, etc.

2. CHARACTERISTICS OF THE SME SECTOR

During the last 5 years the Bulgarian SME sector registered relatively stable performance in terms of size, industry structure, employment contribution, share of exporters, competitiveness, and integration into European and world business networks (Simeonova-Ganeva et al. 2012, 7; Simeonova-Ganeva et al. 2013, 10). In 2010, there were 353,588 enterprises in the non-financial sector of the Bulgarian economy and their number slightly decreased from a year ago. In 2011, this trend continued and the number of enterprises in the non-financial sector was 351,420. Current developments reflect the economic activity slowdown. Due to lower demand, the number of newly established and existing enterprises decreased. In 2011, SMEs accounted for 99.8% of non-financial enterprises and only 0.2% of them were large-scale. 92.1% of SMEs were microenterprises, while small and medium-sized ones were 6.5% and 1.2% respectively.

Average firm size for the whole economy in 2011 was approximately 6 persons, while SMEs had on average 4 persons and large-scale enterprises had 682 persons on average. In 2011, SMEs provided 74.6% (1.48 million jobs) of total employment in the non-financial enterprises in the economy, 17.9 thousand less than in 2010. The share of micro, small and medium-sized enterprises

(MSMEs) in total employment was 30.8%, 22.5% and 21.2% respectively. The number of employees in SMEs has been decreasing, due to the negative impact of the global financial and economic crises.

In 2011, SMEs recorded an increase of 1.7% in tangible fixed asset investments. The money invested amounted to BGN 64,786.4, that is, 62.7% of total investment of non-financial enterprises in the economy (Table 2). The observed development was mainly due to higher positive growth of fixed tangible assets in micro and small enterprises. As a result, the share in investments of microenterprises increased by 4.6% to BGN 32,946.3 million. Investments in small enterprises also increased by 6.3% and accounted for 14.7% or BGN 15 197.9 million of total investments. Only medium-sized enterprises recorded a decrease of 7.2% in investments and their share in tangible fixed assets was 16.1% or BGN 16,642.2 million.

SMEs make up 15.3% of the industrial sector, 39.9% in trade and 84.7% in services. SMEs have also been experiencing a slowdown in economic activity, most notably in construction, trade and transport. However, SMEs in electricity and water supply have had an increase in economic activity.

	Micro	Small	Medium	SMEs
Enterprises				
Number	323,641	22,660	4,378	350,679
Share	92.1%	6.5%	1.2%	99.8%
Employment				
Number	611,753	447,323	421,876	1,480,952
Share	22.5%	21.3%	74.6%	22.5%
Average. number of persons per enterprise	2	20	96	4
Tangible fixed assets				
Amount (million BGN)	32,946.3	15,197.9	16,642.2	64,786.4
Share	31.9%	14.7%	16.1%	62.7%
Growth	4.6%	6.3%	-7.2%	1.7%

Sources: Author's elaboration based on Simeonova-Ganeva et al. (2012) and Simeonova-Ganeva et al. (2013).

Table 2: Characteristics of Bulgarian SMEs in 2011

Private non-financial SMEs contributed to gross value added and turnover to a greater extent than large private non-financial companies (Simeonova-Ganeva et al. 2012, 43). SMEs created more than 60% of the gross value added and more than 67% of turnover generated by all studied private enterprises in 2010. In 2010, the new value added in SMEs decreased by 4.5%, while SMEs' new value added grew by 2.2% in services and declined by 13.9% in the industry sector. Economic activities declined in construction (38.4%) as well as mining and quarrying (26.7%). Reductions were also observed in the service industry where the administrative activities decreased to 2.4%, transport to 1.6% and information and communication to 1.1%. The main contributors to increased value added in 2010 were the wholesale and retail trade (6.2%), and hotels and restaurants (3.3%). Growth was recorded in industries dealing with electricity (27.9%) and water supply (13%).

Bulgarian SMEs typically have low share of exporters, low innovativeness, low use of intellectual property, low competitiveness, low access to finance, and low integration into European and world business networks (Simeonova-Ganeva et al. 2012, 9; Simeonova-Ganeva et al. 2013, 10). Most SMEs have not implemented good practices in relation to business planning, human resource management, intellectual property and the use of information management systems. There are very few SMEs using external debt and equity financing. The most common sources of funding among Bulgarian SMEs are dependent on the means of the owner, and loans from friends and relatives.

Almost half of the Bulgarian SMEs believe that they have insufficient access to financing. The great majority of SMEs do not have sufficient financial resources to finance any investment. Younger SMEs report lower access to credit than other SMEs. Younger and smaller SMEs have more difficulties internationalizing their activities. Start-ups and new SMEs encounter considerable difficulties in acquiring financial resources. While only about 6% of SMEs use the financial instruments available through the European Structural and Investment Funds (ESIF), 26% of SMEs claim to have information on programmes and funds supporting entrepreneurship. Funding from government programmes or other local and foreign programmes cover 3% of SMEs. According to a study by BIA,⁴⁵ the majority of businesses claim that the most significant problems hampering the effective utilization of funds are the serious procedures requiring large volumes of documentation in the application and reporting on European projects. The results showed that among the problems facing businesses in need of EU funds include late payments on projects and the need to provide financial resources for the project.

3. LEGISLATIVE FRAMEWORK ON MICROFINANCE

The legislative framework adopted in Bulgaria supports the bank monopoly on deposits, but allows other for-profit and non-profit organizations as well as banks to extend credit. There is no special law or other regulation concerning microcredit. Regulations governing microfinance are related to that of credit institutions and loans.

The Law on Credit Institutions regulates the banks and other financial actor providing credits. This Law governs the terms and procedures for granting licenses and conducting activities. It supervises the clients' compliance with the prudential requirements and termination of credit institutions (banks) for the purpose of ensuring a stable, reliable and sound banking system. It also protects depositor interests, as well as requirements for disclosure of information by the Bulgarian National Bank (BNB) in the area of prudential regulation and supervision of banks.

The Law of Supplementary Supervision over Financial Conglomerates regulates the supplementary supervision of regulated entities that are part of a financial conglomerate. The Law contains specific rules for capital adequacy, methods for determining capital adequacy, risk, intra-group transactions, risk management and internal control mechanisms.

The Law on Bank Bankruptcy regulates the bankruptcy proceedings of a bank with a registered office in the country. This law indirectly concerns the borrowers of the bank.

The Commercial Law contains a special section referring to bank credit. It specifies the definition, form, obligations of the borrower, provision of the necessary information relevant to the conclusion and performance of the contract for bank credit, and the conditions for early claim of the credit by the bank.

The Law for the Bulgarian Development Bank regulates the activities of the Bulgarian Development Bank that are related to:

- improvement, stimulation and development of the overall economic, export and technological potential of SMEs by facilitating their access to finance;
- implementation of schemes and instruments for financing public investments and development projects which are of significance to the national economy;
- acquisition and management of mid-term and long-term local and foreign resources necessary for realisation of the country's economic policy.

The Law envisages the provision of various types of guarantees to SMEs, including the obtainment of loans.

The Law on Non-Profit Legal Entities regulates the establishment, registration, organization, activities and dissolution of non-profit legal entities (associations and foundations). These organizations can provide loans if they do not use deposits and do not distribute profit.

⁴⁵ "Burdensome procedures and large volume of documents are the main obstacles to effective absorption of EU funds," *BIA News*, 12 July 2011.

The Cooperative Law regulates the creation and functioning of cooperative organizational forms. The law envisions that cooperative organizations may provide loans.

The Government Ordinance N2/2009 on the Licenses, Approvals, and Permissions Granted by the Bulgarian National Bank according to the Law on Credit Institutions regulates the requirements pertaining to documents and procedures for the issuance of licenses, approvals, and permissions by the Bulgarian National Bank to credit institutions in the country.

The Government Ordinance N22/2009 of the Central Credit Register determines the operation of, provision to and receipt of information from the Central Credit Register. The Central Credit Register is organized and maintained by BNB. It is an information system of customers' credit indebtedness to banks, financial institutions, payment institutions and electronic money institutions granting credit. All financial institutions operating in Bulgaria provide data to the Central Credit Register.

According to the European Microfinance Network (2012, 59) the legislative framework plays a positive role in the development of the microfinance sector in Bulgaria because it offers:

- 1) light supervision from the Bulgarian Central Bank;
- 2) access to information about credit provided by the Central Credit Register, which allows for better assessment of risk and avoidance of over-indebtedness of the clients.

4. GOVERNMENT PROGRAMME SUPPORTING MICROFINANCE

Government support of microfinance for SMEs is implemented through the Bulgarian Development Bank (BDB). BDB is a financial institution 99.9%-owned by the Bulgarian state. It is the successor of Encouragement Bank established in 1999. Its focus is to support small and medium-sized enterprises. BDB is one of the most important banks in Bulgaria, ensuring better access to financial resources and microfinance for SMEs.

The programme for the Competitiveness of Enterprises and Small and Medium-sized Enterprises 2014-2020 (COSME programme) was established by EU Regulation No.1287/2013, at the European Parliament. It is based on, and further improves the Competitiveness and Innovation Framework Programme (CIP) and the Entrepreneurship and Innovation Programme (EIP), established in 2007-2013. COSME will handle all SME funding related areas except innovative activities. This is because innovative activities will be supported by the Horizon 2020 programme. The COSME programme is a funding instrument that will improve access to finance for SMEs. The European Commission is responsible for implementing the COSME programme, while the European Executive Agency for Small and Medium-sized Enterprises (EASME) and the European Investment Fund (EIF) are responsible for financial instruments. The COSME programme has a total budget of EUR 2.3 bn for the period 2014-2020 and will focus on the following four areas of support:

- Improving access to finance for SMEs in the form of equity and debt;
- Improving access to markets for SMEs within the EU and globally;
- Improving framework conditions for the competitiveness of enterprises;
- Promoting entrepreneurship.

For the period 2014-2020, nearly EUR 1.4 bn in the COSME budget has been allocated to loans and venture capital. These funds may be used in conjunction with national financial instruments for SMEs. Financial instruments of the COSME programme include a loan guarantee facility (cover loan guarantees of up to € 150,000 for SMEs) and an equity facility for growth (support for venture capital funds, with a particular focus on expansion and growth phase SMEs).

The Joint European Resources for Micro to Medium Enterprises (JEREMIE) initiative was jointly developed by the European Commission and the European Investment Fund. It promotes the use of financial engineering instruments to improve SMEs' access finance via Structural Funds interventions. Bulgaria uses part of its European structural fund allocations to invest in revolving financial instruments, including microfinance, to support:

- creation of new enterprises or the expansion of existing enterprises;

- access to investment capital by enterprises, particularly SMEs, to modernize and diversify their activities, develop new products, secure and expand market access;
- business oriented research and development, technology transfer, innovation and entrepreneurship;
- technological modernization of productive structures to help reach low carbon economy targets;
- productive investments to create and safeguard sustainable jobs.

Loans, guarantees or venture capital funds invested in enterprises will also receive contributions from the European Regional Development Fund (ERDF). ERDF will invest in the form of equity, loans and/or guarantees. Returns from investments are reinvested in enterprises. In this way, a pool of funds can be re-used several times, recycling public funds, leveraging capital as well as increasing the sustainability and impact of public resources allocated to SMEs.

The Joint Action to Support Microfinance Institutions in Europe (JASMINE) initiative is a scheme created jointly by the European Commission, the European Investment Bank (EIB) and European Investment Fund (EIF). Its objective is to:

- **disseminate good practice** in the EU as regards microcredit lending.
- **support the development of microcredit providers active in the European Union** in various fields such as institutional governance, information systems, risk management and strategic planning (capacity building).
- **help these intermediaries become sustainable and viable operators** on commercial terms.

Originally, the **JASMINE Technical Assistance (TA) Facility** provided various financial and non-financial services to microfinance institutions (MFIs), but the concept has evolved over the years. As it stands now, the **JASMINE TA Facility concentrates on delivering TA** to microcredit providers, while financing is made available to microcredit providers **through the European Progress Microfinance Facility (EPMF)**, managed by EIF. A range of **consistent tools and services are developed under JASMINE**. They all focus on improving the quality of microcredit providers and establishing good practice in this sector. The two types of services available are:

- Capacity building aimed at beneficiaries selected via Calls for Expression of Interest, managed by the EIF.
- Microfinance Development tools and services for the entire microfinance sector.

The European Progress Microfinance Facility (Progress Microfinance) increases the availability of microcredit – loans **below €25,000** – for setting up or developing a small business. It has a particular focus on, but is not restricted to, groups with limited access to the conventional credit market. Examples include female entrepreneurs, young entrepreneurs, entrepreneurs belonging to a minority group, entrepreneurs with a disability, sole traders etc. Progress Microfinance does not directly finance entrepreneurs, but enables **selected microcredit providers** in the EU to increase lending by:

- issuing guarantees, thereby sharing the providers' potential risk of loss
- providing funding to increase microcredit lending.

The conditions for microloans to entrepreneurs – amount, duration, interest rates and fees, timeframe to get a loan – depend on the particular microcredit provider.

The Competitiveness and Innovation Framework Programme (CIP) has several schemes and a budget of over €1bn to facilitate access to loans and equity finance for SMEs where market gaps have been identified. The CIP financial instruments are implemented for the European Commission by the European Investment Fund on a trust basis. They cover different needs depending on the small businesses' stage of development. The SME guarantee facility provides loan guarantees to encourage banks to make more debt finance available to SMEs, including microcredit and mezzanine finance, by reducing the banks' exposure to risk. SMEG provides co-, counter- and direct guarantees to financial intermediaries providing SMEs with loans, mezzanine finance and equity.

5. MAJOR MICROFINANCE INTERMEDIARIES AND INSTITUTIONS

Both financial and non-financial institutions provide microfinance to SMEs in Bulgaria. The Bulgarian Development Bank is the only Bulgarian bank providing financing via other credit institutions as well as direct financing. The Bulgarian Development Bank aims to be a modern banking institution, as it seeks to make full use of its unique position in the local banking market to implement state policy in the Bulgarian economy. The main foci of the bank are local SMEs, project financing for export-oriented companies, as well as investment banking and public projects of national importance. BDB is the best-positioned local bank to raise funds from international partners. It is focused on the following areas:

- Start-ups and innovations
- Exporters of finished goods
- Manufacturing industry
- Extractive industries
- Agriculture and Tourism

Its subsidiary, the National Guarantee Fund, issues guarantees for bank loans to the non-financial sector. BDB is among the top four Bulgarian banks in terms of credit rating, rated BBB- by Fitch Ratings, the global credit rating agency.

Most banks licensed by the Bulgarian National Bank provide microcredit to SMEs. The most active banks in providing microcredit to SMEs include ProCredit Bank (Bulgaria) EAD, UniCredit Bulbank EAD, Raiffeisenbank (Bulgaria) EAD, United Bulgarian Bank AD, Allianz Bank Bulgaria AD, First Investment Bank AD, Societe Generale Expressbank AD, DSK Bank EAD, CIBANK JSC. Bulgarian banks dispose with much greater financial capacity than non-bank financial institutions, allowing them to provide the majority of microcredit.

Many of the non-bank financial institutions licensed by the Bulgarian National Bank provide microcredit to SMEs. Some of them have piloted successful projects in the past decade and have gained significant experience. **Ustoi JSC** supports the development of microenterprises in Bulgaria by providing entrepreneurs with fast and sustainable access to financial services. **Ustoi's** mission is to increase income and sustain the employment of microentrepreneurs in Bulgaria. **Ustoi** exclusively targets the smallest economically viable companies by providing accessible financial services with minimal requirements and fast procedures. **Ustoi** financial products are available to the majority of the microenterprises, including those operating in rural areas. The company operates on a regional basis. **Ustoi** provides services to mainly female microentrepreneurs living and working in their respective regions.

Mikrofond AD was established to finance Bulgarian entrepreneurs without access to bank financing. The operations of Mikrofond AD were funded by both national and international financial institutions. In 2010, the company signed a loan agreement with the European Investment Fund, under the microfinance mechanism, Progress of the EU. Mikrofond AD has established 10 branches in the country, supplying alternative funding for start-up, micro and small businesses without access to bank funding. Mikrofond AD's vision is to be a sustainable financial institution that accumulates social and community capital, and funds microentrepreneurs and sustainable projects with social impact. The clients of the company include active entrepreneurs registered as legal entities, private agricultural producers and freelancers.

Joint Opportunities for Business Support Microfinancing Institution (JOBS MFI) is a non-bank financial institution and subsidiary of the Bulgarian Development Bank. It grants microfinance to microenterprises, including **sole traders, jobseekers and unemployed people**, wishing to create their own microenterprise. JOBS MFI also gives microfinance to **disadvantaged groups** in the labour market. Potential final beneficiaries will also have access to **business development services** (counselling, training, mentoring etc.) in order to strengthen their business skills and make sure the lease/loan provided will create real value added for the establishment/development of their microbusinesses.

Nachala 2007 EAD is a financial institution owned by the Nachala Cooperative, one of the oldest non-bank institutions extending loans in support of the development of entrepreneurship and small business in Bulgaria. The operations of the Nachala Cooperative are supported by various international organizations such as USAID.

Another group of microfinance institutions providing microcredit to SMEs are credit cooperatives. Credit Cooperatives are licensed and supervised by the Bulgarian National Bank. Credit Cooperatives provide access to microcredit at economically reasonable rates and offer personalized relationship lending services to disadvantaged customers situated in remote rural areas. Clients may receive consulting services and get involved in a social network of members.

Many non-profit NGOs registered in Bulgaria provide microcredit to unemployed people or disadvantaged groups in order to increase their social inclusion and diminish poverty.

6. MODELS OF MICROFINANCE FOR SMEs

The Bulgarian microfinance market is characterized by a large diversification of products offered to SMEs. The underlying product features of the microfinance market are especially diverse.

The interest rates of available microfinance products for SMEs vary according to the credit amount, currency and collateral. The following are the interest rates of the various MFIs and microcredit schemes:

- fixed interest rate;
- *base interest rate + margin*;
- 50% lower than the bank's standard rates (JEREMIE loans).

The time period of the available microfinance products for SMEs varies according to the credit amount and required collateral. It is usually between 12 and 60 months.

Microcredit with smaller amounts and shorter terms do not usually require collateral. Accepted collateral includes:

- mortgage
- pledge on fixed assets
- leveraging the owner of a co-borrower on the loan;
- direct debit consent from all accounts of the customer
- co-borrower: at least one natural person other than the owner(s) meeting the rules for lending to individuals;
- warranty contract;
- pledge on machinery, equipment, automobiles, etc.;
- pledge on cash funds;
- guarantee by the National Guarantee Fund or the Municipal Guarantee Fund of Sofia Metropolitan Municipality for Small and Medium Enterprises;
- pledge on other movable assets.

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3.5 MICROCREDITING AND SMALL AND MEDIUM ENTERPRISES IN GEORGIA

by

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ABSTRACT

This paper provides information on the Georgian SME sector. It presents the legislative framework on microfinance, outlines the different microfinance organizations and microfinance intermediaries, and highlights their activities. The author also presents available government support measures. Finally, it shows the microfinance model. Last but not least, it concludes that microfinance loans are more accessible to the masses than bank loans.

Keywords: characteristics of the Georgian SME sector, microfinance legislation, microfinance organization, microfinance intermediaries, government support, microfinance model

JEL classification: G21, L26, O1

CHARACTERISTICS OF THE SMALL AND MEDIUM-SIZED ENTERPRISES (SME) SECTOR

According to the Law on the National Investments Agency of Georgia, small enterprises are classified as any enterprise that annually employs not more than 20 persons and has an annual turnover not more than GEL 500,000; and medium enterprises are those that annually employ not more than 100 persons and has annual turnover of not more than GEL 1,500,000. [6]

The new “Tax Code”, which came in force from January 2011, provides simplified procedures for micro and small businesses. According to the new “Tax Code”, Micro and Small businesses are covered by special tax regimes.

The status of microbusiness is given to a physical person who is not using hired persons to work and is conducting economic activity independently from which annual total income does not exceed GEL 30,000.

The Ministry of Finance of Georgia is responsible for granting and abolishing the status of microbusinesses. The tax organ is responsible for granting a certificate for the status.

A physical person who has been granted the status of microbusiness is free from income tax and current taxes.

The status of small business is given to a physical person / an individual / sole entrepreneur whose annual total income from economic activity does not exceeds GEL 100,000.

Small businesses only need pay one single tax. The tax rate for small businesses is 3% or 5% of income. The removal of bookkeeping requirements is in conformity with international standards. Although some small businesses are taxed at 5% of their income, they are only obliged to keep simple “purchases and sales journals” and cash registers. Small businesses are only taxed at 3% when they have documentary proof that 60% of their income has gone into expenditure and consumption. [7]

In 2013, there were 59,032 enterprises operating in the country. 85% (50,039) of these were small enterprises and 9% (5,403) were medium enterprises. Most businesses in Georgia are small and medium-sized enterprises (SMEs). The number of enterprises increased in 2013, increased by 8% from the previous year and 76% from 2006’s figures. In 2013, the number of SMEs in Georgia increased by 8% from 2012’s figures and 72% from 2006’s figures.

In 2013, 40% of employees in enterprises worked in SMEs, with 15% in medium-sized enterprises and 25% in small enterprises. The number of employees in SMEs decreased in 2013, down by 3.5% from 2012’s figures and down by 6.9% from 2006’s figures. However, the number of employees in SMEs in 2013 increased by 19% when compared to figures from 2006.

The employment distribution in 2013, according to economic activities is as follows:

- Industry – 22.1%,
- Trade – 21.5%,
- Health and social work – 11.3%,
- Transport and communications – 10.7%,
- Real estate – 9.7%,
- Construction – 9.4%,
- Hotels and Restaurants – 4.8%,

- Others – 10.5%.

61% of employees in the business sector in 2013 were employed in the capital of the country, Tbilisi; 9% were in the Autonomous Republic of Adjara; 8% in Imereti, and 7% in the municipality of Kvemo Kartli.

Average monthly remuneration of employees of small and medium businesses increased by 40% and 24% respectively in 2013. When compared to figures from 2006, employees in small businesses had a threefold increase in salary and employees in medium-sized enterprises quadrupled their salary.

SMEs had a turnover of USD 4,862.1 m in 2013, increasing from 2012's turnover by 13.4% and increasing from 2006's turnover by 231%. In 2013, SMEs' share of the total turnover in Georgia was 18.3%, of which 8.6% came from small enterprises and 9.7% came from medium-sized businesses. SMEs in Georgia had a turnover of GEL 1,728.5 m in the second quarter of 2014, 7% higher than the previous quarter. In the second quarter of 2014, SMEs' share of total turnover was 15.6%, with 9.3% coming from small enterprises and 6.3% from medium-sized enterprises.

Georgian SMEs had an output of USD 2,718.9 m in 2013, 11% higher than in 2012 and almost triple that of 2006. In 2013, SMEs contributed 19.2% to total output, of which small enterprises produced 9.7% and medium-sized enterprises 9.5%. In the second quarter of 2014, SMEs had an output of GEL 953.3 m, 14.3% higher than the previous quarter. In the second quarter of 2014, SMEs contributed to 16.8% of total output, with small enterprises making up 9.3% and medium-sized enterprises 7.5%.

In the second quarter of 2014, the Georgian business sector had a turnover of GEL 11.1 bn, 11% higher than the previous quarter.

The business sector's production value also increased by 13.3% from the first quarter of 2014.

In the second quarter of 2014, the number of persons employed in the Georgian business sector rose by 2% and numbered 507.6 thousand persons. [1]

Georgia has improved the business environment for all enterprises (including SMEs) by simplifying administrative regulations, reducing tax burdens, fighting corruption, facilitating free trade, promoting privatization campaigns and initiating a policy partnership platform in order to build a national lifelong entrepreneurial learning concept. Anti-corruption measures are recognized as one of the most successful parts of the reform policy.

Georgia's Small Business Administration (SBA) assessment shows high scores for responsive administration and access to finance.

Key policies are in place for more developed women's entrepreneurship.

However, a lack of data compromises Georgia's performance, particularly in the indicators addressing start-ups and SME growth training.

Georgia has made significant improvements by following a horizontal approach to business climate development. This approach is based on effective consultations with the private sector and functioning intra-governmental coordination mechanisms.

Georgia made significant progress in reforming the operational environment for SMEs, particularly by streamlining the company registration process. Reforms to the company registration process have helped to remove burdensome regulations, saving time and reducing costs for SMEs and entrepreneurs.

In Georgia, a broad range of public services are offered in one single location (Public Service Halls), thus increasing their accessibility and reducing the administrative burden for SMEs.

Georgia has developed a broad range of e-government services, often using online tax filing systems as a starting point. The country has also improved its infrastructure for e-government by introducing electronic signatures. Georgia currently provides advisory and financial support for start-ups through publicity funded schemes. [8]

According to the World Bank 2013 study, *Fostering Entrepreneurship in Georgia*, Georgian innovative firms have created 30% more jobs and are much more competitive in the domestic and global markets than non-innovative firms.

In Georgia, however, SMEs' share of GDP remains small at less than 20% of GDP.

Financial systems in Georgia are not conducive to business development. Companies cite high interest rates and risk averse lending policies (requiring high levels of collateral) as major hindrances to expansion. In addition, risk capital is lacking.

Due to the lack of borrowing opportunities, SMEs must rely on owners' capital or retained earnings for investments, which greatly impedes their growth.

SMEs, especially start-up companies, also voiced difficulties in access to finance, deficient knowledge and technology transfer, limited skills etc. [9]

LEGISLATIVE FRAMEWORK ON MICROFINANCE

Law of Georgia on Microfinance Organizations

The Law of Georgia on Microfinance Organizations regulates the operation of microfinance organizations in Georgia and creates an environment conducive for their development.

A **Microfinance Organization** is a legal entity founded as a limited liability or a joint-stock company, and registered by the National Bank of Georgia on the basis of its application. It implements the activities stipulated by this law under the supervision of the National Bank of Georgia. A microfinance organization is obliged to create a supervisory board that is regulated by the stipulations of the Law of Georgia "On Entrepreneurship" for joint-stock company supervisory boards. Only a microfinance organization has the right to use the term "Microfinance Organization" or its abbreviation, MFO, in its company name apart from the denominations envisaged by the Law of Georgia on Entrepreneurship.

If the National Bank of Georgia determines that a microfinance organization has breached the norms stipulated by Georgian legislation, the National Bank of Georgia has the right to issue a warning, impose a financial fine, or adopt the decision to cancel the registration of the microfinance organization.

Microfinance Activities

1. A microfinance organization is authorized to provide the following activities only:
 - a) Extend microloans, including personal, collateral, unsecured and group loans (credit) or loans on property and others to legal and real entities;
 - b) Invest in state and public securities;
 - c) Provide money transfer;
 - d) Operate as an insurance agent;
 - e) Provide consultation services in microcredit;
 - f) Receive loans (credit) from resident as well as non-resident legal and real entities;
 - g) Possess the share of the authorized capital of a legal entity, the total amount of which does not exceed 15% of the authorized capital of the microfinance organization.
 - h) Provide other services and operations defined by Georgian legislation including micro leasing, factoring, foreign exchange, issue, realization, refunding bonds and promissory notes and other operations connected with this.
2. A microfinance organization may provide the activities stipulated by this law only after it has been registered as a microfinance organization by the National Bank of Georgia under the rules defined by the Bank.
3. A microfinance organization shall not receive a deposit from either real or legal entities.

The concept and volume of microcredit are defined as follows:

1. Microcredit is money extended by a microfinance organization to a borrower or a group of borrowers under the conditions set by the credit contract defining the maturity, return, valuation and purpose of the microcredit.

2. The maximum total amount of microcredit extended by a microfinance organization to a single borrower may not exceed GEL 50,000.

Authorized Capital of a Microfinance Organization

The share of paid-in capital that a microfinance organization is authorized to contribute may not be less than GEL 250,000. If an amount more than GEL 250,000 is needed, the total capital that a microfinance organization is authorized to issue will be determined by the by-law and filled by monetary or non-monetary deposits as stipulated by Georgian legislation.

Auditing, Accounting and Reporting

1. A microfinance organization shall be responsible for:
 - a) Carrying out transparent financial and tax accounting and applying the principle of publicity;
 - b) Developing and implementing procedures of internal control;
 - c) Inviting an external audit in compliance with Georgian legislation every year;
 - d) Maintenance of accounting and submission of financial statements according to international standards and Georgian legislation;
 - e) Reporting to the National Bank of Georgia. The form and the deadlines for submitting a report is stipulated by an administrative act of the National Bank of Georgia (act no. 1682, dated 24 September 2009, and enforced from 1 December 2009);
 - f) Guaranteeing the truthfulness and accuracy of the submitted information and financial statement;
 - g) Annually publishing a financial statement of the accounting year and a report of the external audit in a periodical.
2. In the event that a microfinance organization fails to comply with all the requirements on the submission of financial statements (as stipulated by the National Bank of Georgia) twice in succession, the Bank has the right to cancel the registration of the microfinance organization.
3. A microcredit organization is obliged to keep the following documents for a period of six years:
 - a) Account books and records, inventory, balance sheets as well as their explanatory instructions and other organizational documents;
 - b) Source documents evidencing the entries in the account book.

Conditions for Extending Microcredit

1. A microfinance organization and a borrower form a written credit contract in compliance with this law and the Civil Code of Georgia.
2. Credit stipulated by this article can be issued to a group or individual, and may be secured or non-secured. A microfinance organization will stipulate the rules and procedures for extending credit.
3. Interest rates, commission fees and service fees will be stipulated by the microfinance organization.
4. A microfinance organization has the right to monitor the purposeful use of credit by the borrower, and the borrower is obliged to provide opportunities for monitoring as mentioned above. If the borrower does not comply with the terms of using the issued credit with defined purpose, the microfinance organization may refuse to extend the undisbursed part of the credit and recall the credit prior to the agreed maturity period. [5]

GOVERNMENT PROGRAMMES SUPPORTING MICROFINANCE

In October 2014, the Ministry of Economy and Sustainable Development of Georgia launched a new state programme, "Supporting Micro and Small Businesses in Georgia".

The programme aims to develop and promote micro and small enterprises in the country, support business entities/entrepreneurs, develop regional markets and increase incomes. The programme is designed to provide proportional financing to micro and small businesses for the population living in the outlying regions. A budget of GEL 20 million has been allocated to this new state programme.

The “Supporting the Micro and Small Businesses” programme allows modern business practices to be implemented in Georgia’s rural regions.

For the 26-months duration of the programme, it will be funded by state budget and implemented by local non-governmental and financial organizations. The project aims to benefit four targeted communities across the country. The total budget of the project will be distributed proportionally according to the population of each region.

The implementation of the aforementioned programme is designed to fulfil the following purposes:

- increase the competitiveness of regional businesses,
- launch modern business practices in the rural regions,
- regional diversification of production as well as other direct and indirect benefits of economic activity,
- growth and development.

The programme caters to residents in the rural regions of Georgia (except the capital of Georgia) and provides financing to entrepreneurs of micro and small businesses in the outlying regions (3,315,300 people).

The programme's support mechanism and methodology issues participatory funding to start-ups, existing entities (except legal entities) and groups of business entities for up to a maximum of three business units (except legal entities). An entrepreneur may receive a maximum loan of GEL 5,000 and a group of entrepreneurs in a business partnership may receive a maximum loan of GEL 15,000. Entrepreneurial groups and business entities participating in the programme may receive loans that are not less than 20% of the funding. The programme includes technical assistance, training, internships and individual consultations.

According to the programme, the target regions of Georgia are divided into 4 lots:

Lot 1 - Adjara, Guria, Samegrelo and Zemo Svaneti (population: 1,011,700 people, 30.5% of the region's population) - Estimated Budget GEL 6,100,000;

Lot 2 - Kakheti, Mtskheta, Shida Kartli (population 827,600 people, 25% of the region's population) - Estimated Budget GEL 5,000,000;

Lot 3 – Imereti, and Racha-Lechkhumi and Kvemo Svaneti (population 749,200 people, 22.6% of the region's population) - Estimated Budget GEL 4,520,000;

Lot 4 - Samtskhe-Javakheti, Kvemo Kartli (population 726,800 people, 21.9% of the population living in the region) - Estimated Budget GEL 4,380,000.

The state programme “Produce in Georgia” aims to develop entrepreneurship, support entrepreneurs, develop industry, and promote the creation of new enterprises as well as new factories.

Its goal is to enhance the private sector's competitiveness, improve the export potential growth in finance and real estate, and provide access to modern technology and technical assistance.

The programme includes the following three components: access to finance, access to infrastructure (real estate), and access to consultation services.

The budget of the programme is GEL 46 m, of which GEL 30 m is allocated for agricultural production and GEL 16 m for industry production.

This state programme is an opportunity for start-ups to fulfil their plans and create new factories in the field of agriculture or industry.

The state programme “Produce in Georgia” started in June 2014. The Ministry of Economy and Sustainable Development and the Ministry of Agriculture of Georgia are the coordinators of the

programme. Also, the following institutions are involved in the programme: the Entrepreneurship Development Agency, the National Agency for State Property Management, the Innovation and Technology Agency of Georgia, and the Agricultural Projects Management Agency.

The Memorandum of Mutual Understanding between the Ministry and commercial banks involved in the state programme “Produce in Georgia” was signed at the Ministry of Economy and Sustainable Development of Georgia.

Negotiations as to participation in the state programme were held with all commercial banks in Georgia. The banks involved in the programme are as follows: Bank of Georgia, TBC bank, VTB Bank Georgia, Bank Republic, BasisBank, International Bank of Azerbaijan-Georgia, Kor Standard Bank, CARTU bank, Investbank, Halyk Bank Georgia, Liberty Bank, ProCredit Bank, PrivatBank, Progress Bank.

The Memorandum of Mutual Understanding includes issues regarding the industry’s access to finances within the framework of the state programme “Produce in Georgia”. The banks will allocate credit to entrepreneurs within the framework of programme. The state will provide co-sponsorship to 10% of the interest rate for 24 months. The programme issues credit ranging from a minimum of USD 150,000 to a maximum of USD 2 million.

In February 2014, the Enterprise Development Agency was established to promote and support start-ups, SMEs and the export potential of the country. The Enterprise Development Agency is integrated in the system of the Ministry of Economy and Sustainable Development of Georgia as a legal entity of public law.

The Enterprise Development Agency promotes enterprises and export development in terms of both financial and entrepreneurial skills.

The Enterprise Development Agency offers consultation, educational and technical assistance to entrepreneurs (both legal and physical persons), prepares industry and export related surveys, provides information to export-oriented legal and physical persons, and cooperates with international and donor organizations.

The agricultural sector is important to the Georgian economy. In recent years, agriculture gained greater prominence in the Georgian political agenda. In 2011, the Ministry of Agriculture was allocated a 78% increase in the state budget. Huge steps have been taken to attract foreign direct investment (FDI) to the agricultural sector. Entities willing to establish agricultural processing enterprises will be able to acquire agricultural land for only 20% of the market price. There is 0% property tax on small plots of land (less than 5 ha), 0% property tax on property transactions, 0% value-added tax (VAT) on primary supply of agricultural products, and 0%, import duty on agricultural and other equipment. There are also opportunities for privatizing agricultural land (75% of all agricultural land is state-owned), 100% depreciation allowance on investments, and liberal labour regulations. [10]

In the spring of 2013, the “Preferential Agro-Credits Project” was launched to support workers in the agricultural sector and to provide access to financial resources in the form of preferential agro-credits. 12 banks and 2 microfinance organizations are involved in the project. The “Preferential Agro-Credits Project” was developed by the Ministry of Agriculture, financed by the Rural and Agricultural Development Fund, and implemented by the Agriculture Project Management Agency.

Banking and credit institutions, and suppliers of agricultural production means have identified three key components of the “Preferential Agro-Credits Project”:

1. Commodity interest-free credit for small farmers - 0%;
2. Preferential agro-credits for medium and large farmers - more than 8% (current assets and short-term financing of the purchase of stock)
3. Preferential credit for rural agro-industrial enterprises - more than 3% (long-term financing for fixed assets and technology).

The Agriculture Project Management Agency’s “Spring Works Assistance Project” offers agricultural cards to small landowner farmers. To date, 710,000 farmers (possessing up to 5 ha land) from all over the country have received agricultural cards amounting to a total of GEL 195.8 million (USD 119 million). Additionally, a total of GEL 700 million was mobilized in the agrarian sector this year, of which GEL 200 million was dedicated to the project supporting small landowner farmers. [11]

MAJOR MICROFINANCE INTERMEDIARIES AND INSTITUTIONS

As of 31 December 2013, there are 21 banks operating in the Georgian banking sector. Final ownership of non-resident beneficiaries in bank assets is at 85%, while equity capital is at 83%. [14]

On 6 August 2013, a banking license was granted to FINCA Bank Georgia JSC, which had been operating as a microfinance organization in the Georgian market since 1998.

As of 2013, the 2% maximum limit on early payment fees for loans (introduced by the National Bank of Georgia for commercial banks in 2011), was also applied to microfinance institutions.

This indicates that the banking market in Georgia is a highly competitive one. It also allows more consumers the opportunity to switch to less costly financial institutions and choose a more acceptable credit product. As a result, the number of complaints multiplied as well.

As of 31 December 2013, there are 17 credit unions, 67 microfinance organizations, 1,051 currency exchange bureaus and 35 monetary remittance units in Georgia. In 2013, one microfinance organization became a qualified credit institution.

At the end of 2013, there were 67 microfinance organizations in the country. This is an 8.1% increase from 2012 and 22.3 times increase from 2006. Within the seven year period of 2006-2013, the microfinance sector grew by 312 times. The number of employees in microfinance organizations also increased by 7% in 2006-2013. [12]

The Association of Development and Support of Microfinance Organizations of Georgia was established in 2009. The Association supports the development of the microfinance sector in Georgia, defends the rights of microfinance institutions, supports their juridical guarantees and takes an active part in the auditing process while selecting acceptable international auditing and rating companies. It also considers minimum expenses for the auditing service, cooperates with government authorities and international organizations, cooperates with those interested in developing the microfinance sector and assisting people in need of microfinance etc. 18 Georgian microfinance companies are members of this Association.

SMEs are important to the Georgian economy because 99% of registered companies in the country are SMEs. SMEs also employ half of the country's labour force. The Georgian government acknowledges the importance of SMEs by offering several programmes devoted to the development and promotion of micro and small enterprises in the country. In addition to supporting micro and small enterprises, these government programmes also support business entities and entrepreneurs, develop regional markets and increase income. The programmes are designed to provide financing for micro and small businesses. Some of these government programmes are "Supporting Micro and Small Businesses in Georgia" (launched in October 2014) and "Produce in Georgia" (launched in June 2014). In recent years, agriculture has gained greater prominence in the Georgian political agenda. This may be seen in government schemes such as the "Preferential Agro-Credit Project", and "Spring Works Assistance Project".

As previously mentioned, the Enterprise Development Agency was established in February 2014 to promote and support start-ups, SMEs and the export potential of the country. The Enterprise Development Agency is a legal entity of the Ministry of Economy and Sustainable Development of Georgia.

The International Financial Corporation (IFC), a member of the World Bank Group, helps microfinance organizations in Georgia by increasing micro and small businesses' access to finance, especially in poor and rural areas, creating jobs and reducing poverty in Georgia.

IFC provides Georgian microfinance organizations with financial resources and loans, enabling the organizations to extend loans to underserved entrepreneurs across the country. Long-term funding helps organizations grow and expand access to high quality financial services and products, while funding lower income entrepreneurs contributes to the growth of the economy.

Financing microfinance firms also helps improve corporate governance, as it provides broader access to finance. However, it is not easy to improve the rural Georgian population's access to credit. This challenge must be overcome in order to reduce poverty.

This project is part of the IFC Corporate Governance Program in Europe and Central Asia. It is implemented in partnership with the Swiss State Secretariat for Economic Affairs (SECO) and the Development Bank of Austria (OeEB).

Georgia became an IFC member in 1995. Since then, IFC has invested about USD 656 m in 51 projects across various sectors and supported regional development projects in the country. IFC has also implemented a number of advisory projects aimed at developing the private sector.

IFC also has a programme to improve the performance of agribusiness companies in Europe and Central Asia by allowing them to create jobs and drive economic growth. The IFC Agribusiness Standards Advisory Program is designed to help businesses implement sound environmental, social and food safety management systems. It helps firms reduce operational costs, boost productivity, reduce waste and access new markets. This programme is especially important in countries where infrequently applied standards cause spoilage, reduce worker productivity, and present greater risks for the environment and neighbouring communities.

IFC has also partnered banks in order to expand financing for SMEs. In so doing, IFC supports their growth, job creation, and contributes to increasing the competitiveness of Georgia's economy.

Little risk capital is available to start-ups, and bank borrowing is expensive. Nearly all the firms surveyed by the World Bank had been established with personal savings, funds borrowed from friends and families, and in some cases, concessional loans financed by the European Bank for Reconstruction and Development. These firms must first establish themselves as creditworthy before they can expand their ventures with bank loans. They also need other sources of finances. Likewise, the financial infrastructure must be developed to support new ventures.

ProCredit Bank is the only lender targeting SMEs, but it lends to very small firms that are not too risky and have high growth potential.

Start-up companies usually have no few or no sources of revenue in the early stages of development. They require large initial capital investments to develop their products, but do not have to the means to repay bank loans. This is because loan payments present a high opportunity cost to these new innovative start-ups. For this reason, loans are most appropriate for companies that already have steady revenue streams. Therefore, start-ups focused on developing their first products should rely on equity investments. [9]

MODELS OF MICROFINANCE FOR SMEs

Microfinance is one of the fastest growing sectors in Georgia. The number of microfinance organizations in Georgia increased by 8.1% in 2013. There is also an increase in the number of loans issued by microfinance organizations. Microfinance organizations issued more loans in 2013, increasing by 24% from the previous year. Loans from microfinance organizations totalled GEL 381 m, of which 99.4% were to individuals, 0.5% to legal entities and 0.1% to groups. 61.4% of microfinance organization loans went to men in 2013, while 38.6% went to women. Microfinance organizations issued loans to enterprises in various fields in 2013, specifically, 46.4% were custom loans (up by 56% from 2012), 23.5% went to agriculture and forestry (up by 2.1% from 2012), 20% went to trade and services (down 6% from 2012), and 10.2% went to other sectors (up by 14% from 2012). [12]

The microfinance sector is characterized by high profitability. This is especially true since the National Bank of Georgia (NBG) is not involved in the regulatory framework inspecting the adequacy of loan loss reserves.

Although microfinance organizations charge higher interest rates than commercial banks, people prefer to borrow from them. This is because microfinance organizations do not make their borrowers undergo bureaucratic procedures.

Unlike commercial bank loans, microfinance loans are more accessible to the masses. Because microfinance organizations do not require borrowers to produce stable income documentation, the loans issued have high credit risks. The high credit risks of these loans are reflected in interest rates of loans.

The Association of Young Financiers and Businessmen in Georgia (AFBA) calculated the average interest rate of 30 microfinance organizations in the country. The research revealed that the benchmark rate on mortgages started at 30% and rose to 60%, while the rates on business, consumer, car and pawn loans averaged 31-32%, 28-30%, 58-60% and 36-40% respectively. [13]

The total assets of microfinance organizations increased in 2013, up by 20% from the previous year. In fact, microfinance organizations' total assets in 2013 amounted to GEL 811.9 m. This growth was carried out at the expense of liabilities and capital, which amounted to GEL 609.3 m and GEL 202.6 m respectively. Although the growth of microfinance organizations' assets lagged significantly behind the average indicator of previous years (approximately 50%), it remains high.

According to 2013 data, the net loan portfolio comprises 75% of total assets and amounted to GEL 614.5 m. The ratio of net loans to total assets has not changed in recent years. The growth rate of loans is almost identical to that of total assets at 20%.

As microfinance organizations received significantly more funds from non-resident financial institutions, they were able to increase their share in the structure of borrowed loans. However, funds from non-resident institutions decreased in the second half of 2013. The decrease in funds from non-resident institutions in the latter half of 2013 is due to one microfinance institution obtaining a banking license. When this microfinance institution obtained its banking license, it was discovered that its borrowed funds were mostly from non-resident financial institutions. At present, microfinance institutions continue to attract funds from non-resident institutions.

Since 2009, there has been a gradual increase in resources from individuals. When a microfinance organization becomes a qualified credit institution, in accordance to NBG stipulations, it is often discovered that the microfinance organization's liabilities is mostly composed of funds borrowed from individuals.

In November 2013, the NBG organized a meeting to discuss the growing trend of microfinance organizations borrowing from individuals. The meeting also discussed other questions related to the development of the microfinance sector. The meeting was attended by the directors of the microfinance institutions in Georgia and representatives of international financial organizations. During the meeting, potential risks related to microfinance organizations attracting funds from large segments of the population were highlighted. These risks are particularly significant considering that interest rates on deposits in the banking sector have decreased drastically. Microfinance organizations thus received the recommendation to increase their activities by attracting resources from other larger investors. In addition to such general recommendations, microfinance organizations actively borrowing from less informed retail investors received written notice that a continuation of such activities would instantly result in their organizations becoming qualified credit institutions. As a result, the majority of microfinance institutions changed their asset funding practices by ceasing their advertisement campaigns to attract resources from retail depositors. Consequently, there is a reduction of microfinance organization funds from citizens. Instead, microfinance organization funds now come from larger creditors.

Throughout 2013, the interest rate reduction in the financial market had a corresponding influence on the parameters of microfinance sector profitability in return on equity (ROE) and return on assets (ROA). However, due to asset growth and high margins on the products offered to the market, the figures were still impressive.

The National Bank of Georgia is systematically working on legislative initiatives to develop this sector. NBG is also dedicated to improving the normative basis regulating the microfinance sector.

At present, microfinance organizations conducting analyses of a borrower's solvency without relying solely on collateral when issuing credit are treated separately from microfinance organizations that do not require documentation of solvency. According to the data provided by the Association for the Development and Support of Microfinance Organizations of Georgia, only 20.7% of the total loan portfolio of the association's member organizations (which comprises 60% of the sector's portfolio) is secured by mortgages. [14]

Microfinance organizations lack proper regulation. While the National Bank of Georgia regulates banks, it is not mandated to regulate microfinance organizations. Instead, microfinance organizations simply present their financial papers to the NBG and the latter cannot supervise their activities.

Meanwhile, 25% of consumer complaints submitted to the NBG come from the microfinance sector. NBG plans to require microfinance organizations to standardize agreements and place all important items of the agreement on the very first page in order to make them easier to understand, and to make the financial costs of the product more transparent.

The Association of Microfinance Organizations has already developed an ethics code reflecting the core standards of the relationship between microfinance organizations and clients. To protect consumers, NBG has issued a normative act limiting microfinance organizations' commission fee for loan refinancing to 2%, similar to that for commercial banks. The National Bank of Georgia intends to ensure better protection of consumers' rights in their relations with microfinance organizations. [15]

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3.6 SMALL AND MEDIUM-SIZED ENTERPRISES' ACCESS TO FINANCING IN GREECE: THE EMERGENCE OF MICROCREDITING

by

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ABSTRACT

Under the pressures of the deep economic and social crisis, Greece is in a process of fostering entrepreneurship as a key lever for growth and job creation. Several public and private initiatives are implemented, creating a simpler business entrepreneurial ecosystem. Existing firms have been making efforts to adapt themselves to playing a role in global markets. As a result, new ventures focusing on growth relevant sectors have emerged. However, access to finance remains challenging for young and small firms in particular. Due to these firms' difficulties in obtaining financial assistance, economic and social recovery is undermined. The present study discusses the paradigm

of Greece and attempts an analysis vis-à-vis the Greek SME sector and the current initiatives for financing. Some thoughts relevant to financial policy formulation are presented. These thoughts relate to general policy and framework, rather than specific policy articulation.

Keywords: SME sector, entrepreneurship, access to financing, microcredit, Greece,

JEL classification: G21, L21, L26, L31

ECONOMIC AND SOCIAL SNAPSHOTS

Greece is in its fifth year of deep recession. The impressive growth rate between 2002 (when Greece joined the single European currency) and 2009 (its last year of “prosperity”) gave way to the most severe post-WWII crisis. The crisis was mostly financial and initially appeared to be a public debt issue. It was treated as such by the organizations that came to Greece’s rescue: the European Commission (EC), the European Central Bank (ECB) and the International Monetary Fund (IMF), jointly known as “Troika”. In fact, by 2009, government debt had reached a record high of 130% of GDP, with a steep rising trend for 2010. At the same time, government deficit had reached another record high of 15.6% of GDP. Both figures were unsustainable and accelerating fast.

By the end of 2010, it was obvious that the crisis was a lot more complicated and included the whole gamut of economic, political, institutional and social models. Public deficit had been growing for decades, as did foreign trade deficit. It appeared that the Greek political elite had long chosen to benefit from the low rates of the euro by borrowing instead of implementing desperately needed but unpopular structural reforms.

The Troika responded to the challenge by forcing very serious budget cuts and austerity measures on the government. It also compelled the government to implement much needed structural and institutional reforms. However, emphasis was given to the former, which yielded rapid and impressive results, while reforms were underestimated and poorly implemented and/or delayed.

In the following years, the Greek economy was hit by a storm. According to the National Statistical Service of Greece [1] and Eurostat [2], GDP has fallen to EUR 182 bn in 2013 from EUR 231 bn in 2009, decreasing by 21%. The GDP per capita decreased to EUR 17,400 in 2013 from EUR 22,600 in 2009. At the same time, the government debt escalated to EUR 319 bn in 2013, accounting for 175% of GDP.

The relative unemployment index reached a record high of 27.3% in 2013, up from 9.6% in 2009. This made Greek unemployment rates the highest in Europe. In particular, youth unemployment rate reached an all-time high of 60.80% in February 2013.

Household income dropped by a third in 2007-2012, reflecting average losses of EUR 4,400 per person. The reduction of household income, increased taxes and high unemployment inevitably resulted in a serious social crisis, while none or very poor social protection measures were taken. The following figures on selected social indicators [3] [4] are conclusive.

- The ratio of the average income of the richest 10% to the poorest 10% reached 10.8 (compared to an EU average of 7.4), showing an increase of income inequality.
- The relative poverty risk also increased, reaching a record of 15.1% for working people and 27.9% for non-working people.
- One out of five working age adults lives in a household where nobody worked.
- The share of people reporting insufficient money for food reached 17.9%.

When the social situation is not taken into account, the results of austerity measures were almost spectacular, raising hope and aspirations. Partially due to the reduction of demand stemming from the reduction of income, the longstanding trade deficit (reaching a record high exceeding EUR 4,000 m in 2009) decreased to EUR 1,700 m in 2013 (excluding oil). Exports reached EUR 2.4 bn in January 2013, showing an increase compared to the corresponding month in 2009 (when exports had reached EUR 1.1 bn).

In autumn 2014, the Greek government, facing very serious political problems because of the social crisis, announced its estimates and predictions as follows:

- Growth of 0.26% for 2014 and 2.9% for 2015

- Primary surplus of 2.9% for 2014
- Unemployment rate of 24.5% for 2014

Despite the government's optimistic forecasts, those figures, which are also supported by the EC, do not seem to be coming true.

THE GREEK SME SECTOR

Small and medium-sized enterprises (SMEs) in Greece, according to the European Commission's 2003 recommendations, are enterprises:

- employing less than 250 employees,
- with annual turnover not exceeding EUR 50 million, or with annual total balance sheet not exceeding EUR 43 million,
- fulfilling the autonomy criterion, i.e. 25% or more of the capital or voting rights not belonging to one or more enterprise which do not fall under the SME or microenterprise definition (depending on the case).

More specifically,

a) very small or microenterprises employing fewer than 10 persons,

b) small enterprises employing fewer than 50 persons, and either have an annual turnover not exceeding EUR 10 million, or an annual total balance sheet not exceeding EUR 10 million,

c) medium-sized enterprises employing fewer than 250 persons, and have either an annual turnover not exceeding EUR 50 million, or an annual total balance sheet not higher than EUR 43 million.

According to the 2013 Small Business Act (SBA) Fact Sheet on Greece [5], which is based on data from 2009, there were 531,437 enterprises in Greece. This figure does not include enterprises in the sectors of electricity, and wholesale and retail trade. Also, the data do not cover enterprises in agriculture, forestry, fishing, and the largely non-market services sectors of education and health.

The structure of Greek firms is presented in Table 1.

Table 7: Enterprises and Employment by Category (Source: SBA Fact Sheet Greece 2013)

	NUMBER OF ENTERPRISES			NUMBER OF EMPLOYEES		
	GREECE		EU-27	GREECE		EU-27
	Number	Share	Share	Number	Share	Share
MICRO	513,780	96.7%	92.3%	916,074	54.5%	28.9%
SMALL	14,978	2.8%	6.5%	282,808	16.8%	20.2%
MEDIUM-SIZED	2,301	0.4%	1.1%	227 958	13.6%	17.3%
SMEs	531,059	99.9%	99.8%	1,426,840	84.8%	66.4%
LARGE	278	0.1%	0.2%	255,413	15.2%	33.6%
TOTAL	531,437	100%	100%	1,682,253	100%	100%

As depicted in Table 1, the SME sector is more important in Greece than in the average EU country, and Greek SMEs tend to be smaller than their EU peers. SMEs represent the overwhelming majority of Greek firms and are structured as follows:

- There are 513,780 micro-firms (including self-employment), representing 96.7% of all firms.
- There are 14,978 small firms, accounting for 2.8% of all firms.
- There are 2,301 medium-sized companies, representing 0.4% of all firms.

SMEs contribute to 84.8% of employment. This is much higher than the EU average and is mainly due to the small-scale structure of the Greek SME sector. Microenterprises account for 54.5% of employment, which is by far the largest figure in the EU. Total value added is high per se (34.6%), but it is rather low when percentage of employment and number of microenterprises are taken into account.

The crisis had a significant negative impact on Greek SMEs. It is estimated that it has caused a decrease of approximately 165,000 Greek SMEs in 2008- 2014. [5] SMEs were profoundly affected by the prolonged recession, which was in turn aggravated by austerity measures and the delay of much-needed structural reforms. Not unlike low income households, SMEs, and particularly microenterprises, suffered disproportionately more than large enterprises.

A different analysis of employment per sector reveals a number of additional particularities pertinent to SMEs in Greece. Keeping in mind the utmost importance of the trade balance in situations like the current Greek crisis and the continuous trade deficit over the past decades, Table 2 provides an interesting breakdown of employment per sector. Table 2 emphasizes the “non-tradable” characteristics of Greek business activities. It is based on the data of the Eurostat Labour Force Survey 2007, 1st level NACE figures. [6] It should be noted that differences from Table 1 are due to the inclusion (in Table 2) of Greece’s major employer, the government.

Table 8 Employment by Category (thousands, 2007)

	NON-TRADABLE	TRADABLE	ALL SECTORS
LARGE EMPLOYERS >250	1,004 (22.5%) [including government]	115 (2.6%)	1,120 (25.1%)
SMALL - MEDIUM EMPLOYERS <250	2,326 (52.2%)	1,009 (22.7%) [164 (3.7%): non- agricultural >20 employees]	3,335 (74.9%)
ALL SIZES	3,331 (74.8%)	1,125 (25.2%)	4,456 (100%)

Goods and services are defined as “tradable” when they improve trade balance, i.e. are exportable and/or substitutes to imports. Tradable activities include manufacturing, tourism, information and communications technology (ICT), refineries, shipping, agriculture etc. On the other hand, non-tradable activities include the government, the army, telecommunications, retail, microenterprises such as cafeterias and cloth repair shops, and the majority of self-employed persons (lawyers, doctors, chemists etc).

As seen in Table 2, the majority of the total workforce (74.8%) is engaged in non-tradable activities, whereas 25.2% are in occupations related to tradable ones, with a share of 22.7% labouring for SMEs and 2.6% working for large employers. Additionally, only 3.7% of the total workforce is engaged in non-agricultural tradable ventures with more than 20 employees. In the Greek state-centred production model, a disproportionately large number of non-tradable professions are still “closed”, regulated and protected.

A changing entrepreneurial ecosystem?

During the crisis, it became obvious that Greece would largely benefit from an intervention to the societal system of values, and the enhancement of a culture of creativity, innovation, risk-taking and entrepreneurship, based on new ideas, multiculturalism and internationalization. Efforts towards this direction initially started within the universities. [7] Institutions of all levels made an integrated effort to support this to various degrees. The media also played an important role in this direction. Thus, in the crisis years, there have been rapid changes in the mentality of the population and media towards entrepreneurship. At the same time, there is an overshoot of the number of initiatives for public and private start-up clusters and incubators, which often emphasize high-tech ventures, mostly

ICT. New ventures emerging in the absence of career alternatives have become key levers for growth restoration and job creation.

As seen in Figure 1, only 42,347 new ventures were established in Greece in 2012. [8] [9] It is interesting to note that about 25% of these ventures are microenterprises operating as restaurants, convenience stores and cafeterias, which were established as an easy solution to unemployment. The boom of such microenterprises is obvious to anyone walking down the streets of Athens or other cities. 90% of all new ventures do not emphasize high value-adding or tradable activities. Instead, they operate in sectors that do not improve trade balance, such as accounting and business consulting, retail stores, restaurants, and cafeterias etc. Yet, a considerable number of start-ups (approximately 4,000 companies), accounting for almost 10% of all new ventures established, focus on growth-relevant sectors that could improve trade balance such as tourism, agriculture, food, energy and ICT.

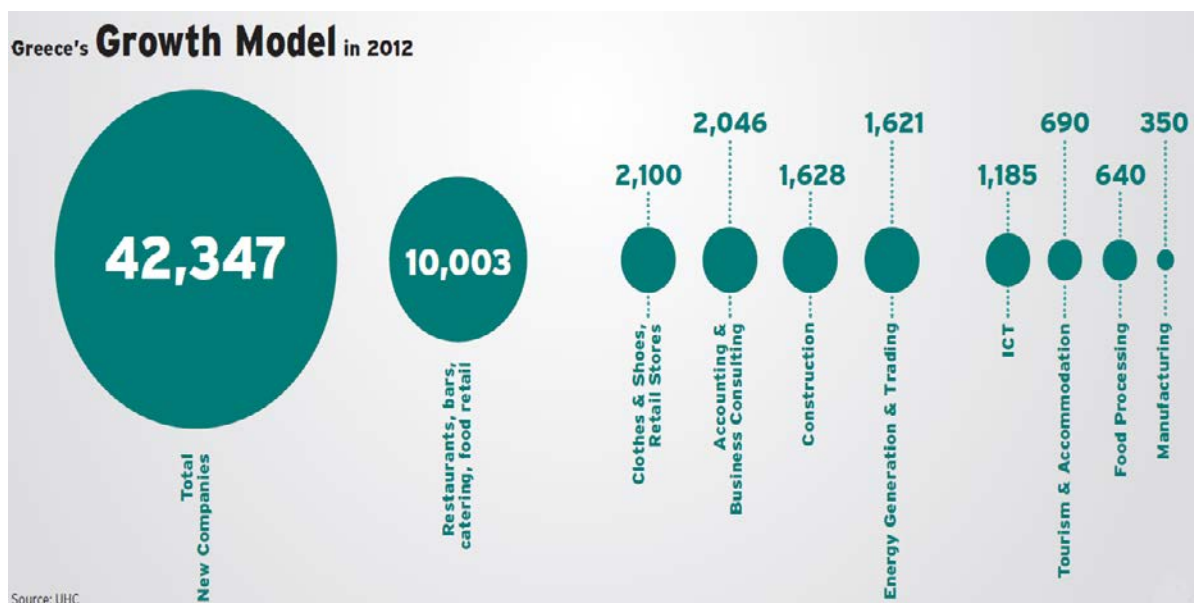


Figure 4 Greece's Growth Model by 2012

Source: Endeavor Greece, "Entrepreneurship and investment opportunities in Greece today," 2013.

According to Endeavor Greece's 2013 report on entrepreneurship and investment opportunities in the country, 10% of these new ventures focusing on growth-relevant sectors exhibit higher probability for survival mainly because they use more sophisticated business practices than their competitors. [9] Of those, a further 10% can be high-impact companies because they are led by especially capable entrepreneurs that have the potential to scale-up their business, and create multiple jobs and revenues. Taking into account this "law of the 10% of the 10% of the 10", an optimistic note can be made: [9] These 40 new high-impact firms and future ones focusing on growth-relevant sectors could help reduce unemployment and transform the Greek economy.

At the same time, government initiatives and reforms imposed by the Troika have made it easier to do business in Greece today. Out of 189 economies, Greece has improved its ranking in doing business and is in 72nd place in 2014. [10]

This was the result of some of the recent reforms. Specifically, starting a business became easier through the introduction of a simpler form of Limited Liability Company, called a private company, and the abolishment of the minimum capital requirement for such companies. Six formal procedures were eliminated and the time to start a business was significantly reduced. Investor protections were also strengthened through the introduction of a requirement for director approval of related-party transactions. In addition, trading across borders was made easier by the implementation of a system allowing electronic submission of customs declarations for exports.

While Greece has overcome its previous failures of the past few years to become more competitive, it is still ranked 91st out of 148 economies. [11]

Overall, the Greek entrepreneurial ecosystem presents the characteristics depicted in Figure 2. [11]

Greece scores high in infrastructure, technological readiness, higher education and training. The average Greek executive has received a more comprehensive education than his European and American peers.

On the negative side, Greece faces a very difficult macroeconomic environment and is constrained by public institutions (e.g., government efficiency, corruption, undue influence). Despite the public institutional constraints, slight improvements are seen in the country's institutional environment. Incidentally, these improvements are behind the country's financial market development. The most problematic issues for businesses include access to financing, bureaucracy and the tax system, accounting for almost 60% of the problems facing entrepreneurs in Greece. Although justified by the financial situation of the state, taxes have become more costly for companies. This is because corporate income tax rates have increased and employers' contributions to the social security fund have decreased.

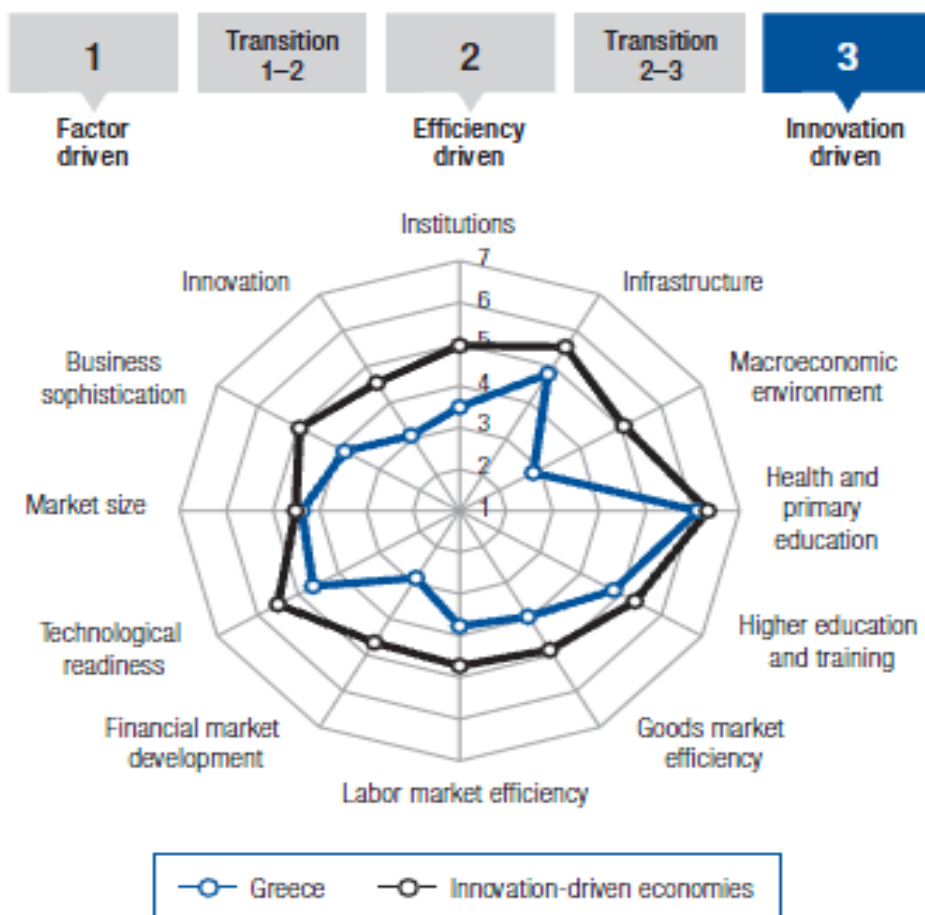


Figure 5: Entrepreneurial eco-system

Source: Klaus Schwab, ed., *Global Competitiveness Report 2013-14*, Geneva: WEF, 2013.

In line with the problems identified in the entrepreneurial environment, a recent survey by the European Investment Bank reveals that 42% of Greek SMEs report “access to finance” as their most pressing problem. [12] In times of crisis, the erosion of confidence and trust in the financial sector has had an overall negative impact. Non-performing loans reached EUR 78 billion, accounting for 35% of the total loans portfolio and are still growing. [13] At the same time, the real estate market collapse led to a severe devaluation of collaterals of this nature and their usability. Financial institutions have grown extremely careful, if not suspicious.

Furthermore, particular issues pertinent to the Greek Banking System can be identified: Private sector involvement (PSI) of the exchange of privately-held Greek government bonds in 2012 and massive private funds transfer from Greek banks to foreign ones resulted in a shortage of funds for new business loans. Banks had to undergo a number of successful stress tests, consolidations, buyouts, mergers and important recapitalizations. Nevertheless, actual bank interest rates for business loans are still non-competitive, exceeding 7%, while ECB interest rate has hit a record low of 0.05%.

Although large Greek companies suffer from the crisis, their size and their international network helps them cope with these financing difficulties. By their nature and the nature of their activities, SMEs and non-tradable microenterprises in particular suffer considerably more from a shortage of funds.

Initiatives to enhance SMEs' access to financing

In view of the problems associated with access to financing, joint European efforts, which include the limited resources of the Greek state, were set in place, mostly by expanding existing initiatives. Those initiatives were incorporated in the National Strategic Reference Framework (NSRF), also known as ESPA in Greek.

European involvement includes Structural Funds, the European Regional Development Fund (ERDF), the Cohesion Fund, the European Investment Bank (EIB), and the European Investment Fund (EIF) managing funds and providing risk financing solutions to financial intermediaries.

A set of existing European instruments were used in 2007-2013 to support SMEs in Greece, remaining still operational in 2014. This includes:

- The Joint European Resources for Micro to medium Enterprises (JEREMIE) that provides both risk capital and capital for bank loans.
- The Joint European Support for Sustainable Investment in City Areas (JESSICA) to promote sustainable investments and growth in urban areas.
- The European PROGRESS Microfinance Facility to enhance employment, social inclusion and social protection.
- The Joint Action to support Micro Finance Institution (JASMINE) to disseminate good microcredit lending practices in the EU and support the development of microcredit providers active in the EU.

EIB has facilitated SMEs' access to finance via partner banks and non-bank institutions through guarantees from the Greek state. In 2013, the most important instruments available in Greece leveraging capital market investments in SMEs and expanding the volume of new loans to SMEs include the following:[14]

- Trade Finance Facility for Greece, which is the first trade finance operation of the EIB (up to EUR 500 m) supporting both imports and exports of Greek SMEs.
- Youth employment, which is the first SME loan partly dedicated to youth employment, pilot signed with Pancretan Cooperative Bank.
- Guarantee Fund for Greek SMEs, which is the first decentralized financial instrument conceived and rolled out in an EU Member State, providing state guarantee and EIB lending to SMEs via its partner banks in Greece. EIB loans for SMEs can rise up to EUR 1 bn with a 2015 target.

The Greek state has also implemented a number of intermediaries to facilitate SMEs' access financing such as:

- The National Fund for Entrepreneurship and Development (ETEAN) launched in 2011. ETEAN is a public facility that is supported by the EIB with up to EUR 500 million. It implements the Trade Finance Facility in Greece, which supports the foreign trade activities of Greek SMEs and provides guarantees on a portfolio of foreign trade letters of credit, letters of guarantee each. [15] It also manages the Enalio Fisheries Fund and the Agriculture Entrepreneurship Fund and the Fund for Island Entrepreneurship.
- The Business and Cultural Development Centre (KEPA). KEPA is a public non-bank microfinance institution supported by the EIF and operating within the framework of the European Progress

Microfinance Facility and JASMINE. It provides microfinance products for microenterprises development and unemployment reduction.

Sources of financing for SMEs

Apart from the use of own capital, risk capital and loans are among the main sources of financing for Greek SMEs today. Microcrediting has also very recently started to develop. SMEs' access to financing is facilitated by the implementation of a structure of new venture capital funds and intermediaries or through use of existing ones. The following is a non-exhaustive list of key stakeholders:

Venture capital funds

Venture capital funding has long been absent from the list of financial sources of SMEs, especially new ventures. Seed, start-up or early stage capital investments were almost non-existent, with investments targeting mostly growth capital or capital for acquisition. The situation changed during the crisis with the emergence of venture capital funds targeting new ventures. To illustrate:

- Elikonos Fund, Odyssey Partners, Open Fund II and Piraeus Tech Catalyst Fund are young, seed and early stage high-tech venture capital funds. They attracted EUR 48 m from JEREMIE equity and an additional EUR 21 millions from private investors. JEREMIE participation in each of these funds lies between 50% and 70%. The funds provide maximum investments of EUR 750,000 per company annually and their participation percentage is between 35% and 40%. A number of investments have already been made. Several financing rounds may be performed for each venture.
- NBG Technology Fund is a 13-year-old fund, which became active in the acquisition of early-stage companies. EIF is a limited partner of the fund.

Loans

According to SBA Fact Sheet 2013, banks' willingness to provide loans in Greece is much lower than the EU average with a higher proportion of SME loan applications that are rejected. [5] Yet, the new SME Guarantee Fund established on March 2012 guarantees EIB loans totalling € 1bn to SMEs via partner banks in Greece. As presented on Table 3, EUR 500 m have been signed to date and EUR 153 m are already allocated. The number of beneficiary SMEs to date is 250.

Table 9: Guarantee Fund for Greek SMEs

Partner Banks	Signatures		Allocations (EUR millions) to-date	Beneficiaries to-date
	EUR millions	Year		
Eurobank	100	2012	49	172
Piraeus Bank	50	2012	10	3
Alpha Bank	100	2013	94	75
Pancretan Cooperative Bank	50	2013	0	0
National Bank of Greece	150	2014	0	0
Alpha Bank	50	2014	0	0
Total	500		153	250

Eurobank, Piraeus Bank, Alpha Bank and National Bank of Greece are commercial banks, which have already signed agreements with EIB to provide SMEs loans. The most recent agreements are that of Alpha Bank and the National Bank of Greece, which were agreed on June 2014 with the EIB for EUR 200 millions. This amount is to be matched by another EUR 200 millions from the two banks.[16] The Pancretan Cooperative Bank is a cooperative bank that has also signed an agreement with EIB to provide loans.

MICROFINANCE

Microloans are loans of up to EUR 25,000 for microbusinesses and self-employed entrepreneurs. The microfinance market in Greece is in its infancy. Therefore, a solid institutional and legal framework for microfinance is still lacking. Microloans are subject to the institutional framework as well as banking rules and regulations.

Access to microloans is supported via intermediaries, which can be either banks or public non-bank institutions. The main microfinance intermediaries in Greece to date are:

- The National Fund for Entrepreneurship and Development (ETEAN). ETEAN improves SMEs' access to finance, inter alia through business restart (access to working capital) and bank guarantee letters for small, very small and microenterprises. [5]
- The Business and Cultural Development Centre (KEPA). KEPA provides microloans for the development of microenterprises and unemployment reduction.
- The Pancretan Cooperative Bank and the Cooperative Bank of Peloponnese are cooperative banks that partnered with EIF within the framework of JEREMIE Microfinance and PROGRESS Microfinance initiative for a total programme amount of EUR 60.6 m. [17] They provide microloans to microbusinesses and self-employed entrepreneurs.
- Almost all commercial banks that signed agreements with EIB to provide loans to SMEs are already shown in Table 3 of the previous section. Apart from loans to SMEs, these banks may provide microloans. However, the percentage of the agreed funds targeting microfinance remains unclear. [18]

In January 2014, ActionAid Hellas, in partnership with the French Association pour le Droit à l'Initiative Economique (ADIE), started a two year project to implement the first non-bank microcredit institution in Greece, through its new founded subsidiary, Action Finance Initiative (AFI). At this early stage, AFI cooperates with the Pancretan Cooperative Bank.

Although the total microloans provided to date does not exceed EUR 5 million, the microfinance market is growing in Greece. However, potential beneficiaries are still confronted with severe microfinancing challenges. First, they face the constraints related to the lack of institutional and legal frameworks. Second, while microloans are considered low interest loans, they still have an overall rate of ca. 3.8%, modulated by collaterals. As a matter of fact, the EIB part (50%) of the loan bears zero interest and does not require any collateral. On the bank side (the other 50% of the loan), an actual interest of ca. 7.5% and important collaterals are applicable. [19] Third, the public sector microfinance intermediaries (ETEAN, KEPA etc) often introduce serious administration overhead and delays. In addition, traditional Greek entrepreneurs tend to consider these organizations to be operating on favouritism, political clientelism and corruption, a view not always shared by younger entrepreneurs.

CONCLUDING THOUGHTS

Greece is in its fifth year of deep economic and social crisis. During the crisis, entrepreneurship has emerged both as a response to unemployment, and a key lever for growth and job creation. There is a shift in the Greek people's mentality and attitude towards entrepreneurship. Several initiatives for public and private start-up clusters and incubators have been implemented, "ease of doing business" has improved, and numerous new ventures have emerged. While such apparent signs of a changing entrepreneurial ecosystem create optimism, a lot more needs to be done.

Although several initiatives to facilitate financing have been implemented to SMEs and microenterprises, access to finance remains challenging in Greece, and their risks undermine economic and social recovery. In order to introduce appropriate public policies for SME financing and microfinancing, a number of key points (and other points) must be taken into consideration. First, the existing trade deficit creates a pressing need for a shift to viable tradable sector businesses. Second, it is more difficult for microenterprises to penetrate the tradable sector than the non-tradable one. Third, it is doubtful that preferential issuing of microloans to microenterprises will improve trade balance and yield realistic results. Fourth, the 10% of the 10% of the 10% of new companies represent high-impact companies that can enhance the economic growth of Greece. Finally, one should keep in mind that more than one-fourth of the working-age population in Greece is jobless.

To that end, emphasis must be placed on improving SMEs' access to finance by enhancing State and EIB/EC guarantees, as well as preferentially and selectively targeting SME activities that improve trade balance, as a means of economic policy against the economic crisis.

On the microfinance side, focus must be given to the institutional framework and better financing conditions. This will make the support of microbusinesses, the self-employed and unemployed a matter of social policy against the social crisis than a means of fostering national economy growth.

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3.7 MICROCREDITING OF SMALL AND MEDIUM ENTERPRISES IN THE REPUBLIC OF MOLDOVA

by

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ABSTRACT

This article reflects on the main issues related to small and medium enterprise (SME) financing in the Republic of Moldova, the relationship between SMEs and microfinance institutions, as well as the tensions and changes in this field.

Keywords: Characteristics of SMEs in Moldova, microfinance organizations, savings and loan association

JEL classification: G21, L26, O12

1. THE SME SECTOR IN MOLDOVA

The role of small and medium enterprises (SMEs) has become increasingly important in our society, not only because it creates job opportunities, but also because they are key actors in developing local and regional collectivities.

The middle class in any country mainly consists of SME owners. In the Republic of Moldova, there are 50,900 enterprises, representing 97.4% of the total number of registered enterprises. The majority of SMEs (20,000 of them) carry out their activities in the field of commerce; that is, 40% of all SMEs in Moldova are in commerce. In 2013, there were 4,900 SMEs active in the processing industry, 0.5% more than 2012 and 2.6% less than 2008. The increasing number of SMEs in the industrial sector proves that this sector is developing. Development of SMEs in the industrial sector involves complex organizational and production processes, which in turn leads to improved infrastructure, highly qualified staff and market stability.

At the end of 2013, there were 524,500 numbers of employees in the Moldovan economy with 298,400 working in SMEs; that is, 56.9% of Moldovan employees work in SMEs. These figures show that the number of employed persons in the national economy decreased to 47,600 and the number of employees in the SME sector fell to approximately 30,000 employees.

A breakdown of SME employees by region are as follows: 167,600 persons (55.8%) in Chişinău, 51,100 persons (17%) in the northern region, 48,300 persons (16.1%) in the central region

and 23.1 thousand persons (7.7%) in the southern region. As these figures indicate, most SMEs and their employees are centred in the capital, Chişinău.

In 2009, the income generated by SME sales decreased in all the areas of activity, except finance. However, the situation improved at the beginning of 2010 and SMEs registered an income increase in all areas. Although incomes generated from SME sales in 2009 decreased from 2008 figures by 11.5%, SME sales in 2013 increased from 2009 figures by 27.1% and amounted to MDL 77,413.2 m.

In 2013, SMEs generated a total income of MDL 2,008.5 m, increasing MDL 923.9 m from the previous year.

In the West, the middle class is the driving force of a developed economy. As the middle class has only just emerged in the Republic of Moldova, the economy requires permanent support and protection from the government.

In 2013, Moldovan SMEs did not perform very well. As a result, they are facing some difficulties in their development. SME contribution to GDP in Moldova is 32.3%.

SMEs in some European countries contribute greatly to GDP. Indeed, the SME sector in some countries contributed over 60% to GDP. Constant support from the government is needed if Moldovan SMEs' contribution to GDP is to increase.

Owing to the impact of the international economy and international financial markets on SMEs, it would behove the government to develop SMEs. Doing so also helps Moldova to integrate into the EU. To promote both short and long-term measures supporting SMEs, the government should comply with the Small Business Act (SBA) policies of the European Commission (EC) and implement general policies for SMEs at the national level.

To this end, the government has implemented a Strategy for SME Development in 2012-2020. This strategy identifies a series of issues on SMEs' access to financing, specifically: **high interest rates and the volatility of these rates, adequate banking policies related to financing SMEs, quality of projects that need financing, poorly developed business infrastructure, and inadequate market support for companies with high risk capital.**

In order to improve Moldovan SMEs' access to financing, the Strategy for SMEs aims to meet the following objectives:

- Develop innovative schemes vis-à-vis SME financing.
- Ensuring efficient remittance transfer.
- Attracting long-term loans from international financial institutions.
- Develop a system that offers credit to SMEs.
- Facilitate SMEs' access to public acquisitions.

Accomplishing the objectives set out in the Strategy will improve SMEs' access to financial resources. This will ensure that SMEs' contributions to investments, fixed capital and GDP will be a minimum of 38% by 2020.

SMEs in Moldova do not have easy access to financing. Indeed, the lack of adequate financial sources is a major obstacle for SMEs.

The following principles are at the heart of Moldova's strategic vision to improve its entrepreneurs' access to financing by 2020:

- Developing financial intermediation.
- Optimizing the costs of financial resources.
- Simplifying the rules for securing credit and loans.

Access to financing is traditionally one of the most critical issues for SMEs. The following groups often face the most difficulty in securing loans:

- Small enterprises with less than 10-49 employees (around 89%);

- Enterprises that have been existence for 3 to 6 years (around 83%);
- Enterprises in rural areas (around 82%).

Currently, businesses in the Republic of Moldova rely on traditional financing that involves using one's own capital or borrowed capital, as well as non-traditional financing derived from international programmes and assistance funds.

In the Republic of Moldova, financing SMEs is part of the business market. Although, financial institutions and public sector institutions do their best to compensate the lack of finance resources, SMEs still face difficulties in obtaining capital.

At the moment, SMEs may avail themselves to a wide range of funding opportunities. Some of them are as follows:

- Self-financing
- Credit
- Loans (microcredit)
- Securing products
- Government programmes with partial grants.

Although most SMEs use their own capital to finance their businesses, this is inadequate for their growing financial needs. It is difficult for an SME to expand when it is funded entirely from its own resources. With each passing year, the need for borrowed capital for business expansion increases.

2. THE BANKING SYSTEM

Traditionally, banks finance SMEs. According to the National Bank report in 2013, loans and deposits have increased in a non-uniform manner. The capitalization and liquidation of banks stayed at a comfortable level and the number of non-performing loans (under the standard level, doubtful or compromised) has decreased by 2.9% from 11.6% in 2012.

Table 1: Loans and credit given by commercial banks to enterprises

	2007	2008	2009	2010	2011	2012	2013
Total value of loans and credit [MDL, m]	31,190.2	35,507.1	19,539.9	28,589.4	32,620.7	na	37,291.9

Source: MNB database

The credit offered increased by 18.6%, up from 16.1% in 2012. This increase was due to the national currency evolution (22.6 %).

At the end of 2013, there was an 18.4% increase in the number loans offered to businesses due to the accentuated growth of the national currency (23.1%). However, the growth of foreign currency was less evident (13.2%).

Table 2: Median interest rate for loans offered by banks, %

	2007	2008	2009	2010	2011	2012	2013
National currency	18.85	20.96	20.31	16.25	14.37	11.98	12.51
Foreign currency	10.88	12.02	12.51	9.91	8.75	8.32	8.32

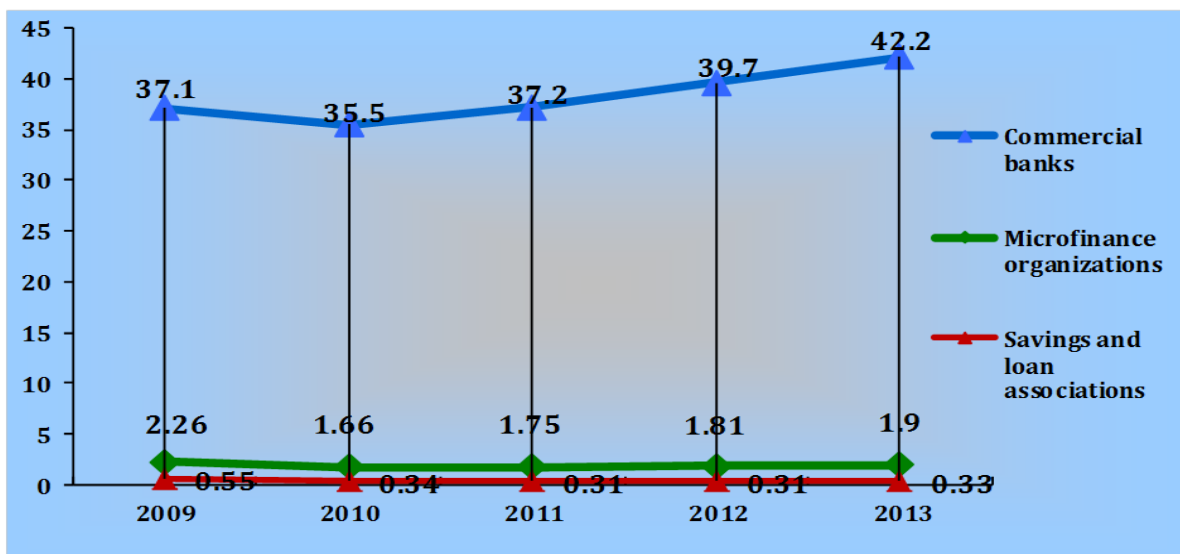
Source: MNB database

Microfinance institutions are important to the development of the financial market. However, there are too few microfinance institutions, and they cannot satisfy the SMEs' ever growing need for loans. In 2013, only 10% of the working population in Moldova benefited from microfinance loans. Even so, the microfinance sector registered a 2.6% growth from 2012 figures.

3. THE MICROFINANCE SECTOR

According to the data in the National Commission for Financial Markets (NCFM) 2013 report, there were 338 savings and loans associations (SLAs) and 87 microfinance organizations (MOs) in the Moldovan microfinance sector. The NCFM report also examined the factors contributing to the changes in the activities and functions of the non-bank financial market.

Diagram 1: GDP performance of total portfolio of loans granted by the banking and microfinance sector (%)



Loans from microfinance entities in 2013 made up about 2.23 % of GDP, with SLA loans making up 0.33 % and MOs 1.9%. This indicator has remained constant, increasing by 0.11% from the previous year. The Moldovan microfinance sector provides loans through effective policies and prudent risk management

3.1 Microfinance organizations (MOs)

The activities of microfinance organization (MO) grew in 2013. The number of MOs grew by 15 units (16.4%), within the last eight years.

When national MOs use their own assets and capital, they revealed rates of return at 7.4% and 19.0% respectively, increasing by 2.8% and 9.4% from 2012 figures. This was due to the significant increase of net profit twice in 2013.

Table 3: Microfinance activity in the Republic of Moldova

Indicators	2012			2013			2013 compared to 2012
	SLA	MO	TOTAL	SLA	MO	TOTAL	
No. of economically active persons	1,214,500			1,235,900			101.8%
Sectors	SLA	MO	TOTAL	SLA	MO	TOTAL	x
No. of loan beneficiaries (persons)	34,192**	64,856	99,048	36,525	94,871	131,396	132.7%
Penetration rate (%)	2.8	5.3	8.1	3.0	7.7	10.7	+2.6
Return on assets (%)	3.3	4.8	4.6	4.9	7.9	7.4	+2.8
Return on equity (%)	11.6	9.4	9.6	16.0	19.3	19.0	+9.4

Remarks:

* Data from www.statistica.md

** The value shown is the average number of loan beneficiaries from SLAs in one year of activity.

Microfinance activity rose in 2013, with the loan portfolio increasing by 19.6% and total assets by 30.8%.

Table 4: Evolution of microfinance activities, MDL m

Indicator	2012			2013			2013 compared to 2012 (%)
	SLA	MO	TOTAL	SLA	MO	TOTAL	
Loans granted	273.9	1,590.1	1,864.0	331.9	1,897.0	2,228.9	119.6
Total assets	334.5	1,892.9	2,227.4	403.9	2,509.4	2,913.3	130.8
Net profit	11.0	90.9	101.9	19.6	197.2	216.8	212.8

Source: NCFM database

3.2 Savings and Loans Associations (SLAs)

At the end of 2013, there were 340 licensed SLAs, 302 of which have conducted activities. In order to provide their clients a full range of services in accordance with **legislation, category of license held, bylaws and policies**, 206 SLAs dealt in bank loans and loans received; 64 SLAs received deposits savings; 30 SLAs have not contracted bank loans and external loans; 80 SLAs handled equity.

At the end of 2013, there were 127,000 SLA members in Moldova. The average SLA loan in 2013 was MDL 9,587, increasing by 15.6% from 2012. There were 34,620 loan beneficiaries in 2013, increasing by 4.8% from 2012.

Table 5: General indicators of SLA activities

Indicators	2012	2013	2013 compared to 2012 (%)	2013	
				Share of SLA with an A* category license (%)	Share of SLA with a B** category license (%)

Number of SLA members (persons)	126,746	127,001	100.2	56.0	44.0
Number of loan beneficiaries (persons)	33,020	34,620	104.8	44,8	55,2
Number of savings depositors (persons)	5,824	5,790	99.4	-	100,0
Equity (MDL m)	95.2	122.5	128.7	43,3	56,7
Loans granted (MDL m)	273.9	331.9	121.2	31,3	68,7
Savings (MDL m)	120.0	159.2	132.7	-	100,0
Credits and loans received (MDL m)	100.9	105.4	104.5	58,4	41,6

Source: NCFM database.

Average saving deposits assigned to a member depositor was MDL 27,501, increasing by 33.4% from 2012 figures. The majority of these (MDL 258.8 m) were short-term loans, while loans that exceeded one year totalled MDL 73.1 m. Although this indicates low influence of SLA loans in the SME sector, it shows that microenterprises benefited mostly from short-term loans.

In 2013, MO activity increased significantly from 2012. Net profit in 2013 increased by 116.9% from the year before, due to increased loans portfolios. MO loans were granted as follows: 1% to construction of roads and transport; 7% to agriculture; 16% to building; 19% to industry and commerce; 23% to consumption; 33% went to other purposes. These figures show that MO loans exerted a greater influence on SMEs in 2013.

Despite these results, the National Institute for Economic Research data on business climate change in 2013 shows that 37.5% of entrepreneurs felt that their access to finance worsened and 19.7% said it improved from the state of affairs in 2011. However, access to bank loans improved in 2013 with 28.5% of respondents reporting an improvement and 44% asserting the lack of change from 2011.

As bank loans are the main source of funding for SMEs, interest rates on credit continued to determine the price that SMEs paid for their loans and affected the interest rates on other types of loans, such as those of microfinance organizations and leasing operations.

Although the interest rate of bank loans in Moldova decreased vis-à-vis that of developed countries in the region in recent years, traders and businessmen continue to believe that these rates are very high.

Table 6: Weighted average interest rate on credit provided to businesses,%

	Term of credit	Average rate for new credit provided in the banking system	
		In national currency	In foreign currency
1	2007	18.74	10.87
2	2008	20.84	12.02
3	2009	19.65	12.33
4	2010	15.62	9.82
5	2011	13.85	8.70
6	2012	13.34	8.25

7	2013	11.91	7.77
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Source: BNM data, http://www.bnm.md/md/ratele_medii_dobanzilor

In conclusion, support for the Moldovan SME sector has been enhanced through continuous improvement of microfinance schemes and diversification of financial instruments already implemented, such as the Credit Guarantee Fund, the Program for attracting remittances in the economy (PARE 1+1), and the Programme to Economically Empower Young People (PNAET). These schemes are geared towards improving technological and productive capacity, increasing product quality, facilitating access to export markets and increased management performance. These initiatives will continue in 2014 and beyond so as to create a favourable legal, regulatory, institutional and fiscal framework for the development of SMEs.

To support the development of the SME sector in 2014, the government has allocated MDL 110.5 m (a sum that is 37 times higher than the amount allocated in 2009) to several strategic priorities. A breakdown of the allocated funds are as follows: MDL 72.5 m will go to improving SMEs' access to financing through PNAET and PARE 1+1, MDL 20 m will go to the further capitalization of the National Credit Guarantee Fund, MDL 15 m will go to the development of business incubators, and MDL 3 m will go to the development of entrepreneurial educational programmes.

In addition to these programmes, the government should also develop an efficient channel through which financial resources from households can produce savings for entrepreneurs seeking to fund their business ideas. It is imperative that the government develop placement options for household savings outside the banking system. So doing will encourage the development of financial intermediation. To achieve these aims, the government of the Republic of Moldova should collaborate with financial institutions to:

1. Promote a monetary policy aimed at low and stable inflation;
2. Further decrease interest rates on loans and ensure their stability;
3. Attract foreign investment in the financial sector and secure the involvement of strategic partners interested in developing the SME sector in Moldova;
4. Develop credit guarantees and counter-guarantees for SMEs;
5. Develop innovative financial systems that will support SMEs.

Access to cheap financing sources is vital for the development of a competitive SME sector. Current projects and financial programmes in Moldova have yielded encouraging results, and many entrepreneurs have shown their perseverance and entrepreneurial spirit.

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3.8 BEST PRACTICE IN MICROFINANCE IN ROMANIA

by

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ABSTRACT

This paper analyzes the lessons learnt from three Public–Private Partnerships (PPP) involved in microfinance in Romania for the past 10 years. It will also discuss the microfinance policies implemented over the last 10 years, and delve into their key elements and important factors to show the ways in which they have contributed to the development of the microfinance sector in Romania. It also emphasizes the importance of compliance of Romanian microfinance institutions (MFIs) with the European Code of Good Conduct for Microcredit Provision (EU Code). It is important for Romanian MFIs to adhere to this code because it represents European Union (EU) standards in microcredit vis-à-vis management, governance, risk management, transparent reporting, and managing consumer and investors relationships.

Keywords: public-private partnership (PPP), microcredit company law, business development services, entrepreneurship development, microfinance institutions, Romania microcredit facility, European Code of Good Conduct for Microcredit Provision, Romanian microcredit sector

JEL classification: G21

1. PUBLIC-PRIVATE PARTNERSHIPS (PPP) IN THE PROMOTION OF THE MICROFINANCE LEGAL AND REGULATORY FRAMEWORK IN ROMANIA

The legal framework for microfinance activities in Romania was initially created in 2000. It allowed the Ministry of Labour and Ministry of Economy to channel public funds and funds from the World Bank to microfinance institutions (MFIs). The microfinance programme for the mining areas served as part of the industrial regions' restructuring process. It aimed to implement entrepreneurship development and microfinance provision programmes to the unemployed and potential entrepreneurs from former mining and mono-industrial towns.

Initially, a specific legal framework was considered necessary because a distinction had to be drawn between microfinance activities / microcredit and business development projects implemented by the international microfinance institutions (MFIs). Such a legal framework would raise awareness amongst policymakers in the microfinance (MF) sector, and they would be able of access MF's impact and contribution to the country economic development.

During 2004 and 2005, the legal and regulatory framework was redefined. A working group created as an informal Public–Private Partnership (PPP) between MFIs that were legally registered as non-profit organizations, non-profit foundations, non-governmental organizations (NGOs) and the Small and Medium Enterprises (SMEs) agency affiliated with the Ministry of Economy. This working group, aimed to create a legal and regulatory framework for microcredit providers, enabling sustainable development of the Romanian microcredit sector and increasing the financial flow to SMEs, especially microenterprises, sole entrepreneurs and start-ups.

Microfinance Companies Law No. 240, designed and promoted by the PPP, was adopted by the Romanian Parliament in June 2005. Its main aims were to support the diversification of financial sources for MFI portfolios; protect clients; introduce clear governance mechanisms, risk control, and transparency; as well as take steps towards the sustainability and development of the sector.

During the same period, pawn shops, factoring, mortgage and leasing financial services providers, credit unions, guarantee funds for SMEs, drafted and promoted their own legal framework in pursuit of sustainability and development as well.

Government Ordinance 28/2006, later Law No. 93 on Non-Bank Financial Institutions (NBFIs) in 2009 [1], unified the legal and regulatory framework for all NBFIs, regulated the registration and minimum capital requirements, conditions for granting loans, client protection, reporting requirements, governance and management, etc under a single law. This law aimed to ensure and maintain the financial stability of the Romanian financial sector.

According to Law 93/2009, NBFIs are defined as financial institutions that conduct lending activities within the provisions of NBFi law. However, NBFIs are not banks and cannot receive deposits from their customers. The main lending activities that NBFIs are allowed to conduct are:

- loan origination, including but not limited to consumer loans, mortgages, loans against collateral, microlending, transaction financing, factoring;
- leasing;
- guarantee issuance, agreements to undertake guarantees and provide financing;
- other financing instruments.

The main stages in the development of the legal and regulatory framework for microcredit in Romania are presented in Figure 1.

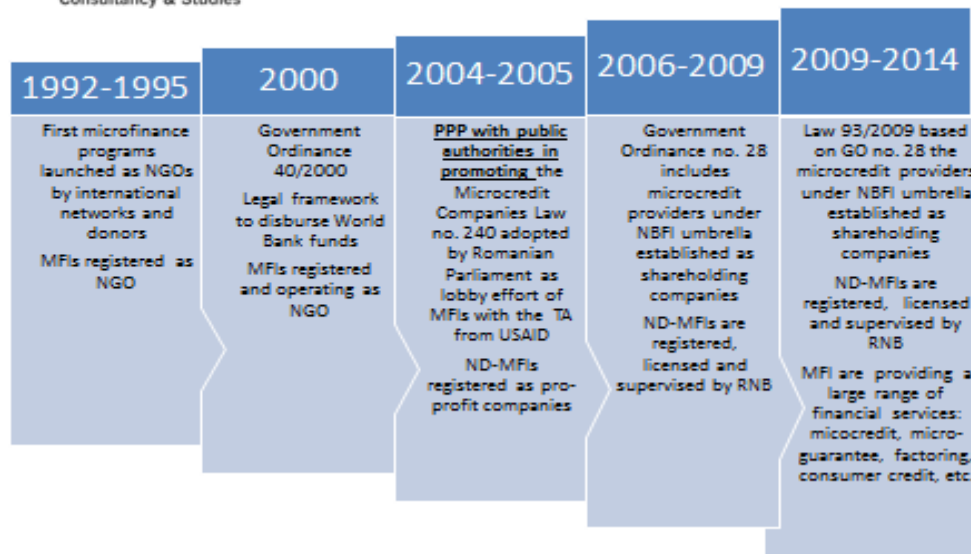


Figure 1: Public-Private Partnership in the promotion of the Romanian MF legal and regulatory framework - Main Stages

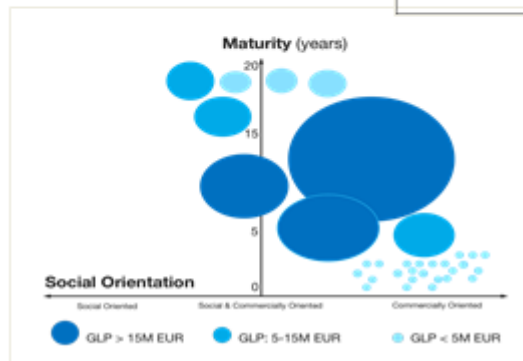
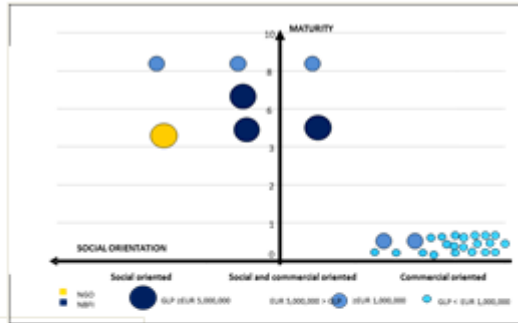
The regulator, the National Bank of Romania (NBR), is also the supervisory authority for all Non-Bank Financial Institutions (NBFIs), including leasing firms, mortgage providers, credit unions, guarantee/counter-guarantee funds, pawn shops and microfinance companies. According to the rules of the National Bank of Romania (i.e. Regulation no 20/2009) [2], all NBFIs are registered in the General Registry and licensed by NBR. Large NBFIs should be listed in the NBR's Special Register if the outstanding loans volume supplied to clients is higher than RON 25 million (EUR 5.5 m), and the level of their own capital and the borrowed resources in the balance is at least RON 50 million (EUR 11.0m).

Due to the legal and regulatory framework for microcredit provision, the structure of the Romanian microfinance sector evolved and new MF providers were registered. The evolution, in terms of portfolios and number of active clients, is presented in Figure 2. Figure 2 showcases this evolution in the Romanian microfinance sector by focusing on the 8 main MFIs that are part of the PPP.

In June 2014, 126 NBFIs were registered in section K of the NBR's General Register. Section K is specially for NBFIs conducting multiple crediting activities. 100 of the 126 NBFIs in section K provide microloans as well as other financial services such as factoring, guarantees and consumer credit. 2 of the 126 NBFIs are registered in section C, which is for NBFIs dealing exclusively with microcredit.

According to the Overview of the Microcredit sector in the European Union, published by the European Microfinance Network in September 2014 [3], the Romanian MF sector is the fifth in the European Union (EU) in terms of the value of loans disbursed in 2013 (EUR 90.9 m). In that report, Romania came after France, Spain, Poland and Germany, and was third in terms of microcredit extended in 2013 (39,402 microcredit loans) after France and Spain.

2005: Micro Credit Companies law
Romanian MC sector covers around
5-10% MSMEs financial market
8 MFIs MC Portfolio: Mil € 30
6,000 active clients



2014: Non Bank Financial Companies law
Romanian NBF sector covers
around 30% financial market
7 MFIs MC Portfolio: Mil€ 135
22,000 active clients

www.eurom-consultancy.ro
Projects / Romanian Benchmarking Brochure

Figure 2: Evolution of the Romanian MF sector in 2005-2014

1.2. The Market Gap

In a perfect market economy, the supply of microfinance services would adjust to meet the demand. In this respect, the 20-year-old Romanian market economy is far from perfect. In reality, there are a number of issues preventing such an outcome in the Romanian microcredit market. Some of these issues are:

- Asymmetric information for the lender, as it is difficult to gather and assess credit relevant information about the borrower, e.g. accurate financial statements, updated business plans, etc.
- High transaction costs, mainly due to costly risk assessment analysis and provisioning policies of the banks, the high cost of capital experienced by NBF, and the expensive monitoring of the activities of microcredit beneficiaries.
- Limited ability for the borrower to provide collateral, as well as the costs associated with collateral (insurance and registration of the collateral pledge on behalf of the lender) etc.

To gain an understanding of the potential gap in the Romanian microfinance market, an estimated annual demand for microcredit in terms of number of potential beneficiaries is compared to the supply of microcredit provided by financial institutions (banks and non-bank financial institutions) and government microcredit programmes.

The ICF and GHK study, "Evaluation of JASMINE Technical Assistance Pilot Phase", published in 2013, provides an estimate of the market demand for microfinance in EU countries (including Romania). This estimate may be seen in Table 2.5 titled, "Estimated demand for microcredit in EU Countries" and seen on pages 21-23 of the study. I have summarized the figures of that table in Figure 3 below.

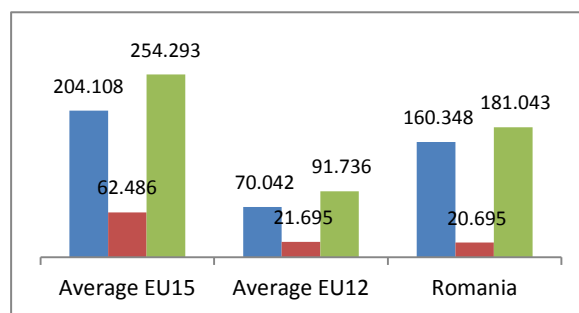


Figure 3: Demand for microcredit in the EU and Romania (number)

In Romania, there were 72,517 microloans, totalling EUR 982 m (averaging EUR 13,542 per loan), provided by commercial and SME Banks, NBFIs and governmental programmes in 2013. These microloans covered only 45% of the estimated demand.

Although the unmet 55% demand for microfinance may increase in the years to come, especially for start-ups, new microfinance instruments funded by the European Structural and Investment Funds as well as the Business Development Support Services (BDSS) for entrepreneurship development will be launched in 2014-2020 to fill that gap.

2. PUBLIC-PRIVATE PARTNERSHIP AND BUSINESS DEVELOPMENT SUPPORT SERVICES (BDSS): MICROFINANCE INSTITUTIONS ACTING AS SOCIAL ENTERPRISES

The non-financial services associated with microfinance services (microcredit, micro-guarantee, microinsurance, etc) are usually called business development support services (BDSS). BDSS assists borrowers, potential and/or existing entrepreneurs in overcoming their difficulties in using the financial products contracted. BDSS assists entrepreneurs by providing market information, training and counselling related to the enterprises' day-to-day operations. BDSS also provides strategic assistance by addressing medium and long-term issues related to strategic planning, market access and business competitiveness.

There is general consensus that the cost of providing financial services should be clearly separated from the provision of business support services. Thus, this necessitates the creation of a separate management structure, or the establishment of a Partnership with a BDSS provider or a third party.

Romanian MFIs have developed a specific approach in delivering BDSS to clients. This is because Romanian MFIs have to work within a specific legal framework requirement. According to the law, NBFIs are only allowed to provide financial services. Thus, they are not allowed to provide other services. Within this legal context, BDSS are provided by NGOs in partnership with MFIs. In a few cases, NGOs providing BDSS are the major shareholders of NBFIs. Figure 3 illustrates the partnership between FAER, NBFIs and the FAER Foundation in providing financial and non-financial services to beneficiaries in Transylvania and North Moldavia. A similar approach in delivering BDSS is used by all major MFIs, e.g. Patria Credit, Vitas, Opportunity Microfinance Romania (OMRO), LAM and Romcom.

Example of a Romanian MFI bridging the gap between social and commercial

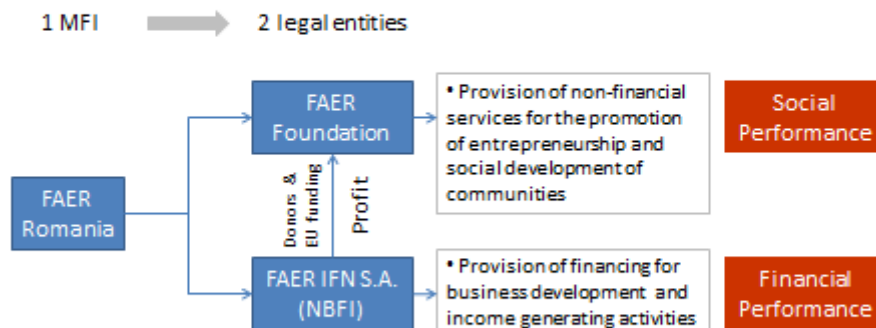


Figure 3: Partnership provision of business development support services (BDSS) to MFIs' clients

FAER IFN Romania is a medium-sized MFI specializing in financial services for rural agribusinesses. Its majority owner, the FAER Foundation, provides BDSS and other non-financial services (such as community development services) to FAER's MFI microcredit clients and the communities where the clients are located. The financial resources covering the cost of BDSS and other non-financial services come from the profits of their financial operations where FAER's MFIs act as a social enterprise using their profit from their financial activity. Donations and EU Structural Funds for entrepreneurship and human resource development also provide additional funding for BDSS.

A good example of the provision of BDSS in association with microloans is the **"Entrepreneurship from idea to success"** project. This project was implemented by the FAER Foundation in 2010-2012 with financial support (EUR 1.3 m) from the EU Structural Funds and the Romanian Government's Sectoral Operational Programme for Human Resources Development. [5] The project's overall objective was to encourage sustainable development by promoting entrepreneurship among small businesses, their employees, potential entrepreneurs, and young people who want to start a business in urban localities with less than 50,000 inhabitants. In so doing, the project would facilitate these budding entrepreneurs' active role in community life, helping them to initiate, develop and better manage their microbusinesses and individual enterprises (sole entrepreneurs, legally registered professionals, family business, etc), thus contributing to job creation and maintenance, and self-employment.

During project implementation, 1,560 participants (of whom 700 were women) attended information sessions, business courses, business development advice activities and exchange visits. 32 trainers and business advisors were trained and certified; a network of four business information and advisory centres supporting entrepreneurship was created; 50 start-ups legally registered their income generation activity during the project's implementation period; 100 micro, small and medium enterprises (MSMEs) received advisory services and received assistance on improving their business performance; and 50 investment and development project proposals submitted by target beneficiaries received funding.

The project contributed to the objectives of the Romania's human resource development strategy at three levels:

- entrepreneurship promotion,
- training and performance management culture for a network of four business information and advisory centres,

- advice, assistance and an e-learning platform to facilitate the continuity and multiplication of project's results.

3. ROMANIAN MICROCREDIT FACILITY – PUBLIC-PRIVATE PARTNERSHIP FOR THE CREATION OF NEW JOBS AND DIVERSIFICATION OF ECONOMIC PRODUCTION THROUGH MICROCREDIT

Context of the Romanian Micro Credit Facility and Summary of Results:

In 2005, there were approximately 19 SMEs per 1000 inhabitants in Romania, which is considerably below the EU-27 average of almost 40. Compared with the EU average, Romanian SMEs play a slightly less prominent role in the local economy, as measured by number of employees and value added.

Therefore, a Public–Private Partnership between the government of Romania, European Bank for Reconstruction and Development (EBRD) (representing the Public), and the Romanian MFIs and SMEs Banks (which are the Private) was initiated to implement the Romania Micro Credit Facility (RMCF, or ‘the Facility’) and achieve the development objective.

General Objective: RMCF aims to support Romanian micro and small enterprises (MSEs), including start-up MSEs, by improving their access to finance. It has 4500 targeted beneficiaries.

Financial Resources: The total budget of the Facility, signed into effect through Contribution Agreements between the government of Romania (Ministry of European Integration) and EBRD in December 2006, was estimated at EUR 18 m. This budget originated from the budgets of the European Commission’s PHARE 2005 and 2006 pre-accession funding programmes. It was also co-financed by the Romanian government (15%) and EBRD through commercial sources.

Romanian Micro Credit Facility – Main Components: RMCF assists the MSE sector by supporting the creation of new job opportunities, sustaining existing jobs and diversifying economic production through three main components:

- (1) **Pillar 1: Lending on component (EUR 12.52 m)** – The lending on funds, together with EBRD’s own resources, are provided to partner lending institutions (commercial partner banks and non-bank MFIs) to lend on to MSEs;
- (2) **Pillar 2: Risk-sharing facility (EUR 3 m)** – The risk-sharing facility is available to encourage partner institutions to lend to start-up MSEs, i.e. those MSEs that have been in operation for 3-12 months. Up to 50% of losses on the principal loans to start-up MSEs can be reimbursed to partner lenders, for up to a total amount of EUR 3 m; and
- (3) **Pillar 3: Support actions (EUR 2.5 m)** – This is to assist capacity building in partner institutions and train RMCF’s designated Romanian successor institution on matters of project implementation and monitoring as well as to support general project implementation and monitoring costs.

RMCF has channelled microcredit funds through 4 partner lending institutions (PLIs), 3 non-bank MFIs and a commercial bank

The disbursement of the RMCF funds through PLIs, MFIs and SME banks is presented in Figure 4.

RMC Facility disbursement of Funds, SA and RSF

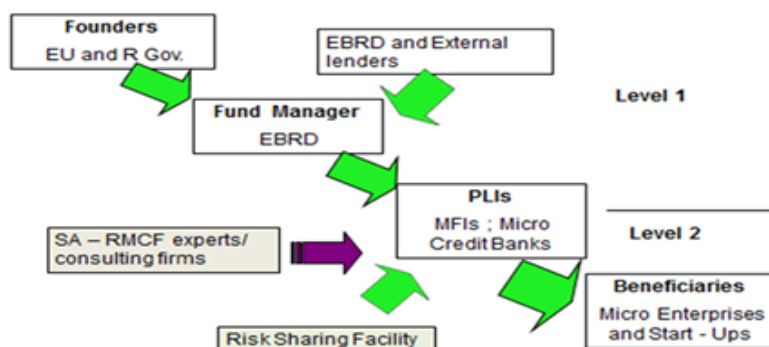


Figure 4: PPP's provision of financial services in the Romanian Microcredit Facility

A summary of the key results during the implementation of RMCF by December 2013 and the lessons learned are presented below:

- The total amount committed to partner lenders reached EUR 29 m, of which the Facility committed EUR 10.2 m (35%), the EBRD EUR 15.3 m (52%) and EUR 3 m (13%) was committed from EBRD's commercial syndication partners;
- As of December 2013, 10,893 micro and small loans, totalling EUR 33.7 m, had been disbursed through RMCF. The average loan size was EUR 3,100. The outstanding loan portfolio was EUR 4.5 m. There were 3,041 outstanding loans. The portfolio at risk for over 30 days improved significantly to 7.14% of the outstanding loan portfolio as of December 2012. In contrast, the portfolio at risk in 2012 was 12.1%.
- Table 1 illustrates the key results achieved in RMCF's lending on scheme as of December 2013.

Table 1: Key lending on results achieved by RMCF as of 31 December 2013

Key lending on results achieved as of 31 December 2013	
No. of loans issued (cumulative)	10,893
Volume of loans issued (cumulative)	EUR 33,771,369
Average size of loans issued (cumulative)	EUR 3,100
Loans to start-ups (% of all loans disbursed)	3.4%
Loans to start-ups (% of outstanding loan portfolio)	3.5%
Micro loans (< 10,000 Euro) disbursed	EUR 30,636,367
Small loans (10,001 Euro to 25,000/50,000 Euro) disbursed	EUR 3,135,002
Loans disbursed to start-up MSEs (MSEs operating for up to 12 months) (included in micro and SME loans)	EUR 1,152,633
Number of loans outstanding	3,041
Volume of loans outstanding	EUR 4,522,604
Average size of loans outstanding	EUR 1,487
Portfolio at risk > 30 days (% of amount of loans outstanding)	7.14%

Lessons learned from RMCF's implementation:

Within seven years (2007-2013), RMCF succeeded in extending 10,893 microloans, each averaging EUR 3,100. These 10,893 microloans totalled, EUR 33.77 m. The number of microloans

extended by RMCF exceeded the initial target of 4,500 loans. The total amount committed by the Facility was EUR 29 m, of which only 35% (EUR 10.2 m) came from the Romanian government and 65% from EBRD. Therefore, EUR 3.4 m of uncommitted EBRD funds were put into Pillar I, the lending on component of RMCF in December 2011.

Only 30.8% of the funds originally contributed under Pillar 3 (Support Actions) have been disbursed by EBRD to technical assistance and consulting projects. The uncommitted funds remain available for the entire RMCF implementation period until December 2016.

No funds committed to Pillar 2, Risk Sharing Facility, (EUR 3 m) have been drawn.

The under-utilization of RMCF funds diminished the potential impact of the facility. The uncommitted funds from Pillar 1 (EUR 3.4 m) were returned to the EC.

The Romanian microfinance sector grew during the RMCF implementation period, becoming the fifth most active in the EU. However, the Romanian microfinance sector is seriously constrained by the lack of lending funds. Despite insufficient lending funds, new MFIs were registered and existing ones expanded their portfolios and outreach. Some examples of these MFIs were Ro Credit – a newly registered MFI (2007), Aurora, FAER, LAM and ROMCOM. These MFIs were able to expand their portfolios and outreach because they drew mainly from commercial funds with high costs. These high costs were reflected in the microcredit interest charged by MFIs to the beneficiaries.

The development of Romanian MFIs was further constrained by lack of access to consultancy, training and capacity building resources. The modest utilization (34.3% or EUR 870,255) of resources under Pillar 3 (Support Actions) was entirely due to the complicated implementation procedures. These complicated procedures were made more frustrating when compared to the similar services provided by the EU and EIF's JASMINE technical assistance programme.

Pillar 2, known as the risk sharing facility, had 0% utilization. As such, it totally failed to achieve its objectives to encourage PLIs to extend microloans to start-ups. So far, only 3.4% (EUR 1.152 m) of the available loans were disbursed to start-ups.

4. EUROPEAN CODE OF GOOD CONDUCT FOR MICROCREDIT PROVISION, ROMANIA'S CONTRIBUTION AND ROMANIAN MFIS' COMPLIANCE WITH EU REQUIREMENTS

The European Code of Good Conduct for Microcredit Provision (henceforth, the Code) provides guidelines and standards for management, governance, risk management, reporting, and consumer and investor relations issues common to the microcredit sector in the European Union. The standards are in place for the benefit of customers, investors, funders, owners, regulators and partner organizations of microcredit providers. The Code respects the diverse legal frameworks on microcredit provision in the EU countries. Instead of introducing or replacing existing regulations for microcredit providers, it lists a detailed set of common operation and reporting standards in microcredit provision.

The Code was developed by experts of Community Finance Solutions in the University of Salford in the UK, and funded by the European Commission. [5] It is based on the recognized best practices in the microfinance sector, in close consultation with MFIs in the EU and its stakeholders. Among the acknowledged contributors to the Code are the Romanian MFI, Vitas (formerly Express Finance) and a BDSS provider, Eurom Consultancy and Studies.

The Code sets out good practice guidelines that will better enable the sector to face the challenges of accessing long-term finance, maintaining and raising the quality of services, and moving towards sustainability.

The purpose of the Code is not to introduce or replace existing regulations of microcredit providers. It is designed to be a tool for microcredit providers' board members, stakeholders and managers to improve their operations in the sector.

The Code also ensures that microcredit customers are treated in a fair and ethical way. It ensures investors and funders that the microcredit sector will operate with transparency and in accordance with EU reporting standards. It also reassures regulators that the sector operates according to sound business practices and principles, and that it is well-governed. It is envisaged that the EC will require MFIs and microcredit organizations in the EU to adhere to the Code requirements in order to have access to EU funds and technical assistance programmes.

The Code is divided into five sections:

- Customer and investor relations: This section covers microcredit providers' obligations towards customers and investors, and the rights of customers and investors.
- Governance: This section covers the standards for both management and the board of microcredit providers.
- Risk management: This section details common approaches and procedures for managing risk.
- Reporting standards: This section details the indicators microcredit providers must collect, report and disclose.
- Management information systems: This section details common standards for microcredit providers' management information systems.

In December 2014, Romanian microcredit providers form 7 out of 12 organizations currently signed up for the Code. Additionally, 2 out of 5 organizations currently endorsing the Code are from Romania.

An analysis of the legal framework for microcredit provision in Romania and the provisions of the Code is presented in Figure 5.



ECGC sections	Law no. 93 on NBFIs provisions
1. Customer and Investor Relations	<ul style="list-style-type: none"> • Confidentiality of customer information • Customer protection against any conditioning of obtaining the loan not related to the respective lending activity • Transparency of loan contracting documentation • Ability to access foreign capital by the MFI
2. Governance	<ul style="list-style-type: none"> • The significant shareholders ensure stability & development of the MFI • The members of the Board and management must have a good reputation and the necessary experience to run the MFI • No management member can be appointed in a management position in another MFI
3. Risk Management	<ul style="list-style-type: none"> • The large MFIs report to the National Credit Bureau • MFIs must respect NBR requirements in terms of risk management
4. Reporting Standards	<ul style="list-style-type: none"> • All MFIs report to the NBR on the portfolio structure
5. MIS	<ul style="list-style-type: none"> • Resulting from Risk Management and Reporting requirements

Figure 5: Microfinance legal framework provision and the requirements of the Code

The current legal framework for microcredit provision in Romania does not contradict the requirements of the Code. However, Romanian microcredit providers should still comply with the Code requirements on transparency of information, and improve management information systems (MIS) in order to collect and process information needed for portfolio management and reporting.

CONCLUSIONS

Microcredit fills a market gap by providing finance to disadvantaged individuals (unemployed, minorities, youths) aiming to start a business. It also caters to sole traders and microenterprises that are not served by mainstream commercial institutions.

Although established some 20 years ago, the Romanian microcredit sector is still young, compared to the Asian and South American microfinance sectors. The Romanian microcredit sector is diverse and fragmented, consisting of social and more commercially oriented MFIs, SME banks, and commercial and savings banks with a downscaling strategy.

The Romanian microcredit sector has certain distinctive features such as a focus on microcredit (instead of the wider array of microfinance services seen in the developing world) and a focus on the financial needs of existing sole traders (NBFIs) and microenterprises (banks). Social inclusion and promoting entrepreneurship through specialized financial products for start-ups are only offered by socially oriented MFIs. A positive characteristic of this sector in Romania is the fact that most of the component entities have already reached operational and financial sustainability, and have good growth potential. They are committed to the principles and requirements of the European Code of Good Conduct for microcredit provision.

The lessons learned in 2004-2013 from Private-Public Partnerships promoting the legal framework for microfinance, as well as from the implementation of the pilot programmes funded from the national and EU budget (Romanian Microcredit Facility, JEREMIE, JASMINE and Progress Microfinance) provide important guidance for the design and successful implementation of financial instruments. This is especially important because financial instruments are expected to be financially viable, dedicated to the development of entrepreneurship and microenterprises, and the reduction of estimated microcredit market gap.

The microcredit sector can play important roles in creating and developing small businesses, reducing unemployment, and addressing financial and social inclusion. Its impact, however, will be diminished in the absence of coordinated measures to stimulate and assist in the establishment of new enterprises through microfinance schemes and BDSS offers from Structural Funds and national sources.

Further improvement of the legal framework for doing business in Romania will also ensure the healthy growth of both potential microfinance beneficiaries and financial institutions providing the necessary funds.

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3.9 MICROFINANCE FOR SMALL AND MEDIUM ENTERPRISES IN THE RUSSIAN FEDERATION

by

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ABSTRACT

Over the last 5 years, Russia has made progress towards the goal of increasing individuals' and SMEs' access to financial services through improvements in the regulatory infrastructure for financial inclusion. Russia has done this by building the legislative base and placing microfinance organizations (MFOs) and credit cooperatives (CCs) unions under the strong regulatory supervision of the Central Bank of the Russian Federation. Russian policy towards financial inclusion also demonstrates openness to state involvement. In turn, state involvement can be used to stimulate or subsidize financial services providers to enable them to give soft loans to SMEs. Unfortunately, 2014 has not been the best one for MFOs and CC unions, as they struggled with borrowers' increased inability to repay loans on account of the weakened Russian economy and financial sector.

Keywords: microfinance, credit cooperation, non-bank financial institutions, financial inclusion, small and medium enterprises

JEL classification: G210

1 ECONOMIC SNAPSHOT

1.1 Macroeconomic

The Russian Federation faces the challenge of balancing political risks and fighting upcoming recession, while still recovering from the 2008-2009 global economic crises and transitioning from a centrally-planned to market-based economy.

Russia's growth is expected to come to a standstill, as economic sanctions of 2014 have impacted the already weak economy. Investor confidence and economic activity are likely to remain weak, reflecting the effect of EU/US sanctions and Russian counter-sanctions on an already feeble economy. According to the prognosis of the European Bank for Reconstruction and Development (EBRD), stubbornly high inflation⁴⁶ (temporarily also accelerated by the aforementioned ban on food imports) and supply-side constraints in a low-investment environment will continue to limit the long-term effects of any major fiscal or monetary policy response. [1]

In 2014, high geopolitical risks, declining world oil prices and increased demand for credit institutions' currency liquidity led to a significant weakening of the Russian ruble against major world currencies. To show this clearly, figures in this paper will be given in the national currency (ruble) so that foreign exchange rates would not muddle with the dynamics.

Most of the changes in the Russian microfinance market occurred after the 2008-2009 global economic crisis (*see below*). At the peak of the crisis in 2009, the Russian Federation was the most seriously damaged economy of the G-20, with a decrease of 8% in GDP and an 80% fall in its stock index. [3] During the post-crisis recovery, the country's GDP resumed positive growth of 4.4% in 2010 (according to EBRD estimates), and was forecasted to continue growing at 4.4% in 2011 and 4.1% in 2012. [4]

In addition to the recovery efforts undertaken in most other G-20 countries (such as using monetary policy to curtail inflation), Russia was also required to address certain transitional and institutional concerns in order to enter into sustainable economic growth. A significant part of these concerns was in a **reform in the financial sector**, with continued institutional building and the increased use of international best practices in corporate governance and business standards. [4]

⁴⁶ According to the Ministry of Economic Development of the Russian Federation [2], inflation was at 6.3% for 9 months in 2014. As a result, the inflation prognosis for 2014 was raised from 7.6% to 8%.

Table 1. Main Indicators of Socio-economic Development in the Russian Federation [2]

MACROECONOMIC: GDP INDICATORS								
	1st quarter, 2013	2nd quarter, 2013	3rd quarter, 2013	4th quarter, 2013	2013	1st quarter, 2014	2nd quarter, 2014	3rd quarter, 2014
GDP in current prices, billion RUR	14,642	15,983	17,538	18,592	66,755	15,992	17,697	
CGP as a percentage to the corresponding period last year, %	101	101	101	102	101	101	101	
GDP, billion USD (at the exchange rate at the end of the period)	471	489	542	568	2,040	448	526	
	31 March 2013	30 June 2013	30 Sept 2013	31 Dec 2013		31 March 2014	30 June 2014	30 Sept 2014
Exchange rate, RUR/USD	31	33	32	33	33	36	34	39
Consumer price index to December 31 of the last year, %	102	104	105	107	107	102	105	106
Producer price index of industrial goods to December 31 of the last year, %	101	99	105	104	104	102	104	105
	1st quarter, 2013	6 months, 2013	9 months, 2013	2013	2013	1st quarter, 2014	6 months, 2014	9 months, 2014
Export, cumulative from the beginning of the year, billion USD	125	252	383	523	523	123	255	384
Export to countries outside CIS, ⁴⁷ cumulative from the	107	217	327	445	445	106	218	331

⁴⁷ CIS stands for Commonwealth of Independent States.

beginning of the year, billion USD								
Import, cumulative from the beginning of the year, billion USD	77	161	248	341	341	72	153	233
Import from countries outside CIS, cumulative from the beginning of the year, billion USD	66	139	214	295	295	64	134	205
Industrial production index, cumulative from the beginning of the year to the corresponding period of the previous year, %	99	100	100	100	100	101	102	102
Mining, cumulative from the beginning of the year to the corresponding period of the previous year, %	100	101	101	101	101	101	101	101
Manufacturing, cumulative from the beginning of the year to the corresponding period of the previous year, %	99	99	100	101	101	102	103	102
Products of agriculture, cumulative from the beginning of the year to the corresponding period of the previous year, %	101	101	102	106	106	101	101	108

Investments in fixed assets, cumulative from the beginning of the year to the corresponding period of the previous year, %	100	99	99	100	100	95	97	98
Retail trade turnover, cumulative from the beginning of the year to the corresponding period of the previous year, %	104	104	104	104	104	104	103	102
MACROECONOMIC: BUDGET								
	1st quarter, 2013	2nd quarter, 2013	3rd quarter, 2013	4th quarter, 2013	2013	1st quarter, 2014	2nd quarter, 2014	3rd quarter, 2014
Federal budget revenues to GDP, % (Ministry of Finance of the Russian Federation data)	21	20	20	20		22	21	20
Federal budget costs to GDP, % (Ministry of Finance of the Russian Federation data)	22	19	19	20		21	19	18
MACROECONOMIC: MONETARY POLICY								
	31 March 2013	30 June 2013	30 Sept 2013	31 Dec 2013		31 March 2014	30 June 2014	30 Sept 2014
Money supply (M2 money aggregate), billion RUR (Central Bank of the Russian Federation)	27,466	28,506	28,629	31,405	31,405	29,800	30,426	

data)								
Refinance rate of the Central Bank, % per year (Central Bank of the Russian Federation data)	8	8	8	8	8	8	8	8
MACROECONOMIC: WELFARE AND LABOUR								
	31 March 2013	30 June 2013	30 Sept 2013	31 Dec 2013		31 March 2014	30 June 2014	30 Sept 2014
Total number of unemployed	4,252	4,089	3,991	4,190	4,137	4,024	3,687	3,720
Total number of registered unemployed	1,083	970	879	918	974	941	869	796
Total unemployment rate, %	6	5	5	6	6	5	5	5
Unemployment rate based on registered unemployed, %	1	1	1	1	1	1	1	1
	1st quarter, 2013	2nd quarter, 2013	3rd quarter, 2013	4th quarter, 2013	2013	1st quarter, 2014	2nd quarter, 2014	3rd quarter, 2014
Per capita income, average for period, RUR⁴⁸	21,753	25,006	25,426	30,516	25,647	22,679	27,329	27,884
Per capita income, average for period, USD (at the exchange rate at the end of the period)	700	765	786	932	784	635	813	708
Per capita costs, average for period, RUR	22,425	24,582	25,614	29,615	25,530	23,062	27,161	27,625
Per capita costs, average for period, USD (at the exchange rate	721	752	792	905	780	646	808	701

⁴⁸ The Gini index for Russia is 42. [6]

at the end of the period)								
Growth in household savings into bank deposits and securities (without purchase of currency), billion RUR	493	858	319	1,139	2,808	-666	625	306
Growth in household savings into bank deposits and securities (without purchase of currency) (at the exchange rate at the end of the period), billion USD	16	26	10	35	86	-19	19	8
Growth in household purchase of currency, billion RUR	344	427	569	534	1 875	686	540	549
Growth in household purchase of currency (at the exchange rate at the end of the period), billion USD	11	13	18	16	57	19	16	14
Share of household incomes put into savings as deposits and securities and purchase of currency, %	9	12	8	13	11	0	10	7

1.2 Banking Sector [2]

In January-September 2014,⁴⁹ the total assets of the banking sector increased by 11.6% to RUB 64,072.5 bn, while the share of five banks with the greatest assets increased from 52.7% to 53.5%, amounting to RUB 34,266.4 bn in 1 October 2014.

Shareholder funds (capital) of credit organizations grew by 6.6% and amounted to RUB 7,433.8 bn in 1 September 2014.

⁴⁹ Without specific notice, data are given for January-September 2014 and on 1 October 2014.

The number of credit institutions in operation in January-August 2014 decreased from 923 to 869.⁵⁰ Shareholder funds of more than RUB 300 m came from 675 credit institutions (77.7% of those operating as of 1 September 2014).⁵¹ As of 1 September 2013, the capital adequacy ratio was 12.6% (on 1 January 2014 – 13.5%).⁵²

Borrowed funds. The balances in the accounts of customers⁵³ in January-September 2014 rose by 8.8% to RUB 38,009.1 bn, and their share in liabilities and capital of the banking sector fell from 60.8% to 59.3%.

The volume of household deposits grew by 2% to RUB 17,297.5 bn.⁵⁴ Their share in liabilities of the banking sector has declined since the beginning of the year from 29.5% to 27%. Individual deposits in rubles decreased by 0.9%, and increased by 15.7% in foreign currency. The share of ruble-denominated deposits in the total deposits of individuals fell from 82.6% to 80.2%. The amount of deposits of individuals for a term lasting over a year has increased over the past year by 6.1%. Their share in the total amount of deposits of individuals was 64.3%, as of 1 October 2014.

The volume of deposits and other borrowed funds of legal entities in January-September 2014 increased by 23.8% to RUB 13,422.3 bn,⁵⁵ and their share in liabilities and capital of the banking sector increased from 18.9% to 20.9%. The volume of deposits and other borrowed funds of the Federal Treasury, the Ministry of Finance of the Russian Federation and other government agencies **increased by 290%** to RUB 1,770 bn (while decreasing by 40.4% to 453.9 billion rubles in 2013).⁵⁶ Debt of banks on loans, deposits and other borrowed funds received from the Bank of Russia increased by 27.1% up to RUB 5,643.6 bn.

The volume of bonds issued by banks amounted to RUB 1,220.2 bn on 1 October 2014, and their growth for the first nine months of 2014 was RUB 7.1 bn. Specifically, on 1 October 2013, the volume was RUB 1161.5.4 bn, and the growth for the first nine months of 2013 was RUB 124.1 bn. Thus, the volume of bonds issued by banks in January-September 2014 increased by 0.6% compared to 12% a year earlier. While the share of this source of funds in liabilities and capital of the banking sector in 2014 decreased from 2.1% to 1.9%, it was unchanged at 2.1% in January-September 2013. The volume of bills issued over the past 9 months decreased by 13.2% to RUB 871.8 bn, while their share in liabilities and capital of the banking sector decreased from 1.7% to 1.4%.

Placed Funds. In January-September 2014, the volume of outstanding loans and other funds provided by non-financial institutions increased by 14.7% to RUB 25,806.2 bn. Their share in the assets of the banking sector increased from 39.2% to 40.3%, whereas the total amount of bank loans and other loans increased from 55.5% to 56.2%. The volume of overdue loans on this type of loans **grew by 18.4%** (in contrast to 2013 where it only grew by 1%), while its share in the volume of loans granted to non-financial institutions increased from 4.15% to 4.28% as of 1 October 2014.

In January-September 2014, loans to individuals increased by 11.4% to RUB 11,096.4 bn. Their share in the assets of the banking sector did not change, remaining at 17.3%. However, the total amount of bank loans and other loans decreased from 24.6% to 24.2%. The volume of overdue loans on this type of loans grew by 43.2%, while its share in the volume of loans granted to individuals increased from 4.42% to 5.58%.

⁵⁰ As of 1 January 2014, the number of credit institutions declined to 923.

⁵¹ This excludes institutions for which bankruptcy procedures had started.

⁵² Data on the value of equity and capital adequacy of credit institutions, as well as the grouping of credit institutions in the value of equity, as of 1 January 2014, have not been published by the Bank of Russia.

⁵³ The balances in the accounts of enterprises and organizations (including the budgets of all levels of government and other extra-budgetary funds), deposits and other raised funds of legal entities, deposits of individuals, as well as clients' funds in the calculations, for factoring and forfeiting operations, the funds debited from clients' accounts but not entered in the correspondent account of a credit institution, deposit and savings certificates (previously reflected in the indicator "debt obligations").

⁵⁴ This includes savings certificates.

⁵⁵ These figures exclude credit institutions, but include deposit certificates.

⁵⁶ Financial authorities and extra-budgetary funds of the Russian Federation, subjects of the Russian Federation and local self-government

The securities portfolio in January-September 2014 grew by 7.2%, while its share in the assets of the banking sector decreased from 13.6% to 13.1%. The main proportion (76.5%, as of 1 October 2014) of the securities portfolio continues to be taken by investments in debt securities, which increased by 4% to RUB 6,410.2 bn. Investments in equity **decreased by 52.4%** to RUB 375.9 bn (it decreased by 0.2% to RUB 790.4 bn in 2013), and their share in the portfolio of securities amounted to 4.5% as of 1 October 2014.

1.3 State of Financial Inclusion in the Russian Federation⁵⁷

The issue of financial inclusion in Russia has its own specifics – more typical, perhaps, for developed countries that have all the basic prerequisites for financial inclusion. For example, for city dwellers, access to a range of financial services has become more commonplace, with uniquely Russian innovations in retail payment services emerging for the convenience of customers. Yet, for residents of smaller cities, towns and rural areas, access to safe, high quality financial services remains a far greater challenge. According to the 2010 National Census, 74% of the Russian population is urban, while 24% is rural. [5]

The limited data available on usage of formal financial services among lower income Russians paints a picture of financial exclusion in Russia. Financial exclusion disproportionately affects remote and rural areas, and older and lower-income people. Over a third of the population has low financial literacy levels, a factor recognized as a serious impediment to financial inclusion.

The outreach of financial services among the Russian population has been growing in recent years, but the majority of the population still do not have a bank account. While about 48% of the adult population did not use any banking services in 2008, this number was reduced to 22%⁵⁸ at the end of 2011. [6] However, 48% of the adult population (aged 15 and above) report having an account at a formal financial institution. This number is much lower than the use of banking services, as many people use banks for payment services without opening a bank account.⁵⁹ [7] The share of the population with access is even lower when analyzing the bottom 40% of the population in terms of income (40%) and for people with primary education or less (24%).⁶⁰ [7]

Table 2. Use of Banking Services by the Adult Russian Population as of October 2011 [6]

Types of services	Percent	Breakdown of users	Percent
Plastic cards	46%	To receive salary	89%
		Debit card	12%
		Credit card	8%
Regular payments	28%		
Credit services	24%	Consumer credit	89%
		Car loan	11%
		Mortgage loan	11%
Deposit services	18%	Current account/Demand deposit	67%
		Term deposit	42%
Remittances	8%		
Internet banking	1%		

⁵⁷ This section draws heavily on the 2014 joint report by RMC and BFA of 2014 [25], which is in turn used in this section. [26]

⁵⁸ In their research, NAFL uses a statistically representative sample of 1600 adults.

⁵⁹ The results are based on a representative sample of 2000 people with a margin of error of 2.8%.

⁶⁰ Russia has the lowest access figures for people with low education among the BRICS countries (Brazil, Russia, India, China, and South Africa) and among developing countries in Europe and Central Asia.

Deposit box	0%		
None of the above	22%		
<i>The total exceeds 100 percent as multiple responses were allowed.</i>			

Some of the reasons for the low or passive use of formal financial services include: distrust in financial institutions, low levels of financial literacy, low income levels, and supply side constraints. In general, the most financially excluded Russians tend to be those living outside of large cities, less educated and older, have lower income and are less technologically savvy.

The majority of the Russian population use traditional channels for financial services – e.g. 68% of people prefer making regular payments through bank branches and 33% through the Russian Post. Very few people currently use mobile banking, e-money or internet banking to make payments (according to customer survey data, these figures stood at 2%, 1% and 1% respectively in 2012, though most leading retail banks offer this possibility).⁶¹ [7] At the same time, there has been a shift in preferences in the last few years towards the use of innovative payment solutions such as automated payment acceptance terminals (a specific Russian innovation) and mobile payments.

However, the issue of financial inclusion is still present. Recent research showed the following picture: [8]

- 53% do not use any financial services
- Savings products usage is five times lower than credit
- Short-term credit usage is as active among higher-income consumers
- Only 3% have term deposit or savings account
- Only 42% use insurance products
- Awareness of financial products is 10–20% lower than the average,

Even so, innovative products are slowly becoming part of the financial system. [8]

⁶¹ [7] provides more data on mobile phone usage – in 2011, 1.7% of adults above 15 years of age used a mobile phone to pay bills, 1.8% to receive money and 1.5% to send money.

Picture 1. Awareness of Delivery Channels



1.4 Characteristics of the SME Sector

Small and medium enterprises (SMEs) are defined as individual entrepreneurs or legal entities with the following prerequisites:

Table 3. Criteria of SMEs in the Russian Federation [9]

Micro-	Small-	Medium-
Up to 15 employees	16-100 employees	101-250 employees
Up to RUR 60 mln revenue	RUR >60 mln, up to 1000 mln revenue	RUR >100 mln, up to 1000 mln revenue
<25% of the government participation		

The SME sector plays a significant part in Russian economic performance.

Table 4. Share of SMEs in the main economic indicators in the Russian Federation in 2010, % [10]

Indicator	Total	By category		
		Medium	Small-	
			Small-, total	Including micro-
<i>Legal entities</i>				

Number of enterprises ⁶²	95.2	1.4	93.8	80.7
Number of legal entities with innovation costs in 2010	72.0	4.3	67.7	43.9
<i>Legal entities and individual entrepreneurs</i>				
Number of employees ⁶³	25.2	3.6	21.6	10.7
Revenue ⁶⁴	28.5	7.1	21.4	7.6
Investment in fixed assets ⁶⁵	10.0	2.8	7.2	3.4
Fixed assets ⁶⁶	5.9	1.4	4.5	2.3

Table 5. Average size of SMEs engaged in activities in 2010

	The average number of employees per SME	Revenue per SME, mln RUR
<i>Legal entities</i>		
Medium-	101	282.8
Small- (without micro-)	32	58.4
Micro-	4	5.6
<i>Legal entities and individual entrepreneurs</i>		
Medium-	79	437.9
Small- (without micro-)	28	39.1
Micro-	2	1.4

Table 6. SME structure by Main Economic Indicators in 2010

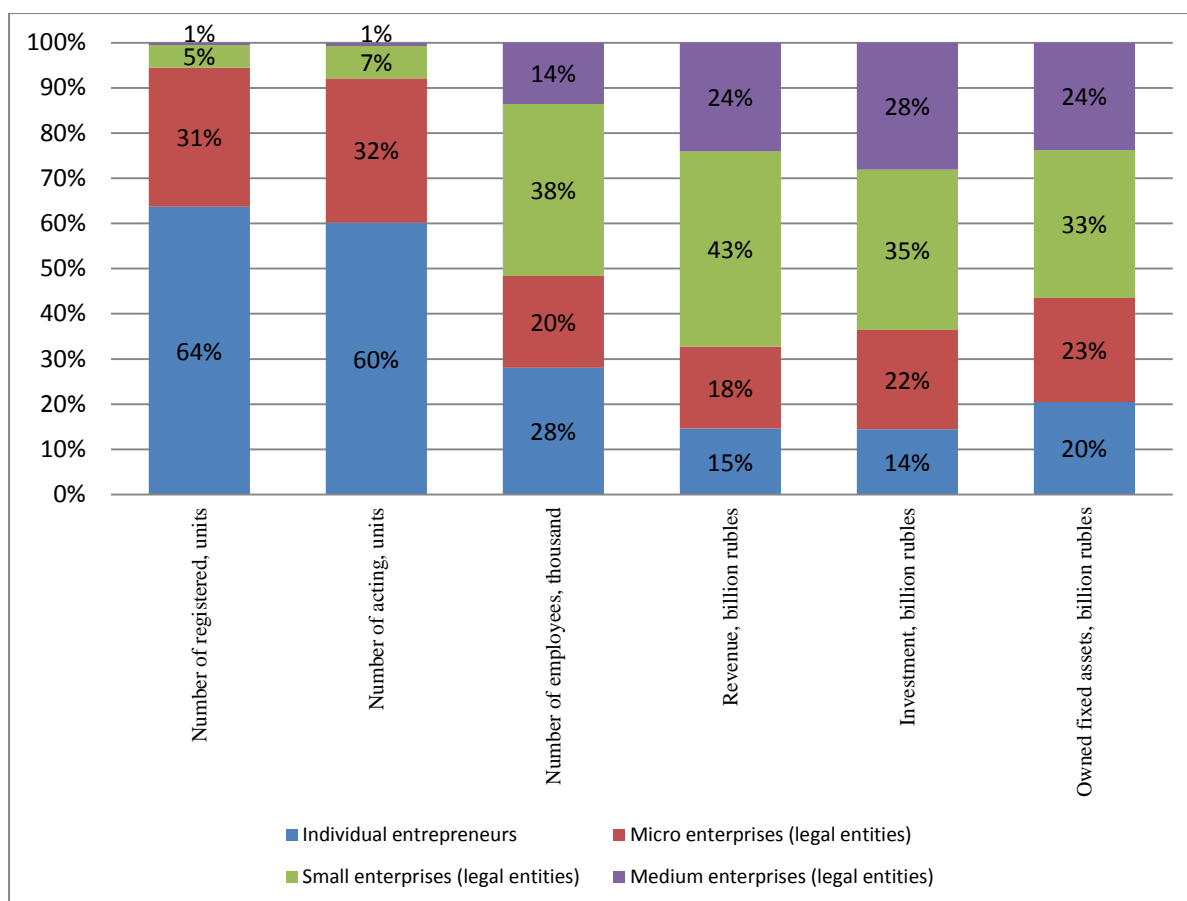
⁶² Of the total number of commercial organizations, excluding banks and other financial organizations.

⁶³ Of the total number of employees in the economy.

⁶⁴ Without banks and other financial organizations.

⁶⁵ Of the total investment in fixed assets, including the investment of individual developers and investment volumes not observed by direct statistical methods.

⁶⁶ Of the total value of fixed assets of commercial and non-profit organizations and fixed assets of individuals.



2 LEGISLATIVE FRAMEWORK ON THE MICROFINANCE⁶⁷

2.1 Adherence to Financial Inclusion

As far back as 2007,⁶⁸ President Vladimir Putin identified the closing of the then vast financial access gap as an important priority of his administration, and it has remained so since. Russia reinforced this priority as an international commitment, for it was reaffirmed in November 2010 as a part of the G-20's Seoul Development Consensus for Shared Growth in the areas of infrastructural deficit, food market volatility and increased access to financial services. Under the Seoul Consensus, Russia is committed to:

- Development of a national action plan for increasing access to financial services;
- Participation in the Global Partnership for Financial Inclusion;
- Creation of a flexible system for SME financing. [11]

Russia has made progress towards this goal, particularly in the regulatory infrastructure for financial inclusion. Russia has made strides in financial inclusion; and in certain aspects – such as the penetration of bank branches per 100,000 adults – Russia has now moved ahead of some highly developed countries.

Russian policy towards financial inclusion demonstrates openness to state involvement, often to stimulate or subsidize private providers. In recent years, billions of rubles were channelled into SME lending, microfinance institutions, and credit cooperatives through the state-owned Russian Small and Medium Entrepreneurship Support Bank. The Ministry of Economic Development is

⁶⁷ This section draws heavily on the 2014 joint report of RMC and BFA [25], which is in turn used in this paper. [26]

⁶⁸ President Putin's address to the State Council, November 2007.

instrumental in launching the Universal Electronic Card – the ambitious e-government initiative that aims, among many other goals, to establish universal access to banking services.

Beyond the emphasis on improving statistics of financial inclusion for lower income Russians, Russian policy has also actively focused on the quality of formal financial services on offer, their appropriateness to the needs of customers, the market conduct of providers, and the financial literacy and capability of financial consumers. These policy priorities, so much discussed internationally in the wake of the global financial crisis, have distinct relevance in the Russian context. Rapid market development, particularly in retail credit, has sometimes resulted in a lag between the introduction of questionable or unacceptable market practices and a regulatory response. There are several Russian initiatives underway related to the quality and appropriateness of financial products on offer and the financial literacy and capability of financial consumers, including plans for establishing a financial consumer protection Ombudsman in Russia and the ambitious multi-year Financial Education and Financial Literacy project in partnership with the World Bank. The Financial Education and Financial Literacy project aims to improve the financial literacy of Russian citizens as well as strengthen the foundations for consumer protection in financial services.

Creation of the **Directorate General on Financial Inclusion and Microfinance** during the reconstruction of the Central Bank of Russia, during which the “mega-regulator” on financial market was created (*see below*). This could be viewed as an additional step in the Central Bank’s commitment to financial inclusion.

On 3 November 2014, Russia signed its commitment to the Maya Declaration and moved one more step forward to the Central Bank’s pledge to financial inclusion.

What is the Maya Declaration? [27]

The Maya Declaration is the first global and measurable set of commitments by developing and emerging country governments to unlock the economic and social potential of the 2.5 bn ‘unbanked’ people through greater financial inclusion. More than 90 such countries, representing more than 75 percent of the world’s unbanked population, have supported the Declaration. Each country makes measurable commitments in four broad areas that have been proven to increase financial inclusion.

These include:

- Create an enabling environment to harness new technology that increases access to and lowers the costs of financial services;
- Implement a proportional framework that advances synergies in financial inclusion, integrity, and stability;
- Integrate consumer protection and empowerment as a key pillar of financial inclusion;
- Utilize data for informed policymaking and tracking results.

Maya Declaration: The AFI member commitment to financial inclusion – Commitment made by Central Bank of the Russian Federation [12]

Financial inclusion issues have recently gained considerable attention in the Russian Federation. Legislative amendments have been made in order to create a sound environment for the elaboration of the national payment system, provision of further access to financial services, and development of financial markets (microfinance, banking, insurance, etc).

According to the Federal Law “On the Central Bank of the Russian Federation (Bank of Russia)” [13], the Bank of Russia is responsible for financial market development and its stability. Financial inclusion plays one of the key roles in this process.

The Bank of Russia will further increase financial inclusion by:

- implementing innovative approaches to consumer financial protection, including widespread adoption of responsible lending conduct and the creation of Financial Ombudsman Service;
- adopting best practices of handling financial services complaints;

- development of financial inclusion evaluation system and indicators under the recommendations of G-20 and the Alliance for Financial Inclusion;
- enhancing financial literacy for the population and entrepreneurs in micro, small and medium enterprises.

The fulfilment of these commitments will be ensured by including the Financial Inclusion stream in the Financial Market Development Strategy (main directions) in 2015- 2017.

2.2 Law on Credit Cooperatives⁶⁹

In the years prior to 2009, there was a rebirth of credit cooperatives (CC) in the Russian Federation. Though the exact size of the growing sector was difficult to quantify, credit cooperatives were known for serving a small proportion of the population through a wide presence in remote areas that were not served by banks. Highly visible instances of fraud and financial pyramid schemes posing as credit cooperatives tainted the reputation of the growing sector, though the extent of these incidents was unknown. In response, Federal Law No. 190-FZ, dated 18 July 2009, “On Credit Cooperation” [14], was introduced in 2009 to establish the rules in the credit cooperative sector and to better understand the extent of the financial flows. The law aimed to streamline the previously fragmented regulatory framework, bringing all existing lending cooperatives under one single law. In the final version of the law, all CCs of both individuals and legal entities were covered – with the exception of agricultural cooperatives.

The definition of a credit cooperative does not mention a social mission or any other qualitative characteristic of a CC. It is therefore broad enough to accommodate different types of loans provided by CCs such as loans to SMEs and consumer loans.

The law requires CCs with membership of 15+ natural persons or 5+ legal entities that want to continue taking deposits from their members to register under the new law. Second tier cooperatives were also defined as credit cooperatives under the law. Under the 2001 Law on Consumer Cooperatives of Citizens, under which most CCs had previously been registered, the maximum number of members for a CC was 2000. The new law abolished this ill-favoured limit, providing **minimum prudential requirements** instead. Broadly, the law defines credit cooperatives’ activities, registration requirements, admission, rights, duties of member/shareholders, and management and governance structures. Notably, the law also includes key normative financial standards for CCs in the form of prudential requirements and ratios.

The law calls for an authorized executive body to serve as the supervisor of the CC sector. Initially, this was the **Federal Financial Markets Service (FFMS)**, with the **Ministry of Finance** as the regulator. In September 2013, the FFMS merged with the **Central Bank** of Russia, which then became the regulator and supervisor for the CC sector. The law requires the creation of **non-profit self-regulatory organizations (SROs)** to take on the role of delegated supervisor, and to whom their member CCs must report. All CCs must be members of an SRO. If a CC has less than 5,000 members, SROs serve as delegated supervisors and support their compliance with the law. SROs must also establish compensation and emergency funds for the benefit of their members. Because cooperative members are shareholders and are supposed to have a common bond, there is a legal expectation that they are aware of the workings of the CC of which they are members. As such, even with the introduction of the law on credit cooperatives, they were still **not covered** under Federal Law No. 2300-1, dated 7 February, 1992, and titled “On the Protection of Consumer Rights”. However, **CCs are now covered under Federal Law No. 353-FZ, dated 21 December 2013, and titled “On Consumer Credit (Loan)”** (for more information see below).

*With the recent inclusion of credit cooperatives under the **Central Bank of the Russian Federation**, credit cooperatives now fall under the consumer protection mandate of the Central Bank of the Russian Federation, though how this applies in practice is yet to be seen.*

The Central Bank of the Russian Federation has recently become the consolidated regulator for the financial sector and has begun to oversee the MFOs and CCs through the establishment of 9 new structural units, including the **General Directorate for Countering Unfair Practices** on the behaviour of financial markets and the **Directorate General on Financial Inclusion and Microfinance**. The Directorate General on Financial Inclusion and Microfinance (for more information,

⁶⁹ This section draws heavily on the 2014 joint report of RMC and BFA. [25]

see *below*) is responsible for MFOs, credit consumer cooperatives, rural credit consumer cooperatives, housing cooperatives, and self-regulatory organizations.

Important notions:

- CCs are non-governmental organizations (NGOs).
- No minimum or maximum limits on “savings” from members.
- Loans can be provided only to members.
- Microloan is not defined for CCs. CCs can freely provide loans in any sum without strict division between microlending and other activities.
- Regulation and supervision is carried out by the Central Bank of the Russian Federation, with delegated supervision to self-regulatory organizations of credit cooperatives (SROs CCs). CCs’ participation in SROs is obligatory. Without it, a CC is not allowed to attract new members.

2.3 Law on Microfinance Activity and Microfinance Organizations⁷⁰

Non-bank microlending activities in Russia started in the mid-1990s with international NGOs and were later adopted by local NGOs, government and municipal funds for small and medium entrepreneurship support, as well as commercial companies. Although most of these lenders provide loans to microentrepreneurs, commercial companies also engaged in consumer lending. Before 2010, there was no legal definition for microfinance (microlending) activities, and these institutions worked under the general provisions of the Civil Code governing lending activities.

Prior to the adoption of the Law on Microfinance Activity and Microfinance Organizations (also known as the Microfinance Law) in 2010, about 280 non-banking organizations identified themselves as engaged in microlending; more than half were government and municipal funds and the vast majority of the remaining ones were registered as NGOs. The total size of the microlending sector at the time of the law is not known, as some microlenders might not have identified themselves as such. None of the microlending organizations were engaged in deposit taking, since only banks are permitted to take deposits. As any legal entity can take loans from natural persons or other legal entities without any restrictions on size, this allows for quasi-deposit-taking under the guise of borrowing. (*For more information on how this changed with the adoption of the law, see below.*)

The combination of two complementary forces – (1) policy makers striving to increase outreach of financial services to MSMEs (through the government funding programme for state MFOs under the **Ministry of Economic Development**) and; (2) industry players desirous of more legal clarity for their microlending activities – resulted in the adoption of Federal Law No. 151-FZ, dated 7 July 2010, titled “On Microfinance Activity and Microfinance Organizations”. [15] The law establishes the definition of a microloan as a loan up to RUB 1 million and defines microfinance activities as activities of microloan issuance. An MFO is defined as an organization engaged in microfinance activities. **The definition does not mention a social mission or any other qualitative characteristic of an MFO. It is therefore broad enough to accommodate different types of loans provided by MFOs such as loans to SMEs and consumer loans.** With a few exceptions, the law allows most legal forms to engage in microfinance activities.

The law appointed a government agency in charge of the regulation and supervision of MFOs. Initially, this was the **Ministry of Finance**, then the regulatory and supervisory powers were split between the **Ministry of Finance** and the **FFMS**, respectively. From 1 September 2013, all these powers were transferred to the **Central Bank of the Russian Federation** due to the merger of the FFMS with the Central Bank of the Russian Federation.

The Microfinance Law includes a number of business conduct rules:

- It establishes general information disclosure requirements: MFOs have to inform their customers of the rules relevant to microloans, including rules of loan application procedures and review, and rules of loan agreement signing and repayment schedule provision. MFOs have to inform loan applicants about loan agreement conditions, the possibility of change in the agreement at the initiative of either the MFO or the borrower, a list of all fees and

⁷⁰ This section draws heavily on the 2014 joint report of RMC and BFA. [25]

commissions, and the amounts charged in connection with loan disbursement, servicing and repayment, as well as delinquency penalties.

- Several provisions in the Microfinance Law prohibit MFOs from changing loan agreements unilaterally and charging pre-payment penalties as long as clients (natural persons and individual entrepreneurs) give MFOs 10 days notice on their intention to prepay.
- The Law requires that MFOs maintain confidentiality of their client data.

The Law did not specify the details of how MFOs were supposed to implement these consumer protection requirements and left room for various interpretations; it also did not address business practices that could potentially be harmful to consumers (such as penalties and loan collection), and neither did it provide for a dedicated complaint and recourse mechanisms for MFO clients.

But MFOs **are covered** under Federal Law No. 2300-1, dated 7 February 1992 titled “On the Protection of Consumer Rights” (see the difference with CCs) and **Federal Law No. 353-FZ, dated 21 December 2013 titled “On Consumer Credit (Loan)”** (see below for more information). However, only natural persons are subject to consumer protection requirements under the general Consumer Protection Law as it does not cover legal entities and individual entrepreneurs.

Important notions:

- MFOs can be in any legal form (NGOs or commercially oriented)
- With the adoption of the law, MFOs registered in the State Registry of MFOs can only take “loans” from individuals with a **minimum** limit of RUB 1.5 m. It is presumed that if a person can lend this sum of money, he/she can evaluate the risks. As MFOs are not deposit taking institutions, they can register with the State Registry of MFOs without license (and without requirements on capital).
- Microloan (in MFOs) is defined as a loan that is less than 1 million rubles.
- MFOs can carry out other activities such as provide loans (not microloans), so long as the sum does not amount to more than 1 million rubles.
- Regulation and supervision is carried out by the Central Bank of the Russian Federation, and MFOs participation in SROs is voluntary at the moment.

2.4 Consumer Credit Law

Though relatively small in terms of portfolio volume, payday lenders have quickly become the most visible part of the microfinance sector, alerting policymakers to the risk of regulatory arbitrage and the need to manage linkages between the objectives of inclusion and consumer protection and also between protection and stability. It can also be argued that the current visibility of payday lending is due to regulated entities conducting such activities. When regulated entities conduct payday lending, they increase the pressure on the regulator. In fact, this pressure has been mounting on the Central Bank of the Russian Federation since September 2013. As a result, the Central Bank of the Russian Federation has to address consumer protection issues, as evidenced by the recent adoption of the **Consumer Credit Law** (in effect from 1 July 2014).

The Consumer Credit Law was adopted when the Central Bank of the Russian Federation became the consolidated regulator for the financial sector and had to oversee MFOs and CCs through the establishment of 9 new structural units, including a **General Directorate for Countering Unfair practices** on the behaviour of financial markets and a **Directorate General on Financial Inclusion and Microfinance**.

The Consumer Credit Law applies to professional consumer lending to individuals, but not loans for productive use (corporate or enterprise lending). The law defines “professional consumer” lending as the activities of a legal entity or individual entrepreneur engaged in “systematic consumer lending”. “Systematic consumer lending” is defined as lending on a fee basis **at least four times in one year**. In an earlier draft of the law, mortgage lending was also subject to the law, but it was excluded in the final draft. *The law standardizes transparency by making it compulsory to disclose general terms and conditions at the point of service. It requires that terms and conditions specific to individual loan contracts, including guidelines on calculating and presenting the annual total*

cost of credit, ceilings on the permitted interest rate and presentation of repayment schedules are transparent as well. The law also limits the size of penalties and fees in case of delinquencies. Additionally, the law sets the standards for the consumer credit contract, the disbursement/transfer of loans using electronic means, and refusal of credit and early repayment. Finally, the law sets minimum requirements for the assignment of rights/claims to third parties, consequences for violation of the loan agreement, and acceptable practices with regards to loan collection.

3 GOVERNMENT PROGRAMME SUPPORTING MICROFINANCE

3.1 Support programme for SMEs through microfinance – the Ministry of Economic Development of the Russian Federation⁷¹ [16]

The government programme for SME development, implemented by the Ministry of Economic Development of the Russian Federation, has many ongoing activities, one of which is a programme for the development of microfinance organizations. This programme assists in the provision of access to loans for small businesses that for some reason cannot use traditional banking products (e.g., due to small loan amount, lack of credit history, remote business area, etc).

The Ministry of Economic Development of the Russian Federation supports only microfinance organizations whose founders are regional (or municipal) government bodies.

MFOs are able to lend to small businesses relatively quickly and on favourable terms. This stimulation of additional lending contributes to bigger profits for both entrepreneurs and microfinance organizations. Microfinancing of businesses, especially small businesses, can be deemed the best option in getting funds to establish and develop an enterprise, providing that loans to SMEs do not exceed 1 million rubles. The maximum size of the “microloan” is determined by Federal Law No. 151-FZ, dated 7 July 2010, titled “On Microfinance Activity and Microfinance Organizations”. From 2010-2014, that law stated that the loan term should not be more than 12 months. However, it has since been amended to 36 months. The loan term is determined by the rules of the microfinance support programme for SMEs set down by the Ministry of Economic Development of Russia.

Subsidies to regions for the development of microfinance have been provided since the start of the programme in 2005. The system works as follows: money goes from the federal budget to the regional budget. Money from the regional budget is then distributed to regional MFOs (the founders of these MFOs should be regional or municipal government bodies). MFOs then provide microloans to local SMEs.

The volume of support to MFOs under the programme has been increasing annually. In 2005, the federal budget allocated RUB 23.5 m to the implementation of the programme in 16 regions of the Russian Federation. By 2011 and 2012, this figure had increased to more than RUB 2.1 bn annually. In 2013, RUB 2.2 bn went to the development of microfinance in 35 regions of the Russian Federation. The majority of these regional subsidies came from the federal budget (on the principle of co-financing with the regional budget) and was for the creation and capitalization of state (regional and municipal) MFOs. **Only state MFOs receive such support.**

As of 1 July 2014, there were more than 70 regional MFOs (a founder of a regional MFO is a regional government body) and more than 100 municipal MFOs (a founder of a municipal MFO is a municipal government body) were created under the Ministry of Economic Development’s programme with a total capitalization of RUB 18 bn. The existing loan portfolio is RUB 11.4 bn (26.1 thousand loans), which means that state microfinance organizations play a major part in the portfolio of loans to SMEs (*see below for a description of the microfinance sector*). State MFOs provide microloans at an interest rate of 10-12%. The programme has a restriction on the margin of no more than 10% for loans given under the scheme. More than 10% is allowed if an MFO borrows from additional sources.

As of 1 July 2014, the share of overdue loans in the total loan portfolios of state MFOs is 7.3%. This is 0.6 % lower than the 1 July 2014 national average for all MFOs of 7.9%.⁷² An average loan amounts to RUB 584,000.

⁷¹ This case study was prepared by RMC for IFC in April 2014. At the time, only data at the beginning of 2014 were used.

⁷² This is according to estimations by the Ministry of Economic Development of the Russian Federation.

As of 1 July 2014, 68.5% of microloans were provided to SMEs in the non-trading sector, including: 18.7% for SMEs in manufacturing, 13.7% in agriculture, 7.7% in consumer services, and 28.4% in construction, transport and other areas.

The share of microloans with terms of 6 months to 1 year is 74.7%.

3.2 Support programme for SMEs through microfinance – Open Joint-Stock Company “Russian Bank for Small and Medium Enterprises Support”⁷³ [17]

Open Joint-Stock Company “Russian Bank for Small and Medium Enterprises Support” was established in 1999. Since 2011, it has come to be known as OJSM “SME Bank”. Pursuant to Federal law No. 82-FZ, dated 17 May 2007, “On the Bank for Development” and Decree of the Government of the Russian Federation No. 1766-r, dated 7 December 2007, “On Share Transfer to the Authorized Capital of Vnesheconombank,” 100% of shares of the Russian Bank for Small and Medium Enterprises Support are owned by the State Corporation, “Bank for Development and Foreign Economic Affairs (Vnesheconombank).” Vnesheconombank is part of the government’s plan to diversify the Russian economy. To do so, it receives funds directly from the general state budget.

OJSC “SME Bank” implements a programme of financial support for SMEs, including the provision of financing for private and state banks, leasing and factoring companies, microfinance institutions (first and second tier MFOs and CCs) on favourable conditions (at reduced interest rates).

The following results have been achieved by OJSC “SME Bank” as of 1 February 2014:

- total amount of support provided to SMEs: about RUB 96,713 m;
- geographical expansion of the programme: 82 regions of the Russian Federation;
- 134 active partner banks: 12,884 existing support agreements with SMEs (SMEs’ liability under these agreements is RUB 76.40 bn);
- 150 active partner infrastructure institutions (leasing and factoring companies, microfinance institutions (first and second tier MFOs and CCs.): 11,566 existing support agreements with SMEs (SMEs’ liability under these agreements is RUB 20.32 bn);
- RUB 0.15 bn were allocated to create financial infrastructure for SMEs’ support;
- number of partners in the programme for the entire period of its implementation:
 - 247 banks;
 - 198 financial infrastructure institutions;
- number of loan agreements between partners and SMEs for the entire period of programme implementation: more than 65,000.

OJSC “SME Bank” focuses on the priority areas of the programme – support for SMEs in the manufacturing sector, innovation-driven SMEs, and entrepreneurs in regions with a difficult socio-economic situations.

Two of the programme’s microfinance products for SMEs are particularly noteworthy: microcredit (up to RUB 3 m), implemented through banks, and microloan (up to RUB 1 m), implemented through first and second tier MFIs (MFOs and CCs).

OJSC “SME Bank” started to support SMEs through MFIs in 2009. As of 1 February 2014, the Bank has cooperated with 26 MFIs. At present, MFIs have received RUB 5,884 m in loan funds, from which 7,189 SMEs have received more than RUB 5,943 m of support in the form of soft microloans (at a lower interest rate). The outstanding loan portfolio under agreements with SMEs amounted to RUB 1,442 m, and the number of active borrowers was 3,627.

Since 2010, support is provided through banks that include microcredit in their product line. As of 1 February 2014, OJSC “SME Bank” has cooperated with 35 banks of this type. Upon receipt of RUB 7,154 m in loan funds, they have provided soft microloans to 3,303 SMEs amounting to more

⁷³ This case study was prepared by RMC for IFC in April 2014. At the time, only data at the beginning of 2014 were used.

than RUB 5,621 m. Outstanding credit portfolios under agreements with SMEs amounted to RUB 2,288 m, and the number of active borrowers was 2,137.

It should be noted that OJSC “SME Bank” aims to provide long-term and affordable support. Thus, the share of the outstanding portfolio with a term of 1-2 years was 48%, and 2 years and more was 50%. In general, the market is dominated by loans for more than 1 year. The weighted average interest rates for SMEs in the outstanding loan portfolio (of MFOs and CCs) was 14.98%, and the credit portfolio (of banks) was 15.60%, which is significantly below market interest rates for SMEs (which start at 20%).

3.3 Support programme for SMEs through microfinance – second tier MFOs and CCs

There are a few second tier MFOs and CCs in the market with government funds (in Voronezh oblast, Volgograd oblast, Moscow etc.). They provide soft loans to MFOs and/or CCs (usually in only one region as they are funded from this region’s budget) that in turn provide soft loans to SMEs.

4 MODELS OF MICROFINANCE OF SMEs

Two statements are true to the Russian microfinance market:

- There are no major difference in models for SMEs (but there is a difference in comparison to consumer lending)
 - In microfinance and credit cooperation, three types of lending are described – lending to SMEs, consumer lending of up to 45,000 rubles for a term of up to 2 months (“Payday Loans”), general consumer loans (not Payday Loans). Payday lending is the riskiest because MFO gives a loan with an interest rate of 1-2% per day for 1-2 weeks. For other consumer lending activities, MFOs’ interest rates start at 25% per year for an unlimited term. In SME lending, there are some options.
 - If an SME loan is given by MFO or CC from commercial funding sources, interest rates start from 30%. If the loan given by MFO comes from government funds or the Ministry of Economic Development Programme, interest rates start from 10%. If the loan given by MFO and CC come from government funds of OJSC “SME Bank”, interest rate is between 10.5-20%. Interest rates for other government funds (usually regional or municipal programmes) are defined by these government bodies.
 - Both MFOs and CCs can provide consumer and SME loans.
 - Both MFOs and CCs provide loans by cash or by transferring to electronic account (bank account, bank card, through electronic payment system, etc).
 - Both MFOs and CCs can conduct other activities such as provide loans of any sum of money, provide other financial (only if the corresponding laws allow these institutions to provide these various different financial services) and non-financial services.
 - Both MFO and CCs sectors have practically no international donor or investor funds.

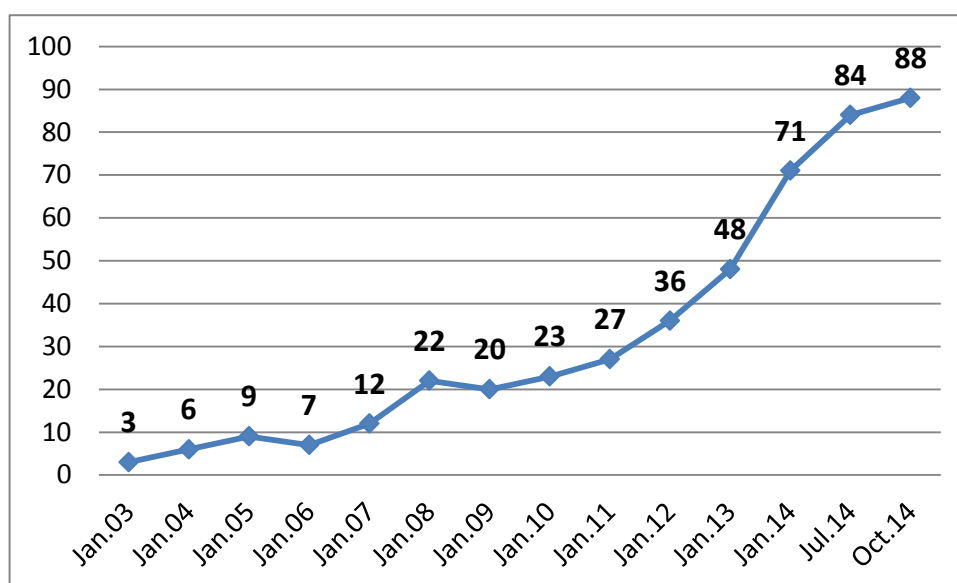
Important notions to remember:

- ✓ CCs are NGOs
- ✓ No minimum or maximum limits on “savings” from members
- ✓ Loans can be provided only to members
- ✓ Microloan is not defined for CCs. CCs can freely provide loans in any sum without strict division between microlending and other activities
- ✓ MFOs can be in any legal form (NGOs or commercially oriented)
- ✓ With the adoption of the law, MFOs registered in the State Registry of MFOs can only take “loans” from individuals with a **minimum** limit of RUB 1.5 m. It is presumed that if a person can lend this sum of money, he/she can evaluate risks. That is why MFOs can register with

the State Registry of MFOs without license (and without requirements on capital); they are not deposit taking institutions.

- ✓ Microloan (in MFOs) is defined as a loan than is less than RUB 1 m
 - ✓ MFOs can carry out other activities by providing loans (not microloans) that are more than RUB 1 m
 - ✓ Institutions providing more than 4 loans to individuals per year need to be registered as professional consumer lenders – as credit (banks and non-banking credit institutions) or non-credit financial institution (MFOs, CCs, pawnshops)
 - ✓ Institutions can provide any number of loans to SMEs without registering as a bank, non-banking credit institution, MFO, CC, or pawn shop, etc.
- There are no major microfinance intermediaries/institutions in SMEs microlending:
 - The largest institutions on the market are in a category of MFOs, not CCs. CCs are mostly regional institutions, while some MFOs have federal network.
 - Large market participants MFIs grow by 35% per year on average.
 - The concentration in MFOs market is rather high – top 15 MFOs make up 35% of the total market (by microloans portfolio). However, this is almost two times less than in the banking sector.
 - Concentration in CCs market is rather low – cooperatives generally work within 1 region only.

Picture 2. Microfinance and Credit Cooperation Market Portfolio, billion rubles



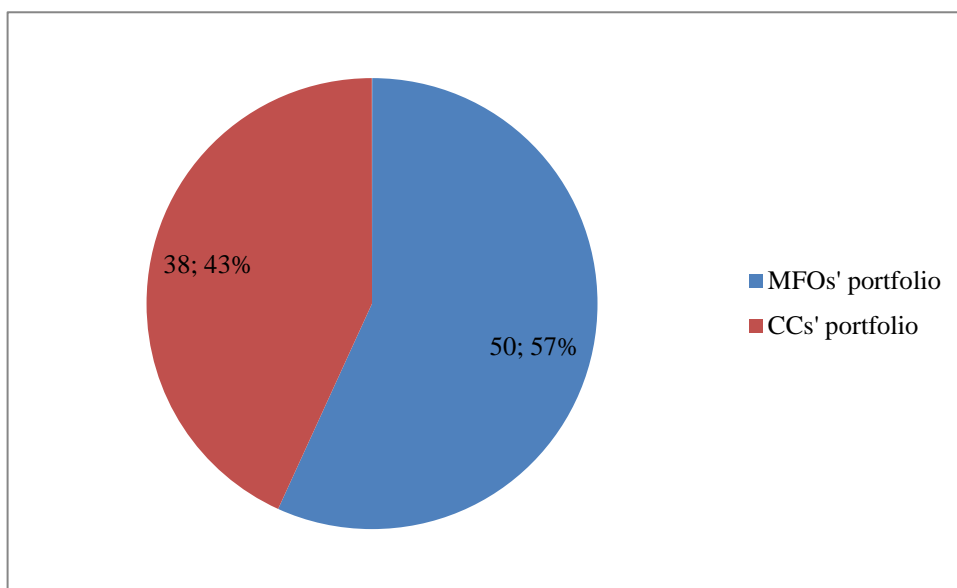
In 2014, there was a big “cleansing” of the Russian microfinance and credit cooperative market, which is expected to continue in 2015. As of 1 January 2015, there were 4,138 MFOs in the State Register of MFOs and 1,495 CCs in 9 SROs of CCs. As of 1 January 2015, 1 SRO of CCs was excluded from the register of SROs of CCs by the Central Bank of the Russian Federation.

Many MFOs, CCs and banks had worsening loan portfolios in 2014, as borrowers were not repaying their loans. At the end of 2014, the negative geopolitical situation in Russia and the decision of the Central Bank of the Russian Federation to increase the key interest rate for banks in December by 6.5% led to deepening negative expectations of MFOs and CCs. As a result, some financial institutions exited the market and existing ones decreased loan portfolios.

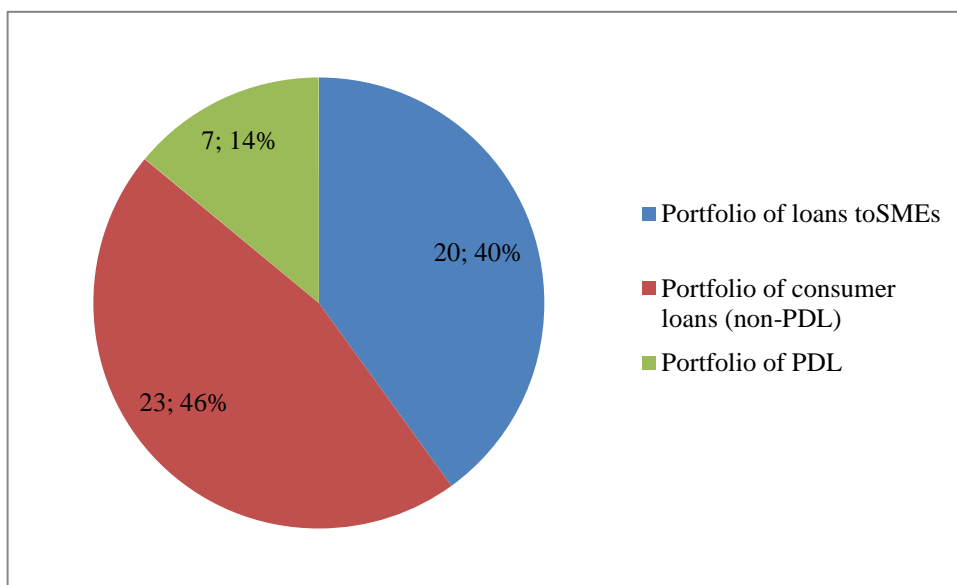
Table 7. Microfinance and Credit Cooperation Market in 2014 [18]

	01 January 2014		01 July 2014		01 Oct 2014
	Estimate of RMC and NAMMS (February 2014) [19]	Reviewed estimate of Expert RA, RMC and NAMMS (May 2014) [20]	Estimate of RMC and NAMMS (July 2014)	Reviewed estimate of Expert RA, RMC and NAMMS (October 2014) [21]	Estimate of RMC and NAMMS (October 2014)
Portfolio of MFOs, billion rubles	36	39	48	46	50
SME loans, billion rubles	18 (50%)	16 (42%)	20 (42%)	18 (39%)	20 (40%)
Other consumer loans (non-Payday Loans), billion rubles	13 (35%)	18 (45%)	21 (44%)	22 (48%)	23 (46%)
Payday Loans, billion rubles	5 (15%)	5 (13%)	7 (14%)	6 (13%)	7 (14%)
Portfolio of CCs, billion rubles	32		36		38
MFOs [22]	3855		4266		4417
MFOs excluded from the State Register of MFOs [22]	690		1069		1329
“Active” CCs in 10 SROs CCs [23]	1608		1629		1633
CCs excluded from SROs CCs [23]	316		390		464
Number of banks / non-banking credit institutions [24]	859 / 64		824 / 60		804 / 55
Portfolio of banks, billion rubles [24]	32168		34281		35366 ⁷⁴
SME loans, billion rubles [24]	5163		5357		5116
MFOs and CCs portfolio to banks portfolio, %	0.11%	0.12%	0.14%	0.13%	0.14%

Picture 3. Microfinance and Credit Cooperation Markets Composition on 1 October 2014, billion rubles⁷⁴ As of 1 September 2014.



Picture 4. MFOs' Portfolio Composition on 1 October 2014, billion rubles

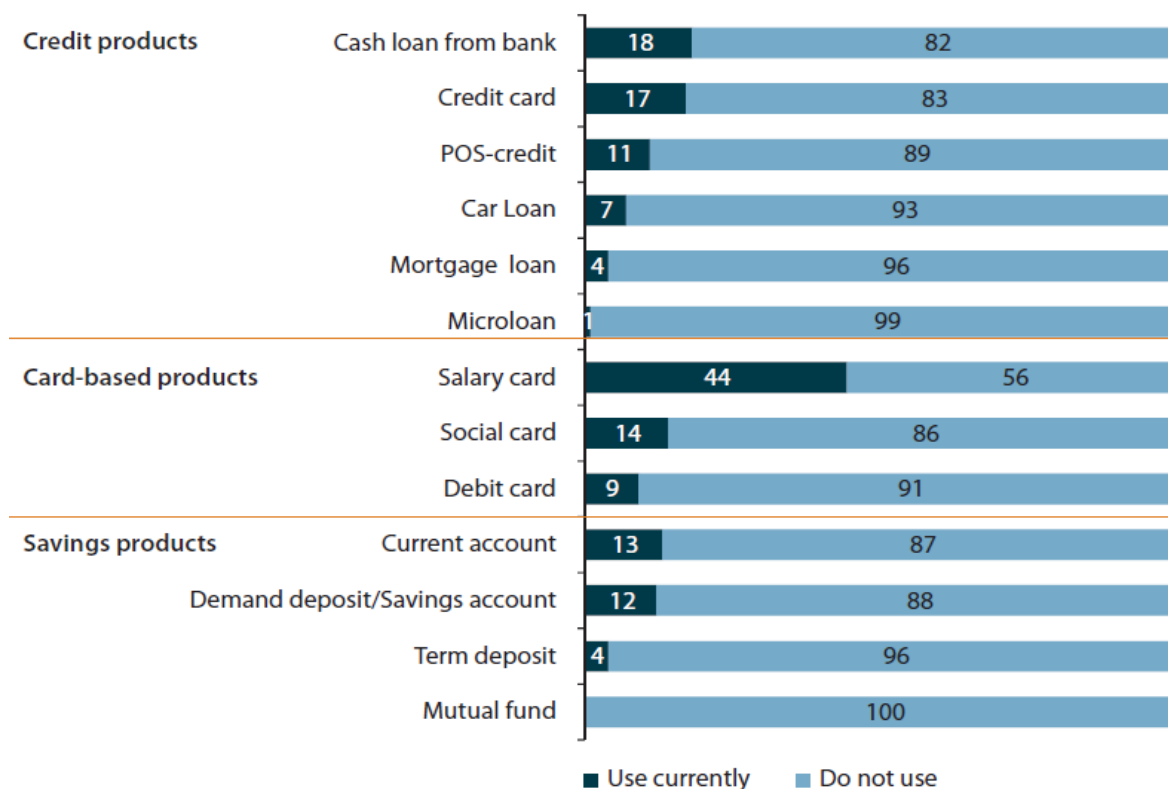


Unfortunately, there are no reliable estimates on CCs' portfolio composition.

Of MFOs' portfolio of SME loans, around 12 billion rubles were loans made by regional and municipal funds under the Ministry of Economic Development's programme.

Although previous data showed high growth in the microfinance and credit cooperation markets, recent research shows that few people (1% of the whole survey group) use microfinance services so far. [8]

Picture 5. Usage: Credit, Savings and Card-Based Products



The Russian penchant for innovation as well as strong local traditions of mutual assistance, have shaped the financial service market in distinctive ways. This is particularly true in areas where bank penetration is weak, as many different financial cooperatives have emerged; some growing to be substantial institutions. At the same time, the number, size, and diversity of providers of retail credit have increased dramatically, even in rural and more remote areas. [25]

Notwithstanding the dynamism of privately and member-owned financial service providers, state-owned institutions remain important players in the Russian financial sector and are especially relevant to lower income Russians. State controlled financial services providers such as savings bank Sberbank, VTB24, and even Russian Post, are critical in providing financial services in many remote communities. There has been a marked trend towards improving both business practices and service among state-owned providers. In many areas and market segments (such as among the elderly), these state-owned providers appear to be competing favourably with private financial service providers. [25]

CONCLUSIONS

Over the last 5 years, Russia has made progress towards the goal of increasing individuals' and SMEs' access to financial services. Russia has done this by improving the regulatory infrastructure for financial inclusion. In 2013-2014, the microfinance and credit cooperatives market (with 5 times the number of institutions than banks, and 40% of the loan portfolio in SMEs' loans) came under regulation and supervision of the Central Bank of Russia.

Russian policy towards financial inclusion demonstrates openness to state involvement, often to stimulate or subsidize financial services providers. In this way, the Ministry of Economic Development of the Russian Federation, Open Joint-Stock Company "Russian Bank for Small and Medium Enterprises Support" (OJSC "SME Bank") as well as second tier MFOs and CCs programmes that support SMEs through soft loans should be acknowledged.

Unfortunately, high geopolitical risks, decline in world oil prices and sanctions weakened Russian economy in 2014. The Russian financial sector was particularly hard-hit. Worsening payment discipline of borrowers in MFOs and CCs (as well as in banks), combined with the Central Bank's

efforts to “cleanse” the market resulted in many MFOs and some CCs leaving the market. It is too early to say how the market will develop in 2015, but market participants have both positive and negative expectations.

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3.10 MICROCREDITING OF SMALL AND MEDIUM ENTERPRISES IN THE REPUBLIC OF SERBIA

by

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ABSTRACT

The small and medium enterprise (SME) sector is one of the pillars of economic development for countries in transition. The characteristics of SMEs enable them to adapt to changes in the market and meet the current demands of consumers. Also, they can create significant jobs for unemployed workers who lost their jobs due to the privatization and restructuring of public enterprises. One of the major problems facing SMEs is the lack of funding for ongoing operations and future development. Due to prevalence of the problem, especially in transition countries, the subject of this paper is microfinance - a modern way of financing business.

Microfinance provides funding to SMEs in developed economies across Europe. The aim of this research is to determine the extent of the presence and development of microfinance activities in Serbia, according to the legal framework and government support for developing this sector. This paper identifies the institutions in Serbia that have opportunities for microfinance development and intensive placement of funds. This paper shows that microfinance is insufficiently developed in Serbia, even though the country has been two decades in transition. There are legal obstacles through the "Law on Banks and other financial institutions", which do not allow the placement of funds in this way. Under that Law, banks are the only institutions authorized to collect deposits and decide on their placement in the economy.

Keywords: microfinance, small and medium enterprises, legal framework, government, transition

JEL classification: G18, G21

1. ECONOMIC SNAPSHOT

The negative effects of the global economic crises caused a general deterioration of the business climate even before 2008. The unstable business climate was exacerbated by war conditions in the 1990s and major political changes after 2000. Despite positive development when Serbia enacted political changes, the country's economic situation has been unfavourable since the beginning of the Serbian economy's transition in 2000 and the appearance of the first effects of the global economic crisis in 2008 (Beraha and Đuričin 2011, 275-303). The growth of economic activity prior to global financial and economic crises was insufficient to compensate the losses incurred in the 1990s. That growth was based mainly on the expansion of the service sector.

Since GDP is a reliable indicator of economic development, it is also a good measure of a country's economic progress, especially if it is expressed per capita. The data in Table 1 shows the unsuccessful economic growth in the Republic of Serbia before and after the global economic crises.

Table 1: GDP in Republic of Serbia, 2005-2014

- in EUR -

GDP	2005	2006	2007	2008	2009	2010	2011	2012	2013	I 2014	II 2014
GDP (in millions)	20,306	23,305	28,468	32,668	28,952	27,968	31,472	29,601	31,994	7,357	7,607 ⁷⁵
Real GDP growth (in %) ⁷⁶	5.4	3.6	5.4	3.8	-3.5	1.0	1.6	-1.5	2.5	0.1	-1.1
GDP per capita ⁷⁷ in Serbia	6,863	7,532	7,373	7,896	8,038	8,387	8,560	9,192	9,308
GDP per capita in EU-28	21,637	23,190	22,459	21,940	22,525	24,241	24,045	25,975

Source: National Bank of Serbia and UNECE Statistical Division Database

During the observed period, Serbia's GDP per capita was almost three times lower than the EU average. Relatively high annual growth rates in GDP were achieved after political changes and before the global economic crises. High growth was reached, due to low initial economic bases. Available data indicate that the Serbian economy recovered slightly in 2010. However, it was not enough to bring growth back to pre-crises levels and the Serbian economy entered a phase of recession in 2012 where real GDP growth was -1.5%. Although real GDP growth rate reached 2.5% in 2013, it was very low in relation to the pre-crises period.

Export promotion is one of the basic prerequisites for sustainable economic growth, and trade liberalization was one of the key pillars of transition in Serbia. The Republic of Serbia continues to record a trade deficit during all observed periods, despite positive results achieved with trade liberalization. The global economic crisis caused the decline in exports in 2009 by 16% from 2008's figures. Reasons for Serbia's foreign trade deficit can be found in its economic isolation. During the economic isolation in the 1990s, Serbia lost all international markets, started de-industrialization, inadequately implemented privatization and did not have sufficient inflow of foreign direct investment (FDI). For these reasons, many factories were closed, industries were destroyed, and the competitiveness of domestic products and services were weakened (Beraha and Đuričin 2011, 275-303). The reduction of the foreign trade deficit in 2013 slightly improved the business climate in Serbia. Serbia also recorded foreign trade surplus in the first and second quarter of 2014.

Table 2: Exports and Imports in Republic of Serbia, 2005-2014

Exports and Imports In EUR million	2005	2006	2007	2008	2009	2010	2011	2012	2013	I 2014	II, 2014
Exports	5,329	6,948	8,114	9,577	8,041	9,521	11,147	11,498	13,963	3,305	3,655
- growth rate in % compared to a year earlier	19.1	30.4	...	18.0	-16.0	18.4	17.1	3.2	21.4	16.0	7.4
Imports	9,612	11,970	15,503	18,267	13,098	14,243	16,497	16,993	17,796	4,109	4,563
- growth rate in % compared to a year earlier	0.7	24.5	...	17.8	-28.3	8.7	15.8	3.0	4.7	2.5	4.3

Source: National Bank of Serbia

In addition to declining economic activity and foreign trade, Serbia's macroeconomic instability further deepened with the growth of public debt. After the breakup of Yugoslavia, this inherited public debt put a huge burden on the country's transition. The effects of transition and the global economic crises forced Serbia to further borrow. The effects of the global economic crises and unfinished transition caused public debt to grow from 29.3% of GDP in 2008

⁷⁵ National Bank of Serbia (NBS) estimate.

⁷⁶ At the constant prices of the previous year.

⁷⁷ Value of GDP per capita is converted from US to EUR, according to average exchange rate of NBS.

to 63.8% of GDP in 2013. Growing public debt has worsened macroeconomic business conditions, as seen in the first two quarters of 2014.

Table 3: Serbian public debt/GDP

- in % -

RS public debt	2005	2006	2007	2008	2009	2010	2011	2012	2013	I 2014	II 2014
RS public debt (external + internal, in % of GDP) ⁷⁸	52.2	37.7	31.5	29.2	34.7	44.5	48.2	60.2	63.8	64.9	65.6

Source: National Bank of Serbia

Budget deficit in the first quarter of 2014 amounted to 8.4% of GDP. Due to limited borrowing capacity, saving measures were implemented. The saving measures will largely affect pensioners and public sector employees. The reduction of expenditures on salaries and pensions financed from the budget will start from November 2014. Expenditures on salaries and pensions currently stand at 13% of GDP and 10% of GDP respectively. The reduction of pensions and salaries of public sector employees will save approximately EUR 400 m. The budget deficit is currently about EUR 2.65 billion. These savings of EUR 400 million will lower Serbia's budget deficit to EUR 2.25 billion.

- in % -

RS budget deficit	2005.	2006.	2007.	2008.	2009.	2010.	2011.	2012.	2013.	I 2014.	II 2014.
RS budget deficit/surplus (in % of GDP)	0.7	-1.7	-1.1	-1.9	-3.3	-3.5	-4.1	-5.7	-4.8	-8.4	-5.1

Table 4: Serbian budget deficit/GDP

Source: National Bank of Serbia

Saving measures reducing the budget deficit can exacerbate the longstanding crisis in the labour market. The economy of Serbia is characterized by extremely high unemployment, which was at 22.1% in 2013.

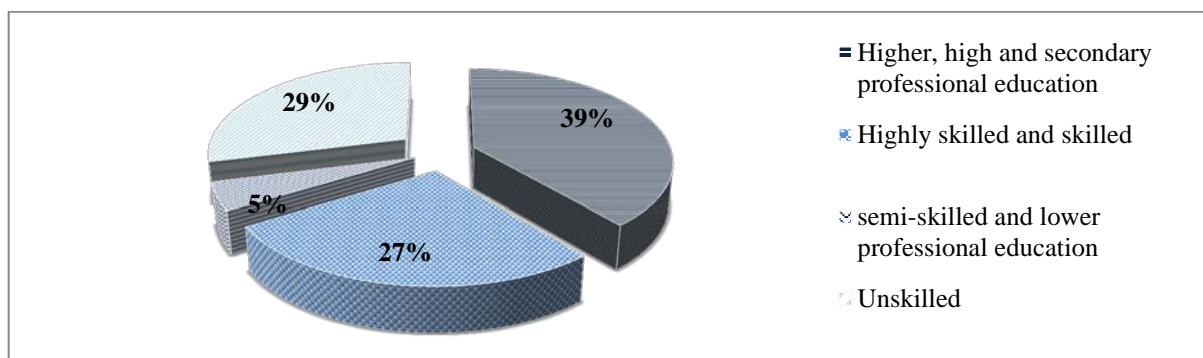
Rate	2005	2006	2007	2008	2009	2010	2011	2012	2013	I 2014.	II 2014
Employment rate	42.3	40.4	41.8	44.4	41.2	37.9	35.8	35.5	37.7	38.4	39.5
Unemployment rate	20.8	20.9	18.1	13.6	16.1	19.2	23.0	23.9	22.1	20.8	20.3
Activity rate	53.5	51.0	51.0	51.5	49.1	46.9	46.4	47.3	48.4	...	53.5
Inactivity rate	46.5	49.0	49.0	48.5	50.9	41.0	49.3	52.7	51.6	...	46.5

Table 5: Employment and unemployment rates in Serbia, 2005-2014

Source: Statistical Office of the Republic of Serbia

The unemployment rate decreased in 2005-2010 to below 20%. However, this trend is not a positive one. The reduction of unemployment during that period was not only caused by the employed getting jobs; it was also caused by the transition of the unemployed into inactive persons (Đuričin 2011, 298-318). Also, reduction in the unemployment rate could not be attributed to real GDP growth because the economic downturn occurred in the observed period.

⁷⁸ Government securities at nominal value.



Graph 1: Unemployed according to level of professional education, average of the last three years

Source: Statistical Office of the Republic of Serbia

Highly qualified persons and persons with college, university and secondary school education accounted for 27% and 39% of the Serbian unemployed respectively.

High rates of unemployment and low income of employees are typical of the Serbian labour market. The average net salary in Serbia in 2013 was EUR 388.3. The average net salary per employee increased significantly from 2005's figures. The increase in inflation rate and retail prices during the observed period negated the positive aspect of increasing net salary. Analyzed by sector, above average wages are mostly seen in largely un-privatized sectors whose stakeholders are mostly state-owned enterprises.

- in EUR -

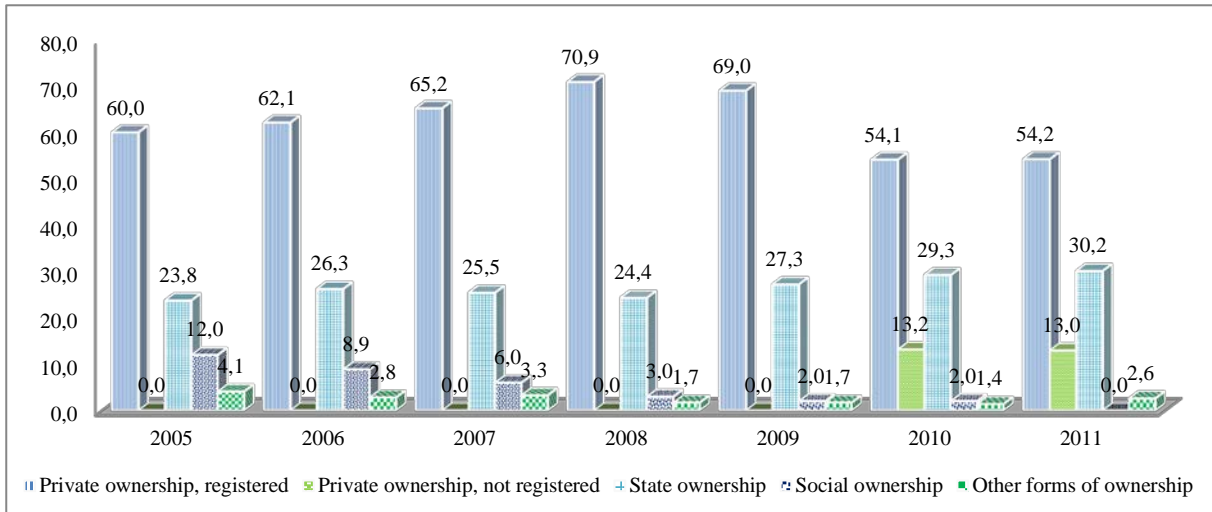
Years	2005	2006	2007	2008	2009	2010	2011	2012	2013	I 2014	II 2014
Total	210,2	258,1	347,2	402,1	337,8	331,3	372,5	365,7	388,3	396,1	394,6
Agriculture, forestry and fishing	154,5	194,3	243,7	303,6	275,4	267,8	309,4	318,0	330,6	326,3	325,9
Manufacturing	166,8	209,2	274,2	322,2	270,6	282,0	321,6	316,0	333,3	346,0	344,9
Construction	186,3	231,8	315,7	374,5	292,0	285,9	323,2	306,8	316,0	308,7	338,9
Wholesale and retail trade	187,5	237,3	314,2	377,7	254,3	250,7	279,3	274,7	297,1	298,7	297,6
Transport and storage	234,5	274,8	349,9	408,8	366,4	360,5	401,3	384,3	405,8	393,8	408,4
Public administration and defence; compulsory social security	272,7	328,5	425,9	475,6	420,4	404,5	458,3	449,3	475,7	468,8	465,1
Education	223,5	268,5	359,9	423,0	379,6	348,1	374,2	360,3	377,9	371,9	379,0
Human health and social care	221,0	265,8	383,8	428,8	384,3	350,8	384,7	366,4	385,5	380,6	381,3

Table 6: Average net salaries by sectors, 2005-2014⁷⁹

Source: Statistical Office of the Republic of Serbia

While public sector wages are higher, the private sector has the largest number of employees. 60% of employees are in privately owned companies, whereas 30% work for public companies, companies that have a social form of ownership or companies that have yet to be privatized.

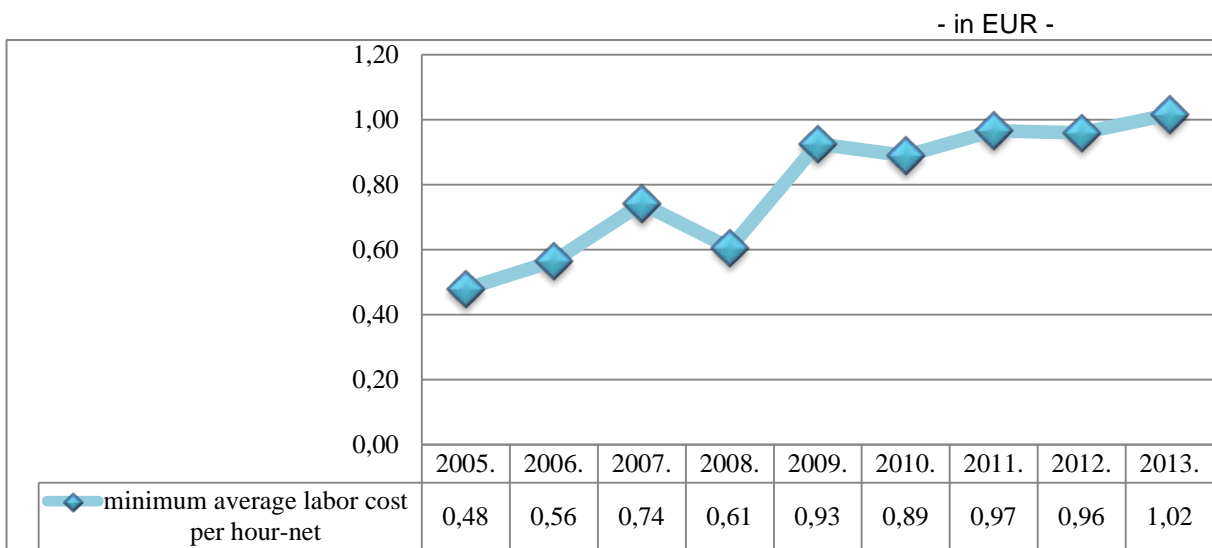
⁷⁹ Value of net salaries is converted from RSD to EUR, according to average exchange rate of NBS.



Graph 2: Employed persons by sectors of ownership, 2005-2011

Source: Statistical Office of the Republic of Serbia

The crisis in the labour market was further aggravated by low hourly minimum wage. Hourly minimum wage in 2013 only increased from 2005's rate by EUR 0.54. Currently, minimum hourly wage in Serbia is EUR 1.02.

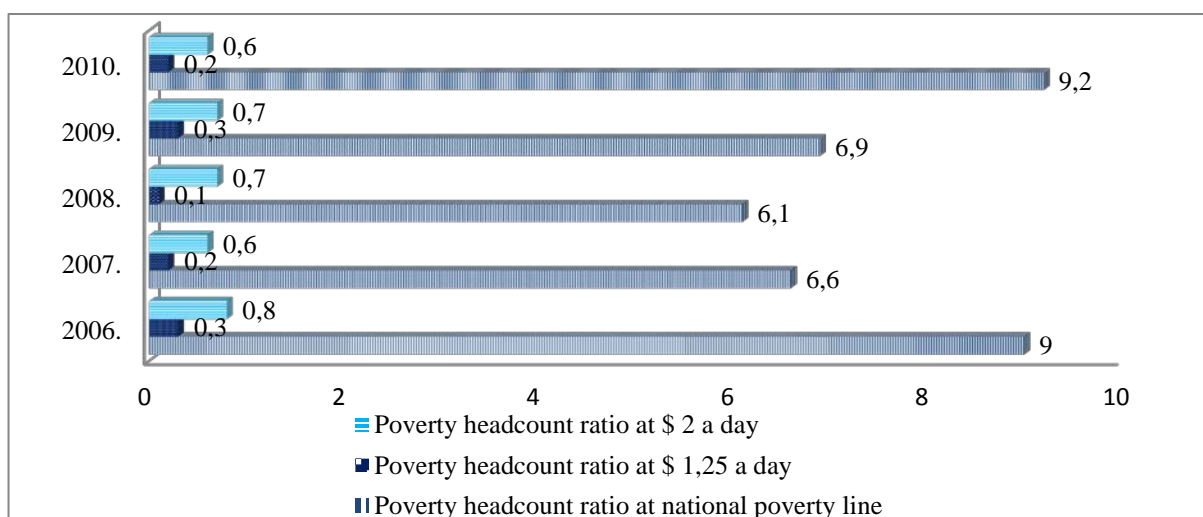


Graph 3: Net minimum average wage per hour, 2005-2013⁸⁰

Source: The legal database, available at: <http://www.paragraf.rs/onama.html>

High unemployment, low labour costs and the overall macroeconomic situation have resulted in the growth of the poverty rate. The poverty rate, or the percentage of the population living below the national poverty line, was 9.2% in 2010.

⁸⁰ The average minimum wage per hour is converted from RSD to EUR, according to average exchange rate of NBS.



Graph 4: Poverty headcount ratio (% of population)

Source: World Bank, Development Research Group, available at:

According to the latest World Bank data, 0.2% and 0.6% of the Serbian population live on less than USD 1.25 and USD 2 a day respectively.

2. CHARACTERISTICS OF THE SME SECTOR

As the small and medium enterprise (SME) sector forms a significant segment of the Serbian economy, the conversion of this sector is part of the transition process. The SME sector of Serbia was characterized by dynamic development prior to the global economic crises. This was the result of an active entrepreneurship policy and low starting base. The global economic crises worsened the performance of the SME sector. Its flexibility and adaptability were the only real bearers of economic recovery, growth and development. The size and flexibility of SMEs allowed them to easily and quickly adjust to changes in the market (Erić et al. 2012, 20). The importance of this sector can best be seen through its participation in the basic macroeconomic indicators of the national economy.

SMEs form 99.8% of the total number of enterprises in Serbia in the last ten years. According to the latest available data, 65.1% of the working population in Serbia are employed by SMEs. SMEs also generate 65.4% of turnover, 55.8% of gross value added (GVA), 51.5% of exports and 60.2% of imports in the non-financial sector of Serbia.

Nationally, SMEs employ 54.3% of the working population, contribute to 49.8% of exports, 58.2% of imports, and 33% of GDP in Serbia.

Indicators	2005	2010		2011		2012	
	Non-financial sector	Non-financial sector	Total economy	Non-financial sector	Total economy	Non-financial sector	Total economy
Number of enterprises	99.7	99.8		99.8		99.8	
Number of employees	59.0	66.4	45.4	65.3	45.1	65.1	45.3
Turnover	65.5	65.3		65.5		65.4	
Gross value added	54.1	55.9		55.2		55.8	
Gross domestic product			33.0		33.0		33.0
Export	39.0	46.6	44.5	48.5	46.5	51.5	49.8
Import	64.0	54.3	52.3	55.8	52.7	60.2	58.2

Table 7: Indicators of development in the SME sector

Source: Ministry of Economy and Regional Development and National Agency for Regional Development

Development indicators show that the number of SMEs has grown by 0.1% from 2005's figures. According to available data, employment by SMEs in the non-financial sector has grown by 6.1%, GVA by 1.7% and exports by 12.5% from 2005. However, SMEs' share in total exports fell by 3.8%. SMEs' slowdown in business activities also lowered their total turnover by 0.1%.

If we observe enterprises by company size, there were no significant changes from the previous year. However, there are currently more microenterprises than before the global economic crises. According to the latest available data, microenterprises account for 96.3% of the SME sector. Small and medium enterprises make up 3% and 0.7% of the SME sector respectively. SMEs dominate in all observed indicators of development, although microenterprises are the most numerous. Small and medium enterprises contributed 53.8% to employment, 60.7% of turnover, 61.6% of GVA, 77.0% of exports and 74.5% of imports in the SME sector.

- in % -

Indicators	2008			2009			2010			2011			2012		
	Micro	Small	Medium	Micro	Small	Medium	Micro	Small	Medium	Micro	Small	Medium	Micro	Small	Medium
Number of enterprises	95.7	3.4	0.9	96.1	3.1	0.8	96.3	3.0	0.7	96.3	3.0	0.7	96.3	3.0	0.7
Number of employees	47.2	22.8	30.0	47.3	23.0	29.7	47.3	23.9	28.8	45.6	24.9	29.5	45.2	25.1	28.7
Turnover	42.0	29.9	28.1	42.5	28.1	29.5	40.1	29.9	30.0	39.4	30.6	29.9	39.3	31.1	29.6
Gross value added	39.9	27.8	32.3	39.8	27.4	32.8	39.4	28.6	32.0	38.5	29.0	32.5	38.4	28.7	32.9
Export	23.4	27.6	48.9	24.0	24.9	51.1	26.4	28.0	45.7	24.0	28.8	47.2	23.0	28.6	48.4
Import	26.1	39.1	34.8	25.8	34.7	39.5	25.0	36.3	38.6	25.6	38.3	36.0	25.5	37.8	36.7

Table 8: Business indicators of the SME sector by size

Source: Ministry of Economy and Regional Development and National Agency for Regional Development

Statistical data on business demographics, which indicate the degree of progress in entrepreneurial development, testify that company formation rates are lower and company closure rates are higher. The number of new enterprises established in 2012 decreased by 10.3% from 2006 figures, while the closure rate increased by 1.9%.

- in % -

Rate	rate of establishing	rate of closing
2006	22.3	10.6
2007	20.7	12.1
2008	18.0	13.2
2009	15.2	11.9
2010	13.7	13.9
2011	13.0	15.3
2012	12.0	12.5

Table 9: Rates of establishment and closures in the SME sector

Source: Ministry of Economy and Regional Development and National Agency for Regional Development

The study, "Status, needs and problems of small and medium enterprises and entrepreneurs," conducted by the National Agency for Regional Development in October-November 2013 indicate that most companies plan to maintain the same level of business activity in the next three years. 53.2% of companies intend to maintain the same level of business activity, while 35.4% plan to expand. 58.1%

of entrepreneurs plan to have the same level of business in the future, while 50.7% of medium-sized enterprises are interested in expanding business activities.

3.2% of firms intend to reduce their volume of business and plan to close, while only 1.4% planned to leave their businesses to others. Plans for closing operations or abandoning them are common for entrepreneurs. 4.6% of entrepreneurs plan to quit their business, while 2.1% plan to leave their business activities to other companies or entrepreneurs.

- in % -

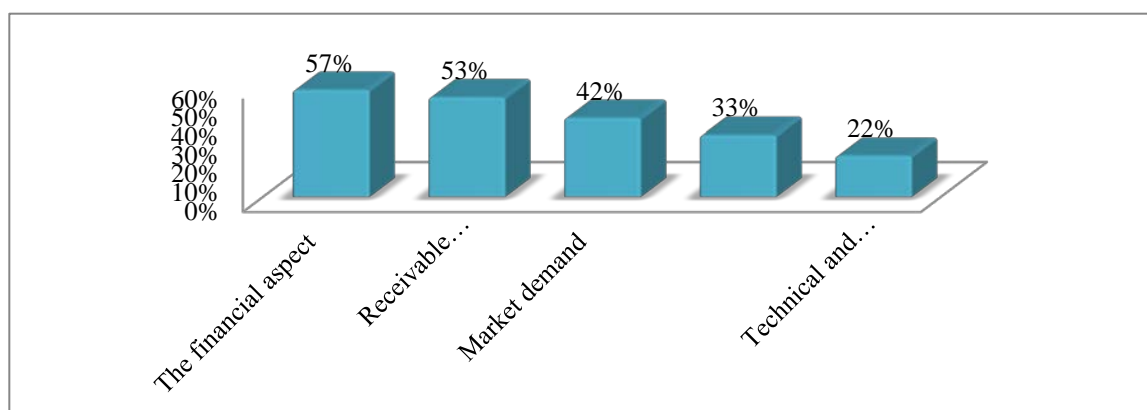
Business plans	Micro	Small	Medium	Entrepreneurs	Total
Expansion of activities	34.7	42.3	50.7	29.0	35.4
The same business level	54.0	48.0	40.0	58.1	53.2
Reducing business volume	3.6	3.0	1.3	3.3	3.2
Closing a business	2.4	1.7	4.0	4.6	3.2
Transferring business to others	1.1	0.9	0.7	2.1	1.4
I do not know / no answer	4.2	4.1	3.3	2.9	3.6
Total	100.0	100.0	100.0	100.0	100.0

Table 10: Business plans of enterprises in the next three years

Source: Ministry of Economy and Regional Development and National Agency for Regional Development

In order to survive in the market, SMEs have to face many difficulties in growth and development. Aspects of operations like provision of the necessary sources of financing, debt collection, growth in demand, market competition and technical-technological development would create better business results and safer development in the future.

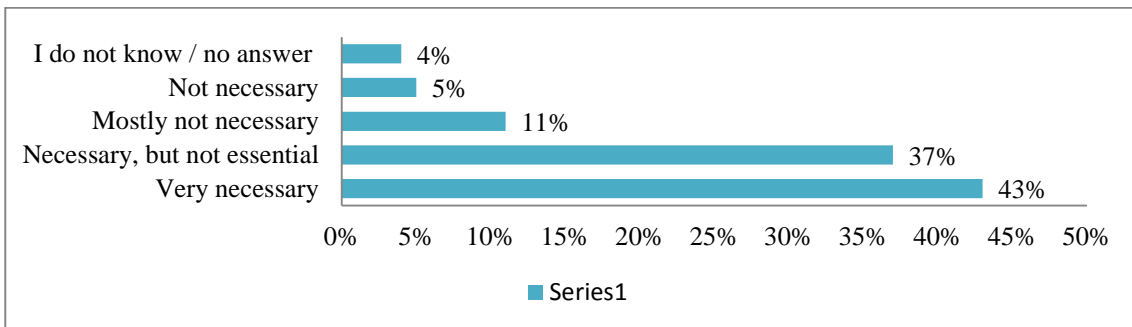
Graph 5: Aspects of business that should first be improved - 5 most frequently answers



Source: Ministry of Economy and Regional Development and National Agency for Regional Development

43% of entrepreneurs consider financial support essential for survival, growth and business development. However, 37% of entrepreneurs view financial support as necessary but not essential. Financial support is largely unnecessary or completely unnecessary in the opinion of 11% and 5% of entrepreneurs respectively.

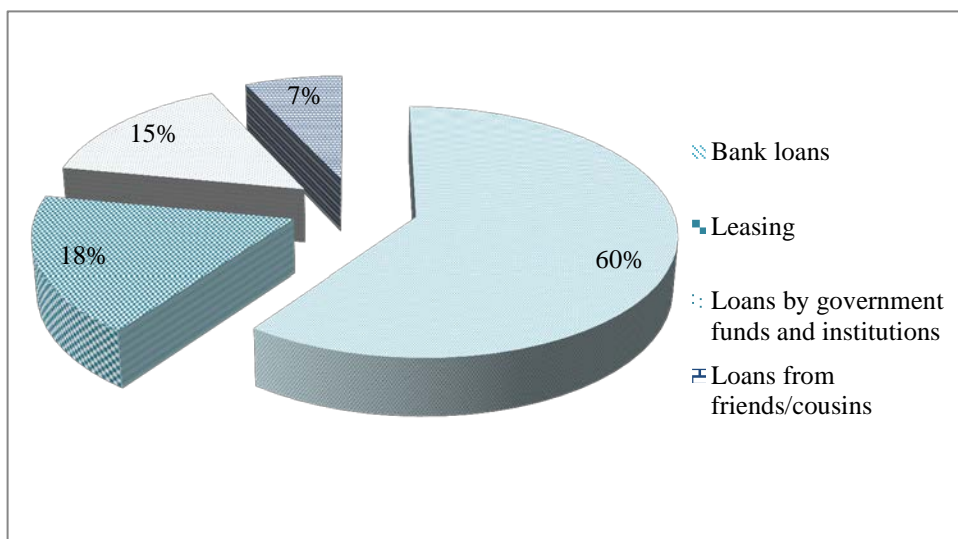
Graph 6: The extent to which you need financial support in the business



Source: Ministry of Economy and Regional Development and National Agency for Regional Development

Most SMEs rely on their own sources of funding in the initial stages of development. However, in the later stages, when capital needs exceed internal capabilities of the owner, a large number of SMEs experience the growing need for external sources of financing. Net cash and retained profit are commonly used internal sources of funding. Their availability is characteristic of the later stages of business growth and development. SMEs commonly use funds from family and friends when relying on informal external sources of financing. Entrepreneurs who choose to use formal external financing sources often rely on traditional forms of borrowing such as loans from commercial banks and leasing, and less on venture capital funds.

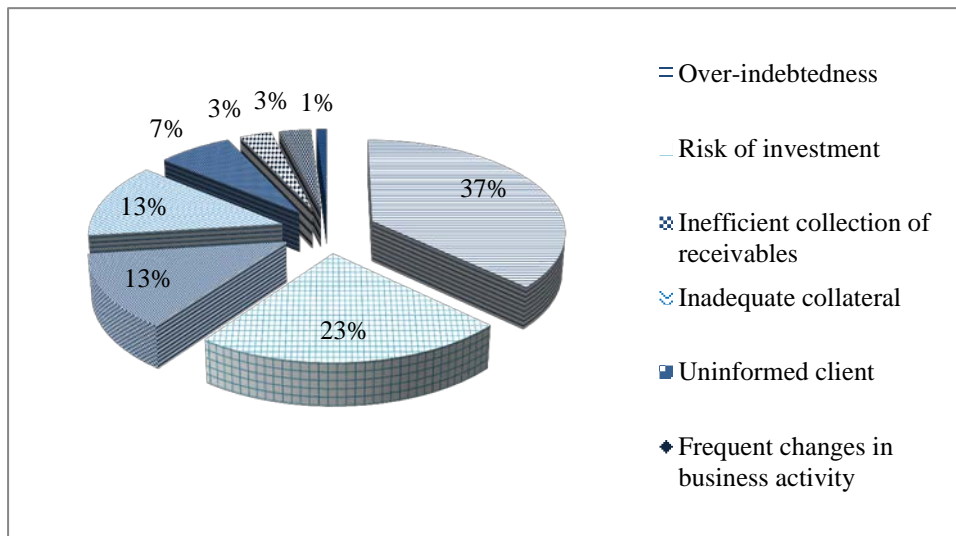
According to the survey conducted in 2010 by the Institute of Economic Sciences and the Serbian Chamber of Commerce, 60% of SMEs used bank loans, 18% leasing and 15% loans from state-owned funds and institutions. 7% of SMEs borrowed from friends and 1% relied on guarantee funds. Companies often use loans from commercial banks to finance investments, working capital and inventory; businesses use leasing from commercial banks to acquire new equipment.



Graph 7: Distribution of responses to the question: Which source of external financing do you usually use?

Source: Erić et al., *Finansiranje malih i srednjih preduzeća u Srbiji*, Belgrade: Institute of Economic Sciences, 2012, p. 71

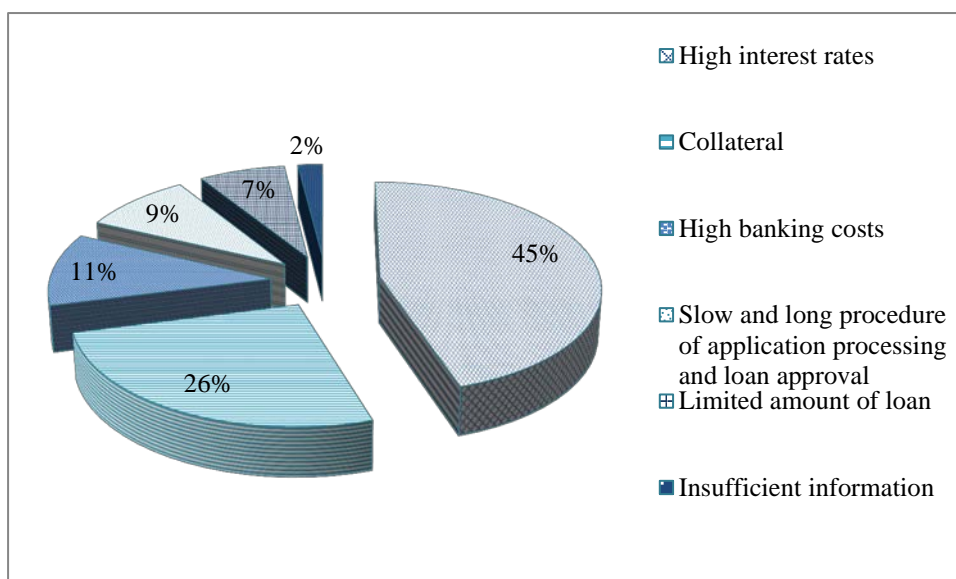
There are two groups of problems that arise from financing SMEs through loans. The first group consists of problems faced by banks when lending money. When dispensing loans, banks are concerned with the size, characteristics and specific needs of SMEs. Survey results show that 37% of the banks polled consider over-indebtedness as the main problem of clients, 23% cite asset risk, 13% inadequate system of debt collection and inadequate collaterals, 7% insufficient client information, and 3% frequent changes in activities of clients and their insufficient training.



Graph 8: Distribution of responses to the question: What are the most common problem banks face when approving loans to SMEs?

Source: Erić et al., *Finansiranje malih i srednjih preduzeća u Srbiji*, Belgrade: Institute of Economic Sciences, 2012, p. 92

Another problem in funding SMEs is the fact that companies face difficulties in using bank loans as external financing sources. 45% of SMEs surveyed indicate that their biggest problem is the high interest rate of bank loans, 26% collateral, 11% high banking costs, 9% cited slow and long procedures of application processing and loan approval, 7% limited amount of credit, and 2% insufficient information.



Graph 9: Structure of responses to the question: What are your greatest problems using bank loans?

Source: Erić et al., *Finansiranje malih i srednjih preduzeća u Srbiji*, Belgrade: Institute of Economic Sciences, 2012, p. 47

There are difficulties unique to start-up SMEs and financially weak would-be entrepreneurs using bank loans. The need for financial support in the early stages of development and the realization of entrepreneurial ideas of financially weak individuals has resulted in the development of specific types of financial services. Those financial services are start-up loans and microloans.

- **Start-up loans** – There is very little funding available to businesses in the start-up phase of development. Borrowing from commercial banks is used only when necessary at this stage of development. There is limited financing available to start-ups, due to the new companies' poor credit capabilities and limited data of their enterprises' financial performance. Since banks are often unwilling to lend money to start-ups, entrepreneurs starting their business have to rely on personal savings, loans from family, friends, business angels, government support programmes and international institutions.

Also, we should keep in mind that the National Bank of Serbia (NBS) followed a restrictive monetary policy for a few years. As a result, there were limited bank loans to the business sector. Likewise, due to the global financial crises, the level of risk has increased. This increased level of risk is seen in the rising rate of non-performing loans. The rate of non-performing loans has risen from 11% in 2008 to 23% in 2014.

Business angels are one of the finest sources of financing start-ups because they provide the necessary capital, experience and skills. Although funding through business angels is limited to companies with high potential for growth and development, not many businesses in Serbia use them. This is because information on them is sorely lacking. According to the survey, only 2% of SMEs are familiar with this form of financing in Serbia (Erić et al. 2012, 1-309), reflecting the absence of the long history of business angel networks in the region.

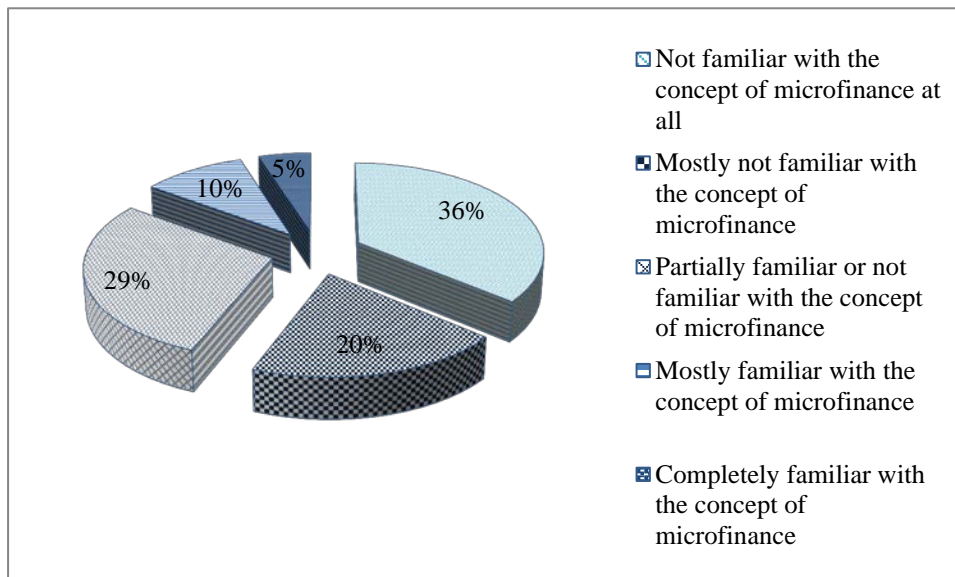
There are some government support schemes available to start-up SMEs; the most notable of which are start-up loans provided by the Development Fund of the Republic of Serbia. SMEs can apply for the long-term start-up loans for construction, extension, reconstruction, renovation, rehabilitation, purchase of office space, manufacturing and industrial facilities or for the purchase of new equipment from the Development Fund of Serbia. Start-up loans are granted under specific conditions: persons of up to 55 years of age who are not employed in public enterprises or public institutions may receive between EUR 2,500 to 12,500, and legal persons may receive between EUR 4,200 to 25,000 for a period of 5 years. The grace period is one year with annual interest rate at 2% if the funds are provided, and an annual interest rate of 3% if the funds are not provided. For orderly repayment of loans, different instruments can be used as collateral: promissory notes of the client, first mortgage on real estate and contract surety.

Among the numerous international institutions, the World Bank is one of the most important sources of financial and technical assistance in Serbia. One of the many forms of support offered to SMEs in Serbia is the financing of start-up projects of up to EUR 50,000. SMEs operating for less than 2 years can apply to the European Commission (EC) for financial assistance as start-up projects. These EC loans are available as part of the Entrepreneurship and Innovation Programme (EIP). The approved loan amount can be up to EUR 25,000, and participation is not required. Loans are granted for a period of 1-5 years with a maximum grace period of 12 months. The nominal interest rate is 7.50% and six-months of Euro Interbank Offered Rate (Euribor), or an effective interest rate ranging from 9.72% to 10.09% with a fixed fee at 1-1.5% of the loan. Lien on property acquired through loans is needed when funding start-up projects in this way.

- **Microcredit or Microloans** – Microcredit or microloan is other type of financial service developed in response to the financial needs of would-be entrepreneurs unable to borrow from commercial banks. The "National paper on microfinancing of SMEs in Serbia" deals with the legislative framework on microfinance, the government programme supporting microfinance, major microfinance intermediaries / institutions and models of microfinance of SMEs by precisely differentiating and defining terms microcredit and microfinance (Elia 2006; Erić et al. 2012, 65).

Microcredit is only part of microfinancing. Microfinance includes microcrediting and other services such as microsavings, microinsurance, money transfer, etc (Elia 2006, 70). The first form of microcrediting was conducted by the Grameen Bank in Bangladesh. The Grameen Bank was founded in 1976 by Muhammad Yunus, who was awarded the Nobel Peace Prize in 2006 for contributing to economic development and providing help to millions of poor.

The graph below presents SMEs' familiarity with the concept of microfinance. 36% of SMEs surveyed are not familiar with the concept of microfinance at all, while 20% are mostly unfamiliar with the concept of microfinance.



Graph 10: Distribution of responses to the question: To what extent are you familiar with the concept of microfinance (as the mechanism through which a bank or entities outside the banking or microfinance institutions, provide small loans in relatively informal way)?

Source: Erić et al., *Finansiranje malih i srednjih preduzeća u Srbiji*, Belgrade: Institute of Economic Sciences, 2012, p. 138

29% of SMEs surveyed are partially familiar or unfamiliar with the concept of microfinance, 10% are mostly familiar with the concept of microfinance, and only 5% of SMEs are completely familiar with the concept of microfinance.

3. LEGISLATIVE FRAMEWORK ON MICROFINANCE

Microfinance represents a way of funding that can create new jobs and reduce the proportion of socially vulnerable persons. The current economic situation in Serbia is unsatisfactory, due to high unemployment and a high percentage of the population living below the poverty line. Microfinance is important because it provides funding to the population that have difficulty accessing conventional means of business financing from the banking sector. First of all, microfinance institutions are geared towards providing permanent and sustainable funding to poor entrepreneurs or small companies according to the characteristics of their business. These clients are not able to fulfil the necessary requirements to obtain financial loans in the banking sector, as they are deemed to be high-risk companies with insufficient capital and opportunities to repay the loan. These conditions make it difficult for SMEs to obtain loans from commercial banks. Therefore, SMEs in Serbia face the highest rate for loans in the region. In spite of their growing financial need, SMEs in Serbia lack long-term sources of funding and suffer from the poor compliance range of banks.

The fact that banks have little interest in financing this sector can be found in the problems facing SMEs, the banks' concerns as to repayment of the loan and the high risk of default. According to the 2013 OECD study, the interest rate of loans to SMEs averaged 4% higher than interest rates to large companies because of a lack of funds from commercial banks on the supply side and the high risk of non-performing loans (NPLs) on the demand side. In recent years, commercial banks adapted their range of services to modern market requirements, including the intensive development of the SME sector. Financial instruments such as factoring, guarantee schemes and other alternative forms of financing in Serbia have only just started to develop. Companies are not sufficiently informed about the significance of microfinance. As only a few companies benefited from microfinance, SME development and the development of microfinance in Serbia have been slow.

The absence of a legal microfinance framework is one of the most influential factors in the slow development of microfinance in Serbia. The "Banking Act" came into force in 2010 and regulations in the banking sector were very rigorous. The new law harmonized with European Union (EU) regulations and the characteristics of business in the EU. The previous act, "Law on banks and other financial institutions", was adopted in 2005 and was the first law regulating the banking sector of

Serbia after major political changes. The "Law on banks and other financial institutions" marked the beginning of reforms in the legal system.

Banking legislation regulating banking operations of domestic and foreign commercial banks disabled the functions of microfinance institutions. Current law states that only commercial banks are permitted to accept saving deposits and issue loans to the SME sector in particular. This creates a "partnership" between the existing microfinance institutions in Serbia and commercial banks. Although there are advantages to this type of business, any internal changes in the partner bank leads to re-negotiation and creates new conditions for cooperation between the two organizations. As operating costs were now increased, an interruption in the work of microfinance institutions came about and administrative procedures became even more complicated.

Instead of facilitating loans, the existing legislation required clients to produce the necessary documentation amid limited time and resources. The aforementioned banking act treats microcredit as "cash loans" or "consumer loans" that have to be secured with 122% of the capital, a sum significantly reducing the possibility of distributing funds from microfinance institutions (MFIs) (Popović-Pantić 2012, 1-270).

The aforesaid problems indicate that the development of microfinance in Serbia is slow and difficult. Since there is no legal framework implementing microfinance support, the "Strategy for the Development of entrepreneurship and the SME sector in 2014-2020" was designed to remove administrative barriers and improve the legal framework. The new strategy aligns with elements of the "May 2011 Commitment", which seeks to improve the competitiveness of SMEs. The absence of legislation resulted in the inadequate development of microfinance in Serbia.

The estimated effects of establishing adequate and effective legislative framework for microfinance in Serbia would be as follows (Government of Republic of Serbia 2014):

- Poverty reduction (65% of users will be lifted out of the poverty),
- Self-employment and job creation for the poorest,
- Reduce dependency on social welfare,
- Increase in government revenue due to the development of the SME sector,
- Promotion of regional development.

4. GOVERNMENT PROGRAMME SUPPORTING MICROFINANCE

High levels of unemployment and poverty prevented a number of Serbians from accessing the credit products of commercial banks. In order to stimulate self-employment and promote the entrepreneurial spirit, the government of the Republic of Serbia has developed a range of instruments that would provide the necessary funding either directly or through creditworthy lending entities.

The institutional framework for the financial support of SMEs in Serbia derive from public sources through grant funds or through competitive loans offered by the Ministry of Economy and Regional Development, the Development Fund of the Republic of Serbia, the Development Fund of AP Vojvodina, the Guarantee Fund of the Republic of Serbia (independently operated in 2003-2009 and annexed to the Development Fund of the Republic of Serbia in 2009), the Guarantee Fund of AP Vojvodina, the Agency for Insurance and Financing Export, Agency for Foreign Investments and Export Promotion, and the National Employment Service. Provision of financial support to SMEs through the aforementioned institutions is regulated by the following laws and regulations: the Budget Law (under the Official Gazette of the Republic of Serbia No. 110/2013), Law on Public Agencies Act (under the Official Gazette of the Republic of Serbia No. 18/2005 and 81/2005), the Development Fund of the Republic of Serbia (under the Official Gazette of the Republic of Serbia No. 36/2009, 88/2010 and 119/2012), the Law on the Guarantee Fund of the Republic of Serbia (under the Official Gazette of the Republic of Serbia No. 55/2003) etc.

The various programmes and grants for SMEs only partially reduced vulnerable entities' and individuals' access to finance problems. In the current macroeconomic circumstances, national economic development programmes are still the largest form of financial support to SMEs, registered farmers, households and unemployed. According to macroeconomic indicators, this is unacceptable for two reasons.

The first reason is stated in the document, "Financing the growth of small and medium-sized enterprises". That document was based on research conducted by USAID in 2012, and it specifies the current disadvantages of state financial support to SMEs, namely:

- Programmes of support were not integrated into the strategic documents of the Republic of Serbia, causing inconsistency in the implementation of the various plans,
- Too large diversification of financial instruments,
- Lack of transparency in communication with the SME sector,
- Under-utilization of existing banking infrastructure in all commercial banks.

The second reason lies in the fact that providing funds for self-employment and entrepreneurship from the Serbian budget is unsustainable in the long run. It is unsustainable because of the growing budget deficit in the near future. The role of the government is to facilitate, rather than direct services to microcredit. In order to maintain macroeconomic stability, the government should avoid limiting interest rates, and not offer unsustainable, subsidized loan programmes (often with a high degree of omission) that deform the market for banks and microcredit providers (Gies 2010, 83). In accordance with recommendations for improving the financial support of the SME sector, emphasis should be placed on the importance of microfinance. The government of the Republic of Serbia should also develop a strategic document to implement:

- Improvement of the enforcement procedure (protection of lenders is vital to a healthy credit environment, whether they are classic or microcredit loans),
- Simplification of financial regulations for the activities of SMEs,
- Development of alternative sources of financing for SMEs (development of non-bank financial institutions as an alternative form of financing),
- Analyze the suitability of banks' financial products for the needs of the SME sector,
- Strengthening services that provide support to lending and increasing their availability (development of quality expert witnesses, property appraisers, integration of all information from financial institutions in a single database).

The government of the Republic of Serbia should play a major role in creating an environment to ensure that microfinance institutions survive, grow and develop. But the government must not be the only option for credit incompetent entities seeking funding. Developing a legal framework that would allow non-depository institutions to issue non-bank loans would attract foreign direct investment, enable job creation and strengthen the entrepreneurial spirit.

Experience shows that private providers of microcredit are much more effective than the state government, and that the "profit microcrediting" model is superior to "non-profit models" (Ibid). According to good practice, the government of the Republic of Serbia should provide macroeconomic stability and create an environment for the development of profitable providers of microcredit. Such an environment is characterized by servicing clients without additional funds from donors or government subsidies. Economically weakened Serbia, which is not in a position to develop a non-profit microcredit sector, should invest all efforts in encouraging the development of microfinance institutions in the private sector.

5. MAJOR MICROFINANCE INSTITUTIONS IN SERBIA

The absence of legislation has resulted in the inadequate development of microfinance in Serbia. Development of several microfinance institutions (MFIs) in Serbia stemmed from the banks' unwillingness to lend money to certain sectors of society. MFIs provide credit support to low-income families, start-ups and microenterprises. The existing microfinance institutions in Serbia perform their activities through banks. MFIs give the available funds to the banks through the commission. Banks issue loans, while microfinance institutions perform all other tasks related to finding clients, technical application processing, control of use of loans etc. These institutions perform most of the activities in the process of loan granting. Banks formally appeared as credit providers due to legal restrictions (Erić et al. 2012, 141). The following MFIs operate in Serbia: MicroFinS-DBS, AgroInvest Holding and Micro Development Limited.

- **MicroFinS-DBS** is a microfinance institution founded in 2007. Its main activity includes microcrediting people who are self-employed and classified as entrepreneurs. To meet the financial needs of entrepreneurs throughout Serbia, MicroFinS-DBS has several offices: Belgrade (main office), Šabac, Subotica, Novi Sad, Sombor, Kikinda, Pančevo, Kragujevac, Čačak, Jagodina, Kruševac and Kraljevo. This MFI currently employs 30 workers. In the near future, MicroFinS-DBS plans to expand its business to other cities in Serbia in need of financial assistance.

MicroFinS-DBS grants microcredit to clients with good business ideas but lack the money to start up a new business or expand their existing ones. Loans are dispensed in cooperation with selected commercial banks. It is paid in dinars to the customer's account in the bank. Loan repayment is the same through the repayment period. This is especially good for entrepreneurs who can plan their cash flow and create market development strategy.

MicroFinS-DBS' loan officers have an obligation to conduct interviews with each candidate before approving the submitted application. In this way, officers evaluate the quality of business ideas, current business environment and future development. Also, the officers visit clients in the field, make estimates of their business sustainability and check the data provided in the application form. After determining the veracity of all information, loan officers will present all loan requirements to the credit committees. The documentation can be forwarded to a commercial bank for payment if the loan is approved. All credits issued are based on the deposit model. MicroFinS-DBS may request the cancellation of the contract and refund the total amount of the loan before the deadline. Cancellation may occur if there are irregularities such as violations of the requirements of the Loan Agreement or incorrect data in the application form.

- **Micro Development Limited** is a microfinance institution satisfying the financial needs of small entrepreneurs and the poor for the improvement of socio-economic and living conditions in Serbia. It was founded in 2009. After 6 years in business, it now employs 19 workers. It is one of the most experienced microfinance institutions in Serbia. It took over operations from the "Fund for micro development" and continues to realize many funding projects. It operates in 14 municipalities in central and southern Serbia, and has created a more balanced regional development in 2014. Since 2013, Micro Development has been a member of the European Microfinance Network (EMF). Funding sources for microcredit programmes are the United Nations High Commissioner for Refugees (UNHCR), the International Committee for the Red Cross (ICRC), the Danish Refugee Council in cooperation with the Danish International Development Agency (Danida) and the United Nations Human Settlements Programme (UN-HABITAT).

The development goals of Micro Development are poverty reduction through the inclusion of vulnerable groups in society, small business development and job creation. Its specific goals are providing income, improving the quality of housing and education for poor people, refugees and gypsies. It is also committed to providing sustainable financial access and services to groups with limited access to formal financial institutions. These groups are mostly entrepreneurs and small businesses for whom funds for business development are extremely limited. Commercial banks are unwilling to issue loans to these groups because they do not represent a sufficiently attractive and reliable segment for funding. For these reasons, the microloans are customized for such categories of enterprises. Loans can be granted for the purchase of fixed or variable working capital and for starting up a new job. A simple procedure for obtaining a loan reduces administrative barriers, and saves time and money. The applicants include entrepreneurs, unemployed persons and farmers. The approved loan is paid in dinars, not indexed and come with a fixed interest rate during the repayment period.

- **AgroInvest Holding** is a branch of Vision Fund International. Vision Fund International operates institutions in 42 countries and has a total portfolio of USD 373 million, 626,000 clients and a 96.7% rate of loan repayment. This institution started operating in Montenegro in 1999. The business expanded to Serbia in 2001. Today, it employs 147 workers.

The primary goal of this MFI is the progress of the economy, reducing poverty and increasing employment in underdeveloped areas. AgroInvest Holding is an intermediary between the commercial banks and the small businesses experiencing difficulty in direct access to financing. The most popular credit issued are those for the launch and promotion of small business in the areas of trade, services and agriculture, as well as for the reconstruction of industrial and office space. Small businesses become successful enterprises upon using the loans provided because they increased incomes and created new jobs. The services of this MFI are also used by enterprises in several business cycles. AgroInvest Holding's loan programmes are mainly intended for entrepreneurs operating in rural areas because their market position is inferior to those operating closer to the major cities and business

areas. This is the way to achieve a more balanced regional development because equal opportunities are provided to all, not only to selected regions. Income level also influences the selection of the target group, as the unemployed and those with low incomes are prioritized. Besides vulnerable people and entrepreneurs from rural areas, microenterprises with good business ideas and sound development plans can apply for these loans.

The absence of a clear institutional framework regulating operation of microfinance institutions in Serbia is a big obstacle to wider use and promotion of microfinance to small businesses.

6. MODELS OF MICROFINANCE OF SMALL AND MEDIUM ENTERPRISES

Microfinance institutions have consultants to help each client understand the loan terms, fill out questionnaires, prepare a business plan and prepare the necessary documentation. Microfinance institutions approve the loan if the client successfully implements all the pre-preparatory actions and his business idea is economically justified. The final decision on granting credit is made by the cooperative bank. Microfinance institutions will monitor and control appropriate use of funds after payment of the loan and the beginning of its use.

The process of granting microcredit in Serbia is carried out in several steps (Erić et al. 2012, 141):

- Contacting microcredit organizations and getting information on the conditions for granting loans,
- Creating business plans and filling out the questionnaire with the assistance of an MFI expert,
- Conducting a preliminary assessment on the customer's viability and creditworthiness,
- Apply for a loan,
- Loan approval and its payout by the intermediary commercial bank and
- Monitoring and consulting microfinance institutions.

Three microfinance institutions operate in Serbia. A detailed overview of the products of each of them will be presented. MicroFinS-DBS offers microloans ranging from RSD 50,000 to RSD 200,000 with equal interest rates and a repayment period of 9-24 months. These loans can be used in diverse ways. The primary goal is the improvement of living standards, and the development of private initiative and entrepreneurial spirit. The process of applying for loan is simple and fast. The client has to provide a report confirming his creditworthiness and associated guarantees to the Credit Bureau. The minimum loan amount is RSD 50,000 and the maximum loan amount is RSD 200,000. The collateral is dependent on the loan amount. It is necessary to provide a minimum of one guarantee from a guarantor working in the public sector if the loan amount does not exceed RSD 160,000. It is necessary to provide a minimum of two guarantees from guarantors employed in the public sector if the loan amount ranged between RSD 160,000 and 200,000. MFIs' management considers this type of loan collateral very good because the stability of jobs in the public sector is better than jobs in the private sector.

Loan products	Amount of credit - RSD	Repayment period - month	Interest rate	Annuity - RSD
1	50,000	9	3.29%	6,508
2	50,000	12	3.29%	5,110
3	80,000	9	3.29%	10,415
4	80,000	12	3.29%	8,177
5	100,000	12	3.29%	10,221
6	100,000	15	3.29%	8,553
7	110,000	15	3.29%	9,409
8	110,000	18	3.29%	8,195
9	120,000	15	3.29%	10,265
10	120,000	18	3.29%	8,940
11	160,000	18	3.29%	11,920
12	160,000	24	3.29%	9,745
13	170,000	18	3.29%	12,665
14	170,000	24	3.29%	10,354
15	180,000	18	3.29%	13,410
16	180,000	24	3.29%	10,963

17	200,000	24	3.29%	15,226
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Table 11: Summary of microcredit products from MicroFinS- DBS in 2014

Source: MicroFinS-DBS, online

at http://www.microfinsdbs.co.rs/index.php?option=com_content&view=article&id=6&Itemid=12&lang=sr

Micro Development's interest rate is not shown in this presentation because it is dependent on the commercial banks issuing the loan. Micro Development offers an assortment of financial and non-financial services to support entrepreneurs. This support is presented in Table 12. Non-financial services such as advice are offered as well. These forms of advice are related to the development of knowledge and skills through certifications, creation of business plan development, market researches, marketing advice etc.

Loans product	Amount of credit - RSD	Repayment period - month	Loan purpose	Users
Micro Classic	20,000-500,000	6-36 month	<ul style="list-style-type: none"> • basic or capital funds for small business activities • for other household needs (scholarship, heating, health etc) 	beginners in business, employees engaged in complementary activities, farmer-entrepreneurs
Microentrepreneurs	20,000-500,000	6-36 month	<ul style="list-style-type: none"> • purchase of fix assets, raw materials or • capital funds for business activities 	entrepreneurs who have registered their business for longer than three months, registered farms

Table 12: Summary of microcredit products from Micro Development Ltd in 2014

Source: Micro Development, online at <http://www.mikrorazvoj.rs/kreditni-program>

AgroInvest Holding provides recommendations to partner bank on behalf of the client intent on obtaining a loan. Recommendations are mainly intended to promote small businesses in the areas of production, handicrafts, agriculture, trade and others. Loans are paid in Serbian dinars and are not indexed. A maximum amount of RSD 400,000 can be issued when a customer receives credit in several business cycles. Collaterals are required, regardless of the credit amount. Also required are notes signed by the guarantor, administrative orders on salaries and pensions, banking accounts, pledge on movable property or on agricultural machinery etc.

Loans product	Amount - RSD	Repayment period - month	Loan purpose	Users	Interest rate
Agro Credit	50,000-200,000	6-24 months	<ul style="list-style-type: none"> • Agricultural credit can be used to satisfy the needs of elementary and revolving funds, such as the enlargement of livestock, machinery, fruit and vegetable crops, greenhouses, irrigation systems, hail and other equipment. 	All farmers and agricultural businesses, registered or unregistered farms that have been established for a minimum of one year in rural areas.	2.9956%
Business Credit	50,000-200,000	3-24 months	<ul style="list-style-type: none"> • Purchase of fixed assets and working capital in production, trade and services 	Small entrepreneurs who mostly live in rural areas and	2.9956%

				have a job with potential for development and expansion activities that can provide additional revenue realization.	
Start-up Credit	50,000-200,000	3-24 months	Starting a family business in the country, with the idea of further growth and development of family farms	Clients with the idea for business in rural areas	2.9956%
Consumer Credit	50,000-120,000	6-18 months	<ul style="list-style-type: none"> Agricultural credit can be used to satisfy the needs of elementary and revolving funds, such as the enlargement of livestock, machinery, fruit and vegetable crops, greenhouses, irrigation systems, hail and other equipment. 	All farmers and agricultural businesses, registered or unregistered farms with an established way of producing a minimum of one year in rural areas.	2.9956%

Table 13: Summary of microcredit products from AgroInvest Holding in 2014

Source: AgroInvest Holding, Online at <http://www.agroinvest.rs/agroinvest/index.php/sr/nain-rada/nai-proizvodi-srbije>

The general characteristics and product range of MFIs in Serbia are summarized as follows (Erić et al. 2012, 140):

- Easy access to credit without administrative procedures and conditions,
- Loans are for entrepreneurs and microenterprises intending to start a business and can be approved in very small amounts not exceeding EUR 5,000,
- Microcredit institutions lend money to clients in Serbian dinars and are not indexed, thus eliminating the currency risk for the client,
- Microcredit institutions are characterized by high rates of loan repayment (over 95%). This is a result of strong relationships with clients, as well as care and support to the development of their business activities,
- Microcredit organizations provide various types of assistance and support to their clients through education, training, better communication and cooperation This provides higher repayment rates in loans granted,
- Microcredit institutions show a high degree of social responsibility,
- Microlending is not regulated by law. Due to this fact, microcredit institutions are forced to operate through commercial banks that charge high rates for their services. It directly affects the interest rate of microcredit and increases the cost of borrowing.

The survival of microfinance institutions and their wide product range in Serbia proves that banking profits can be realized even in association with high-risk clients. MFIs can be further developed, if the state creates an adequate legal framework. An adequate legal framework will regulate microfinance activity and allow Serbian MFIs to operate like other MFIs in Europe. Developing the legal framework for MFIs will contribute to the development of entrepreneurship, the SME sector and overall economic progress.

CONCLUSIONS

When modern businesses discover that funds necessary for operating activities are scarce, they often turn to banks and other financial institutions for loans. Therefore, it is important for banks and other financial institutions to develop various forms of financial instruments and allow customers access to the necessary funds. At the same time, the government should support the idea of making financial assistance available to all by developing economic policy instruments to stimulate entrepreneurship and the growth of small businesses. SMEs, identified as a key player in economic development, cannot borrow under the same favourable terms as major economic entities. Therefore, they are often subjected to high interest rates or additional security conditions before they are issued loans.

Microfinance has been identified as a suitable means of financing companies. It is primarily intended for small businesses and start-up entrepreneurs. In Europe, the system of microfinance is highly developed and there are microfinance organizations offering their customers favourable loans or consultation for better business development. The aim of this paper is to analyze microfinance activities in Serbia, the degree of its development and applicability in its economy. Although we expected domestic SMEs to be familiar with the concept of microfinance, the reality is that few companies are aware of microfinance and its benefits. Serbian SMEs' unfamiliarity with microfinance is not due to lack of interest in management, but the lack of development in microfinance activities. The concept of microfinance in Serbia is still not operational. Although there are three microfinance institutions whose primary purpose is loan approval and cooperation with SMEs, the legal framework has not predicted their existence. According to the "Law of the banks and other financial institutions", banks have absolute power in the financial markets and only they can gather deposits and extend loans in the economy. In other words, microfinance activities are not legally allowed. This presents an obstacle to the development of small businesses, entrepreneurs and the economic development of Serbia.

If the government would adopt a legal framework enabling the development of microfinance in the near future, the effects would be different. Such a legal framework would not only encourage more SMEs to do business and reduce poverty. It would encourage self-employment and the development of innovation. It would establish social equality and growth in government revenues due to regular payment of liabilities. It would also decrease the grey economy and establish balanced regional development.

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3.11 MICROCREDIT STRATEGIES FOR SMALL AND MEDIUM-SIZED ENTERPRISES IN TURKEY IN THE EUROPEAN UNION HARMONIZATION PROCESS

by

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ABSTRACT

Microcredit is regarded as an instrument capable of increasing employment and enhancing income in socio-economically depressed areas through the provision of financial support to micro and small enterprises that are mostly founded and run by families. Due to the effects of the recent economic crises, entities unable to utilize the services of traditional financial institutions turned to microcredit systems. This study analyzes the microcredit facilities in the EU that have been established for SMEs. It will also discuss the applicability of these facilities in Turkey by using the data from previous and ongoing microcredit programmes in Turkey. The study is unique as it presents updated information on Turkey's microcredit experiences in comparison to EU practices. The study concludes with some strategies that Turkey may use to increase the efficiency and sustainability of SME microcredit programmes in the country.

Keywords: microcredit, Turkey, European Union, SMEs

JEL classification: G21, L26

1. INTRODUCTION

Small enterprises, new or existing, often face certain problems in approaching finance providers for both enterprise fixed capital investment and working capital. The insufficient supply of microloans is a major issue, particularly for business creators who are unemployed, women or from ethnic minorities. Supporting the supply of microloans is therefore not only an issue of entrepreneurship and economic growth, but also one of social inclusion.

Well-functioning microfinance systems are vital for the prosperity of people from all income levels, as well as the long-term growth of vibrant national economies. In least developed countries (LDCs) where the majority of citizens hover at or around the poverty line, governments can generate and encourage the growth of domestic capital resources by fostering efficient intermediation of small amounts of money. Creating efficient systems that formalize microfinance services allow for greater circulation of funds and higher rates of investment.

The microcredit experiences in the European Union (EU) are shaped by increasing the competitiveness of small and medium-sized enterprises (SMEs). The EU's microcrediting efforts have also always provided a more generous budget than conventional microcredit schemes. Therefore, microcredit is regarded as a business-oriented financial injection for the development of disadvantaged groups in society. Initially, the EU used microcredit as a facilitating tool to achieve the objectives of the Lisbon Agenda. However, EU society experienced two major undesired and adverse developments, namely: ageing society and migration. These two developments resulted in the European Commission (EC) taking the essential measures to redefine the scope of microcredit. In 2007, the EC published its Communication on microcredit whereupon it was re-introduced as a fundamental tool to hinder unemployment and poverty. This Communication paved the way for further developments in microcredit schemes in the EU and created the basis for new funding schemes. However, the most important feature of the microcredit system is its stimulating role in the establishment of new businesses to counteract the devastating effects of the financial and economic crises. In the last decade, strategies aimed at directly impacting society have become more popular. These strategies highlighted the considerable contribution of microcredit systems in the EU.

Microcredit applications have been rapidly increasing in Turkey, especially after the success of the microcredit phenomenon of Muhammad Yunus, the Nobel Laureate. For instance, non-governmental organizations (NGOs) such as the Turkish Grameen Bank Microcredit Project (TGMP), Community Volunteers Foundation (TOG), Foundation of Valuing Women's Labour (KEDV), and Maya Enterprise for Microfinance and its microfinancing applications have become effective in the last few years. Both economic and humanitarian contributions to sustainable development were the aims of microcredit projects.

In Turkey, it is expected that the approval of the Draft Law on Microfinance Institutions (in line with the country's EU harmonization process) would lead to a considerable increase in the number of the microcredit programmes available to SMEs. The first draft law (dated the 22nd Legislative Term of the 2nd year on 26 May 2004) was initiated in 2004, but was withdrawn afterwards. The second draft was proposed in 2005 in the 22nd Legislative Term of the 3rd year on 23 March 2005. As this was not submitted to the sub-commission, the second draft of the law was unsuccessful too. In 2007, the proposal for the establishment of a microfinance institution came to the commission, but was not mooted in Parliament.

This study will analyze the EU microcredit facilities established for SMEs and discuss the applicability of those facilities in Turkey by using the data from previous and ongoing microcredit programmes in Turkey. The study is unique as it presents updated information on Turkey's microcredit experiences in comparison to EU practices. The study concludes with some strategies that Turkey may use to increase the efficiency and sustainability of SME microcredit programmes in the country.

2. MICROCREDIT IN THE EUROPEAN UNION: A FINANCIAL ASSISTANCE INSTRUMENT FOR MICROENTERPRISES

2.1 Development of Microcredit in the European Union

The EC's 2007 Communication, "A European initiative for the development of microcredit in support of growth and employment", provided a detailed definition of microcredit. Microcredit is defined as the extension of very small loans (microloans) to entrepreneurs, social economy enterprises, employees who wished to become self-employed, people working in the informal economy, the unemployed and others living in poverty who are not considered bankable (European Commission 2007a: Annex 1). The European Commission estimated that the potential demand for microloans for EU-27 was €6,145 million or 712,900 loans. As of 2007, the EC identified three large Microfinance Institutions (MFIs) dominating the market. These are ADIE (France), Finnvera (Finland) and Fundusz Mikro (Poland), which were founded before 1996. In 2005, those three actors supplied 70% of the 27,000 loans disbursed. According to this Communication, 65% of MFIs disbursed no more than 100 loans annually and the average loan amount was EUR 7,700, with wide variations (€10,240 in the EU-15 and €3,800 in the new member countries). The average repayment rate was 92% and over half the MFIs offered parallel advisory and training services (European Commission 2007).

Parallel to the findings of the Communication, the European Investment Fund (EIF) assessed that there were 11 million potential customers in the European microfinance market. EIF categorized four major trends in the demand for microfinance:

- the demand of microloans has had a positive impact on small enterprises,
- the demand for job creation support to avoid unemployment and exclusion,
- the demand for funds to maximize the contribution to the informal sector and the public, and
- the demand for micro-social loans to minimize the adherent effects of immigration (Carpenter 2007).

Initially, there were two trends affecting the microcredit system's effectiveness in improving the economic standards of the disadvantaged members of society (Nowak 2007). Those economic trends were mostly due to the increasing role of the service sector in European gross domestic product (GDP). The growth in the service sector's contribution to European GDP is in turn due to the growing use of new communication technologies putting pressure on the development of small production units that were expected to adapt to this novel form of socio-information dynamics. This

first trend was very much related to the Lisbon Agenda of the EU, whereas the second trend focused on the demographic changes occurring in European society, stimulated by the challenges of the ageing population and the increase in immigration. This second trend was part of the EU's social inclusion policies. However, the economic and financial crises changed the whole socio-economic scene, introducing microcredit as an inclusive support mechanism to financially excluded entrepreneurs with minimal investment capital.

In 2010, the EC published a report on microcredit and concluded that the financial crises would likely lead to a rethinking of banking strategies, which could in turn provide opportunities for developing more microcredit products (European Commission 2010a). The report also concluded that the recession could lead to higher rates of business start-up, which could lead to higher demand for microloan products (Ibid).

The worsening of the financial and economic crises urged the EU to employ microcredit to serve 91.8% of the 20 million enterprises in Europe that had fewer than 10 employees (European Commission 2010). Microenterprises are defined as enterprises with less than 10 employees and have a turnover that does not exceed € 2 million (European Commission 2003). 91.5% of Europe's enterprises have fewer than ten employees. That means nine out of every ten non-financial business in the EU are microenterprises. These microenterprises account for about 30% of all jobs and one fifth of value added (European Commission 2007a). They constitute the target group of European microcredit schemes.

In 2010, the European Commission introduced Europe 2020, a strategy for smart, sustainable and inclusive growth with higher levels of employment, productivity and social cohesion (European Commission, 2010b). Under Europe 2020, microcredit has become one of the key financial tools through which small businesses can improve welfare. It is also a means of establishing financial and social inclusion. The Europe 2020 Policy Framework Objectives for 2014-2020 require Member States to devote public resources to economic development and social cohesion (Leone and Porretta 2014).

The European Commission launched Progress Microfinance Facility (Progress Microfinance) in 2010 in order to increase the availability of microcredit (defined as loans below € 25,000) to individuals setting up or developing a small business. In 2014, the European Commission published the Report on the Implementation of the European Progress Microfinance Facility 2013. According to this report, 20,000 entrepreneurs have already benefited from loans and guarantees worth a total of €182 million from Progress Microfinance (European Commission 2014). The report identified Progress Microfinance's significant contribution to job creation through the provision of credit to the unemployed or disadvantaged who are unable to borrow money from financial institutions.

According to Bendig et al. (2014), MFIs based in EU Member States disbursed a total of 207,335 microloans amounting to a total of EUR 1.26 bn in 2013. This is new benchmark from the statistics of 2011 where EU Member States disbursed 122,370 loans amounting to a total of EUR 872 m. Compared to the survey data from 2011, there was an increase of 45% in the total value of microloans and 69% increase in the number of loans in 2013.

2.2 Microcredit Policies and Programmes in the European Union

The microcredit approach of the intra-EU market differs from the traditional understanding of microfinance as a tool to reduce the undesired economic impact of poverty. Instead, the intra-EU market views microcredit as a system through which the competitiveness of microenterprises can be improved. Even though the EU's Microfinance Framework Programme supports microfinance in African, Caribbean and Pacific countries, there is no equivalent programme in Europe (Carboni et al. 2010, 4). Loans of up to € 25,000 are granted to microenterprises through microcredit programmes in the EU. Today, in the EU, microcredit is utilized as an instrument of economic and social inclusion, and constitutes an integral part of the Cohesion Policy, which is described as a dynamic investment policy aimed at promoting long-term sustainable growth in European regions through the removal of barriers to growth and facilitation of structural adjustment (European Commission 2012).

The EU perceives microcredit schemes as a way of encouraging social inclusion and entrepreneurship through self-employment. As a result, EU microcredit schemes target women and minorities. In the EC Communication, "A European initiative for the development of microcredit in support of growth and employment", microcredit is defined as the extension of very small loans (microloans) to entrepreneurs, social economy enterprises, employees who wish to become self-employed, people working in the informal economy, the unemployed and others living in poverty who

are not considered bankable. Although this definition of microcredit is based on social objectives, the European definition had been deliberated upon by a high density of banks and is dependent on a segmentation of the market (Nowak 2007).

Before microcredit schemes can be implemented in the EU, Member States are required to improve their legal and institutional environments. In so doing, the economic climate further changed in favour of entrepreneurship and best practices, including training and additional financial capital for microcredit institutions. Microfinance for small enterprises is one of the major instruments for the renewal and growth of the business population; it also strengthens entrepreneurship in Member States and Candidate Countries (European Commission 2004). The applicability of microcredit schemes in Europe provided different roles for Eastern and Western European countries. Eastern European countries' policy motivation for microcredit derived from an actual economic need to achieve an operationally self-sufficient private microfinance system for building a coherent market economy, whereas microcredit is promoted in Western Europe as a means of achieving socio-economic goals such as encouraging self-employment, especially among the disadvantaged (Carboni et al. 2010, 4).

Today, there are three main drivers of the microcredit schemes in the EU:

- i) enabling an institutional environment for microcredit and microenterprises,
- ii) financing microcredit institutions through grants and market resources so as to enable them to become sustainable in the long-term, and
- iii) the extension of best practices.

There are some EU initiatives that could be categorized as microcredit. The Multiannual Programme (MAP) 2001-2006 was one of the first activities aimed at enhancing the growth and competitiveness of businesses in a knowledge-based internationalized economy, promoting entrepreneurship, simplifying and improving the administrative and regulatory framework for businesses so that research, innovation and business creation in particular can flourish (European Council 2005). It also worked at improving the financial environment for business, especially SMEs; making it easier for businesses to access community support services, programmes and networks; and improving the coordination of these facilities (Ibid). MAP had a special focus on promoting microfinance and included a specific support initiative for microfinance institutions (MFIs) in the EU. This support initiative was the Microcredit Guarantee Window, and it was delivered by the European Investment Fund (EIF) in cooperation with the Commission (European Microfinance Network 2008). MAP contributed to the microcredit system by introducing the microcredit window of the SME Guarantee Facility.

The SME Guarantee Facility (SMEG) was a part of the Entrepreneurship and Innovation Programme as one of three schemes under the Competitiveness and Innovation Framework Programme. SMEG's microcredit guarantee window was established with the aim of reaching even more SMEs than its predecessor under MAP. It was managed by the EIF on behalf of the European Commission. MFIs that wished to participate in the programme could apply to the EIF. SMEG was founded to encourage financial institutions to play a greater role in the provision of small loans; so doing would enable financial intermediaries to receive grants to partially offset the high administrative costs inherent in microcredit financing (Budavari 2006). The Loan Guarantee Facility (LGF) is the successor of SMEG, and it was successfully implemented by EIF under the Competitiveness and Innovation Framework Programme (CIP) in 2007-2013. CIP offered microcredit guarantees through financial instruments managed by EIF. LGF is part of the programme for the Competitiveness of Enterprises and Small and Medium-sized Enterprises (COSME) and aimed to support European enterprises' growth, and research and innovation (R&I) through guarantees and counter-guarantees, including securitization of SME debt finance portfolios to selected financial intermediaries to help them to provide more loans and leases to SMEs (EIF 2014).

The Joint European Resources for Micro to Medium Enterprises (JEREMIE) is a joint initiative of the EC and EIF. It promotes the use of financial instruments to improve SMEs' access to finance via Structural Funds interventions (European Commission 2012). JEREMIE enables the regional and local European Regional Development Fund (ERDF) managing authorities to transform some parts of their budget into loan capital, which can then be assigned to selected potential financial intermediaries, including microcredit institutes. The JEREMIE scheme for 2007-2013 provided the framework for a series of coherent financial actions aimed at improving the financial environment for small businesses at the national, regional and local levels by increasing small businesses' access to

finance (<http://www.eif.org/jeremie> 2008). Through risk capital, JEREMIE also enabled economic growth and competitiveness.

The Joint Action to Support Microfinance Institutions in Europe (JASMINE) is a joint initiative of the EC, the European Investment Bank (EIB) and EIF. It was developed within the framework of JEREMIE in 2007. Since 2010, JASMINE aims to enhance the capacity of non-bank microcredit providers and microfinance institutions in various fields such as institutional governance, information systems, risk management and strategic planning (Lopriore and Pati 2012, 45). Its objectives are to disseminate good microlending practices in the EU, support the development of microcredit providers active in the EU in various fields such as institutional governance, information systems, risk management and strategic planning (capacity building), and assist these intermediaries in becoming sustainable and viable commercial operators. The JASMINE Technical Assistance Facility concentrates on microcredit providers, while making financing available to microcredit providers through the EIF managed European Progress Microfinance Facility (Jasmine website 2014).

The European Progress Microfinance Facility (EPMF) provides microcredit to small businesses and people who have lost their jobs and want to start their own small businesses. It makes financial resources available to eligible intermediaries so as to enhance microenterprises' access to finance. The Progress Microfinance investment period ends in April 2016 (EIF website 2014a). According to EIF sources, over EUR 100 million has been made available to 21 different microcredit providers in 15 countries across the EU, amounting to nearly 50% of the funds available under the European Progress Microfinance Facility (EIF website 2013). For the budgetary term of 2014-2020, Progress Microfinance is estimated to have a budget of approximately EUR 200 m that microcredit providers and institutions would utilize to make more loans available, help the development of social investment market and improve social enterprises' access to financing (European Microfinance Network 2014).

2.3 The Regulation of Microcredit in Europe

The regulatory environment provides the crucial backbone of the microcredit system. The regulation of microcredit promotes safe and sound financial service provision, guards against systemic risks, establishes a competitive market, improves access and protects consumers (Lauer and Staschen 2013). There is no given official legislation for microcredit in the European Union as a part of the European *acquis communautaire*. The Legislation *vis-à-vis* microcredit (and the institutions that provide microcredit) varies in the various Member States and Candidate Countries. The EC's Expert Group Report on the regulation of microcredit in Europe states that there are two types of microcredit institutions: banks and non-banks. Where the institutional rules on interest rate caps, tax and other issues affect both banks and non-banks that provide microcredit, EU law forbids microcredit providers from deposit-taking and lending without regulation. Even though some Member States have adopted stricter approaches to lending, many countries do not have any specific regulations on the legal establishment of non-bank providers (European Commission 2007a).

3. MICROCREDIT IN TURKEY

Microcredit has become a topic of interest in recent years. The Governor of the Central Bank of the Republic of Turkey, Erdem Başçı, emphasized the importance of microfinance initiatives in his speech at the Istanbul Finance Summit in September 2011. In April 2012, a global microfinance forum was held in Istanbul. It brought together fund managers, social investors as well as representatives from microfinance institutions and development agencies. At this forum, topics such as the role of government in microfinance, new products and technological innovations, risk management and adherence to the dual bottom line of social investment were discussed (Dincer 2013). The inauguration of the Muhammad Yunus International Centre for Microfinance and Social Business by Okan University in Istanbul was another academic contribution to the microfinance environment. As interest in microfinance grew in Turkey, international organizations such as International Finance Corporation (IFC), the European Investment Bank (EIB) and the European Investment Fund (EIF) launched partnerships with financial institutions in Turkey. The United Nations' (UN) recognition of 2012 as the International Year of Cooperatives also served as a global initiative for microfinance. Despite this interest in microcredit, Parliament continues to stall over the ratification of the Draft Law on MFIs in Turkey – a bill that has been repeatedly brought to it since 2007.

The demand for microcredit in Turkey is commensurate with its level of poverty. The number of people living in absolute poverty in Turkey is relatively low. The percentage of poor individuals

living below USD 4.30 per capita per day is 2.06% (TUIK 2013). On the other hand, vulnerability to poverty remains high. Income distribution in population and regions are highly disparate. Micro and informal sector activities play an important role in protecting the vulnerable population from poverty. Access to microfinance services helps decrease vulnerability by enabling people to take advantage of economic opportunities that would allow them to diversify and increase their sources of income.

Micro and small business in Turkey are a visible and productive part of the Turkish economy. According to the 2011-2013 SME Strategy and Action Plan, SMEs account for 99% of all enterprises in Turkey. They employ 78% of the total workforce and produce 56% of all exports. They produce 55% of the total economic value added and contribute to 65.5% of total sales (KOSGEB 2011). Banking Regulation and Supervision Agency data (2014) shows that as of December 2014, SME credit constitutes 27% of the total credit pool. SME credit for microenterprises reached TRY 88 bn in 2014, significantly increasing from TRY 28 bn in 2009.

Even though SMEs are not directly targeted by microcredit programmes, they are most likely to avail themselves to microcredit schemes. There are few funding schemes that may be considered microcredit, as they do not generally apply to microenterprises. However, they are categorized as finance mechanisms for microenterprises. Turkey has taken numerous steps to foster entrepreneurship through microcredit tools. Several institutions provide microfinance support through grants or loans. The Ministry of Science, Industry and Technology's Techno-Initiative Capital Support Program assists individuals with bright ideas and operates in technological development zones. The Scientific and Technological Research Council of Turkey (TUBITAK) has announced a multistage entrepreneurship support programme to stimulate innovation and transform them from ideas to finalized commercial product. TUBITAK's programme focuses on releasing prototypes of products. The SME Development Organization of Turkey (KOSGEB), coordinated by the Ministry of Science, Industry and Technology, is another institution that has branches in every province of Turkey. KOSGEB aims to increase SME capacity and boost entrepreneurship by allocating microcredit to successful applicants. Each institution mentioned above offers up to TRY 100,000 in credit. The financing tools available to microenterprises include grants, co-financing opportunities and interest-free loans.

3.1 Microcredit Supply in Turkey

There is a very limited supply of microfinance services in Turkey, both in terms of the number of people served and the range of services offered. Local funds for microcredit purposes in Turkey come from state-based financial supports, commercial loans and savings, and capital increases. (Sakarya 2005). Currently, state-owned banks, Halkbank and Ziraat Bank, are the primary suppliers of microfinance services. The legacy of directed and subsidized credit programmes, however, has rationed the delivery of credit through these channels, and resulted in supply-driven products and services that do not respond well to the financial service needs of clients. In contrast to most early stage microfinance sectors, NGOs are virtually absent from the market in Turkey. Several are experimenting with microcredit delivery at this time, such as the Grameen Bank initiative in Diyarbakir and Maya Enterprise for Microfinance. There is no clear policy for facilitating the access of the unbanked majority of the population, entrepreneurs of small businesses or those in formal financial sector. There is a continued lack of clarity in government policies regarding microfinance and there is no common understanding of microfinance amongst the government, NGOs and private sector. Microfinance activities in Turkey are mostly government incentives or tools for income generating activities.

The largest players in the microfinance sector in Turkey are the state-owned banking institutions, Halkbank and Ziraat Bank. Nearly all microfinance loans from formal operators are supplied by these state-owned banks. Halkbank provides loans to about 130,000 micro and small enterprises registered with the Confederation of Turkish Tradesmen and Craftsmen (TESK). Average outstanding loans are approximately USD 1,600. Given that these borrowers are registered in the formal sector and can meet collateral requirements, they are likely to be among the better off in the target market. It is likely that nearly 100% of these loans go to men. On the other hand, Maya provides loans to 200 female microentrepreneurs in the informal sector. Average loan sizes are about USD 350. As can be seen, Maya reaches a different market segment than Halkbank. The total demand for microfinance services in the non-agricultural sector is conservatively estimated at 2 million clients. Supply estimates as of the end of June 2014 shows that only 130,000 clients had their demands met. Ziraat Bank serves nearly 2 million clients in the agricultural sector, although more than 50% of these loans are non-performing or restructured. Given the high number of non-performing loans, it is unsurprising to find that few, if any, new loans are disbursed. Since very few loans are

currently disbursed, it is likely that a significant percentage of the agricultural market remains unserved. Currently, poor clients and informal sector businesses, especially women, are unable to access loans through the formal sector (Burritt 2003).

Although there is no explicit regulation in the field of microfinance applications, new microcredit opportunities to improve the income of the poor in Turkey are mostly provided through the initiatives of international organizations like the United Nations Development Programme (UNDP) and World Bank. One of the most recent projects is the Golden Bracelet Project, which is supported by the Young Professionals and Businessmen Association (GYİAD), Turkish Economy Bank (TEB) and UNDP. The project aims to provide microcredit to young entrepreneurs between the ages of 18 and 35. The project is unique in that it specifically targets youths. The project, called Altın Bilezik (Golden Bracelet), aims to provide credit of USD 10 m to 500 young entrepreneurs within the next three years. Female entrepreneurs, vocational high school and college graduates will have priority in the project. TEB will supervise and fund the project, while UNDP will provide technical staff and GYİAD educational support.

Grameen Bank has contributed to the regional implementation of microcredit instruments by concentrating on the underdeveloped regions of Turkey. Of these, the Grameen Bank initiative in Diyarbakir is the most notable. At the end of 2012, there were 6 microcredit offices in Diyarbakir. Of the 8,321 members in the 6 microcredit offices in Diyarbakir, 6,418 benefitted from this programme. Main findings of the analysis conducted by Burtan Doğan and Kaya (2013) show that the beneficiaries are generally between 35-44 years old, primary school graduates and married. However, the applications peaked in 2009 and have been slowing down since. Borrowers cite “economic strengthening” as their main motive for using microcredit. In Sakarya, Grameen Bank focused on female entrepreneurship and has received positive feedback. It is observed that women using microcredit in Sakarya are generally happy about this practice, as it led to significant positive effects in their economic and social lives (Oz and Colakoglu 2014).

3.2 The Regulation of Microcredit in Turkey

There are a few main laws and normative acts regulating the banking sector in Turkey. These are Banking Law No. 5411, Banking Act No. 4839 (June 1999) later amended by Act No. 5020, Capital Market Law No. 2499 (July 1981), Regulation on Capital Adequacy Official Gazette No. 24657, and Regulation on the Establishment and Operations of Banks Official Gazette No. 2445. These laws provide the essential banking acts in Turkey. The most recent development in the regulation of the Turkish microcredit system is the Draft Act on Microfinance institutions. If this act is passed in parliament, new legislation will set up a special legal framework that permits foundations, associations, NGOs or other non-bank organizations to provide microfinance services. Currently, NGOs' lending operations are run by independent profit-oriented companies established to comply with Turkish banking regulations.

The draft law permits associations and other charitable institutions to issue loans, but does not clearly provide the provisions of the secondary legislation that will create the legal basis for practice. Financial solvency and other ratios monitored under this regulation are similar to traditional banks, but are more conservative. For example, requirements on minimum capital are lower and capital adequacy is higher. Like traditional banking law, the regulation establishes the products that the bank may offer and sets parameters on ownership structures (Burritt 2003).

In the Turkish case, Article 6 of Law No. 5302 on the Special Provincial Administrations describes the duties and responsibilities of such administrations. This Article obliges these administrations to allocate microfinance to the poor. Other than this, we cannot observe similar regulations on other institutions.

4. CONCLUSION

Demand for microfinance services can be understood from the perspective of micro and small businesses seeking access to finance to fund operations and growth. It can also be approached from the perspective of poor and low income households seeking a range of financial services including loans, savings and other services to invest in businesses, improve their homes, and meet other consumption needs.

Small enterprises, new or existing, often face certain problems when they approach finance providers for both enterprise fixed capital investment and working capital. The insufficient supply of

microloans is a major issue, particularly for business creators who are unemployed, women or from ethnic minorities. Supporting the supply of microloans is therefore not only an issue of entrepreneurship and economic growth, but also one of social inclusion.

The global experience shows that microcredit is utilized in the provision of a broad range of financial services to those excluded from the formal financial system. However, Turkey's policymakers concede that microfinance is a growing field and has the potential to reduce poverty by providing the poor and unbanked with access to financial services. Because microfinance is still not completely understood in Turkey, there has been limited discussion on the subject within the government, the private sector and NGOs. Although microfinance is acknowledged as an effective mechanism in addressing poverty in Turkey, there are questions regarding the relevance and applicability of microfinance for Turkish SMEs.

In traditional banking, microcredit is often perceived as a high risk and low return activity due to the possibility of business failure and the high handling cost of microloans. Additionally, there is a market gap based on information asymmetry, especially in the EU Candidate Countries. In order to facilitate the harmonization process with the EU, Turkey and other Candidate Countries should adopt European microcredit policies. Even though microcredit does not have a special legislative framework in the EU legal system and microfinance regulations are left to the discretion of the Candidate Countries, the EU's microcredit programmes remain committed to providing access to finance to all in its Member States and Candidate Countries. Therefore Turkey, as a Candidate Country, needs to rapidly adjust her policies to the EU's.

In conclusion, the three issues in the current Turkish microfinance environment are: the need for further research, adjusting her policies in line with the EU harmonization process, and the establishment of a regulatory framework for microfinance. Turkey also needs to conduct further research on the issue of microcredit, if it is to identify the major policy areas that need the support of microcredit programmes. Current research is shaped by poverty-oriented microcredit programmes for disadvantaged groups. Special emphasis should be provided for microenterprises as well. As current information on microcredit projects can only be obtained from primary data sources by researchers' individual attempts, there is a real need for a database of microcredit schemes available in Turkey. Secondly, as the EU harmonization process directly affects Turkey, Turkish policymakers should analyze the best practices in the EU in order to adapt the best parts of EU microcredit policies to Turkey. Last but not least, Turkish policymakers should take political implications into consideration and design a dynamic contemporary legal framework that addresses the current environment, identifies potentials, and foresees the requirements of the microfinance system in Turkey.

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MICROFINANCE IN TURKEY: SUPPLY AND LEGAL FRAMEWORK-RELATED PROBLEMS

by

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ABSTRACT

The author highlights microfinance programmes as a new strategy for poverty alleviation. He analyzes the problems hindering the development of the microfinance sector in Turkey. The paper presents the improvements in microfinance and the activities of two autonomous microfinance organizations, namely MAYA and the largest microfinance institution, Turkish Grameen Microfinance Program. The author draws attention to the problems on the legal framework problems and finally calls for the acceptance of the NGO sector in this field.

Keywords: microfinance, Turkish microfinance sector, problems in microfinancing, MAYA, TGMP, Golden Bracelet Project

JEL classification: G21, L26, O16

The second half of the twentieth century had been an era of advanced technology, high economic growth and increasing living standards for a number of industrialized countries, while the rest of the world did not equally benefit from the advantages of neoliberal policy paradigms. During that period, a minority was enriched while the masses were economically dissatisfied. As a consequence, in different parts of the world, particularly in the less developed countries, income inequalities and levels of poverty have risen. International organizations such as the World Bank (WB) and International Labour Organization (ILO) sought to deal with this by placing poverty alleviation on their agendas (Günel and Aytulun 2006, 155).

Microfinance programme as a new strategy of poverty alleviation also emerged at that time. In 1976, the modern concept of microcredit and microfinance were developed by Muhammad Yunus, a Bangladeshi economics professor and Nobel Peace Prize recipient. Today, with the cooperation of governments, non-governmental organizations (NGOs) and the private sector, microfinance provides a variety of financial services to the poor who are excluded from formal financial systems. To this end, credit, savings, remittances and other financial products are utilized to help the poor become self-employed, generate income and reduce poverty (Arasli 2010).

The microfinance sector is important for the Republic of Turkey as well. As an emerging nation, Turkey is in the upper-middle income category, as defined by the World Bank. Its GDP is the seventeenth largest in the world at USD 1.1 trillion in 2012. Moreover, its economy is prosperous relative to its neighbours, and outpaces most developing countries among the Organisation for Economic Co-operation and Development (OECD) members. Despite this success, poverty and unemployment still remain severe obstacles for the sustainable economic development of the country. According to the Gini index, a measure of income inequality, Turkey is the world's 59th most economically unequal country in the world. Moreover, the poverty profile of the country is not very pleasant.

Even though extreme poverty – those living on less than USD 4.30 per capita per day (TUIK 2013) – is not too high (nearly 2.79% of the population, or 2 million people), the Turkish Statistical Institute considers 18% of Turkey's population (12.8 million people) to be "poor" when it comes to household consumption. Owing to the country's chronic budget deficit problem, it would be difficult to reduce poverty through use of public funds. Additionally, global investors may be wary to invest in Turkey because its financial sector had been hard-hit by four financial crises in the last twelve years. Taking all these factors into consideration, microfinance would be most obvious economic policy to undertake in the reduction of poverty (Carter 2013, 28-32).

This paper aims to analyze the problems hindering the development of the microfinance sector in Turkey. Despite the wide variety of problems, this paper only focuses on the problems

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related to the supply of loans and the legal framework. This paper also argues that supply-related problems have been recently alleviated due to some improvements, while legal framework-related problems have yet to be overcome.

1. PROBLEMS OF THE MICROFINANCE SECTOR IN TURKEY

1.1. Supply-related problems

The major problems related to the supply of microfinance loans are as follows;

- Insufficient supply of microfinance services
- Substantial document and collateral requirements for microbusiness credit
- Over-concentration of public and private banks on small entrepreneur financing, and the virtual disregard of microcredit activities for the very poor.
- Low participation of NGOs in supplying microloans to the poor.
- Gender discrimination: lack of female support in microbusiness loans, and few organizations supporting poor women financially.

The microfinance sector of Turkey is still in its early stage of development (Grossmann 2006, 1). First efforts were initiated in 2002 by an NGO. The Justice and Development Party (JDP) government has paid special attention to microfinance by taking proactive steps in improving the sector. A JDP Member of Parliament was inspired by the Bangladeshi experience to start a foundation in association with Grameen Bank (Günel and Aytulun 2006, 160). In the following years, very few microfinance operators have appeared. Because of the limited number of suppliers, the supply of loans is very limited, both in terms of the numbers of people served and the range of services offered (Karataş and Helvacioğlu 2008, 10).

Currently, the microfinance sector in Turkey includes public, private, and non-profit organizations. The non-profit organizations have the most developed programmes, while those run by public and private organizations are usually limited in scope and scale. To illustrate, the Turkish government runs a very small microfinance programme through the Social Assistance and Solidarity Fund (SASF), established in 1986. This fund provides interest-free loans for 5-8 years of TRY 15,000 (USD 7,500) for microbusinesses (Carter 2013, 52-53). The Small and Medium Enterprises Development Organization of Turkey (KOSGEB) was established in 1990 to develop SME competitiveness in Turkey (KOSGEB 2013). These organizations offer grants and low-interest loans to SMEs, but they do not typically target the poor.

In the commercial banking sector, public banks are the largest players in microfinance and SME markets. However, their products do not target the very poor either. Ziraat Bank, the largest public bank in Turkey, mainly focuses on agricultural loans to SMEs. While there are small loans for animal husbandry and farming equipment in its bank portfolio, all such loans require borrowers to present substantial financial documents such as income statements and tax registration information. Halkbank, the second largest public bank, calls itself "Turkey's SME and Tradesman Bank." Even though it provides a number of consumer loans for activities such as education, marriage and new furniture, it focuses on SMEs as well. Even the "Kredimini" loan of the bank, which provides customers microcredit of up to TRY 5,000 (USD 2,500), requires borrowers to present collateral and other financial documents (Carter 2013, 3-54). Therefore, these strict requirements make it unlikely that the poor would turn to commercial banks for loans. Because public banks in Turkey are unable to completely cover the demand of their main target groups, they have to somewhat disregard the financing of the very poor. For example, Ziraat Bank serves nearly 2 million customers in the agricultural sector, but more than fifty percent of these loans were non-performing or restructured in 2008. Due to this high percentage of non-performing loans and inefficiency, it is difficult for the bank to open new market segments for the poor in the bank portfolio (Karataş and Helvacioğlu 2008, 11).

The low participation of NGOs in microfinance is another significant problem. Although the strongest microfinance programmes in Turkey are held by the non-profit sector, NGOs are almost absent from the market (Karataş and Helvacioğlu 2008, 10). Currently, there are just two autonomous microfinance organizations, namely the Foundation for the Support of Women's Work (MAYA) and the largest microfinance institution, the Turkish Grameen Microfinance Program (TGMP). Their capacity to serve the poor has been improving. Nonetheless, there has to be other NGOs in the market to

cover the demand of the whole microfinance sector in Turkey. Because this low participation of NGOs in microfinance is also related to the legal framework, it will be explained later in detail.

Gender does matter in the supply of microcredit in Turkey. Unfortunately, women in Turkey are more unlikely to get access to loans in the formal financial sector. This is because women's participation in the labour force (27% of all women, as of 2007) is quite low, and most of them are working in informal sectors (Altay 2007, 14-15). Therefore, they cannot present the required financial documents and collaterals to the formal financial sector in order to get microcredit. Even if women have their own microbusinesses, they still find it difficult to access and obtain loans. Halkbank, for example, provides loans to about 130,000 micro and small enterprises registered through the Confederation of Turkish Tradesmen and Craftsmen (TESK). It is likely that nearly 100% of these loans go to men. Only MAYA and TGMP provide microloans to very poor women and housewives with limited sources. For instance, in 2002, Maya provided loans to 200 female microentrepreneurs operating in the informal sector with an average loan size of USD 350 (Karataş and Helvacioğlu 2008, 10).

1.2. Improvements in the supply of microfinance services

Due to the efforts of NGOs, MAYA and TGMP, awareness of the importance of the microfinance sector in Turkey has been raised. Although the sector has only ten years of history in the country, there have been recent remarkable developments increasing the supply of microcredit loans to the poor and women.

The number of women utilizing microcredit loans has grown remarkably. MAYA, for instance, only serves housewives and female entrepreneurs who wish to expand their business. MAYA previously only operated in north-western Turkey, but it has recently opened new offices in different regions of the country. The programme seems to be successful so far because there has been an increase in the number of women benefiting from it. At the end of 2011, MAYA had nearly 2,500 borrowers and a noteworthy loan portfolio of TRY 1.3 m (USD 650,000). The share of TGMP's support for women is even larger than that of MAYA. As of December 2012, TGMP had around 61,000 borrowers and a loan portfolio of TRY 36 m (USD 18 m). These two NGOs have also started outreach activities. Therefore, approximately 115,000 low-income women in Turkey have received microfinance loans in 2002-2012 (Carter 2013, 54).

In order to increase the supply of microcredit loans, corporate social responsibility programmes (via international networks) have been developed. These did not exist until 2008. For example, BNP Paribas (known as the Turkish Economy Bank in Turkey) began a microcredit programme in 2007, in collaboration with UNDP and the Young Professionals and Businessmen Association (GYİAD). The programme, known as the Golden Bracelet Project, aims to provide microcredit to young entrepreneurs between the ages of 18 and 35 with a high school degree or five years' work experience. The goal is to annually assist 500 microentrepreneurs (UNDP 2007) through the USD 10 m budget. Fortunately for female entrepreneurs, they are given priority in the project (Karataş and Helvacioğlu 2008, 11). In the near future, the project plans to provide technical assistance services to the entrepreneurs supported by BNP Paribas as well (MFSF 2013).

1.3 Legal framework-related problems

The major problems related to the legal framework of microfinance are as follows;

- Lack of clarity in government microfinance policies
- Lack of supporting legal and regulatory environment promoting sustainability and growth of the sector
- Lack of legacy for NGOs to operate in the banking sector

According to the Economist's Global Microfinance Business Environment Report (Economist Report 2012, 12-19), Turkey ranked 51 out of 55 countries in overall microfinance business environment. In regulatory framework and practices, it ranked 50th and was 38th in its supporting institutional framework. With these scores, Turkey is the lowest-scoring country in the Eastern Europe and Central Asia region. The report also records a two rank drop for Turkey when compared to 2011.

A well-functioning microfinance system is vital for poverty reduction as well as the expansion of micro and small enterprises. By creating efficient systems that formalize microfinance services,

greater circulation of funds and higher rates of investment can be achieved (Karataş and Helvacioğlu 2008, 2). Despite the importance of microfinance regulation, there is no common understanding of microfinance in the Turkish government, NGOs and private sector. Microfinance is often not thought as a separate sector by the government. Instead, microfinance is usually perceived as a tool for government incentives or a tool for income generation. Because of this narrow understanding and the limited knowledge of microcredit, there has been little discussion within the government on microfinance as an effective mechanism for addressing poverty in Turkey (Karataş and Helvacioğlu 2008, 12-13).

According to the UN report (2005) analyzing microfinance in Turkey, there is no clear policy facilitating the access of the unbanked majority of the population or small businesses to the formal financial sector in the country. On the contrary, there is an ongoing lack of clarity in government policies regarding microfinance. For example, there are different ministerial programmes in the field of poverty reduction such as those by the Ministry of Health (Green Cards), the Ministry of Labour (unemployment benefits), and the Ministry of Education (for universal access). However, there is no single specific government policy in the specific field of microfinance. Nevertheless, the following national agencies have been involved in the various aspects of Turkey's flourishing microfinance agenda: the Banking Regulatory Authority (for preparation of the legal infrastructure); Ziraat Bank and Halkbank (the two largest microlending state banks); Social Solidarity Fund and the Social Solidarity Foundations (to provide microcredit to the poor to establish small businesses); the Confederation of Craftsmen and Artisans (TESK); and the Undersecretariat of the Treasury (to authorize the subsidized credit lines of state banks) (UNDP Project 2005, p.4).

Muhammad Yunus, the pioneer of microfinance, argues that microfinance organizations can have a better and greater social impact if they are legally allowed to operate in the formal banking sector. Currently, microfinance activities are not part of Turkey's formal banking sector. As the sector continues to struggle with the formation of non-regulated microfinance institutions, this creates uncertainty for market actors and puts up a barrier to growth. Furthermore, the two existing microfinance institutions (MFIs) in Turkey are not banks and are not allowed to collect deposits from the general public; this restricts their financial sustainability by making them dependent on donors and subsidized loans (Carter 2013, 79).

Unregulated microfinance is also marginal to the financial sector. Banks are sophisticated and able to provide microcredit, but they consider it a "corporate social responsibility" rather than commercially viable lending (Economist Report 2012, 38). This perception stems from legacy programmes in agribusiness with banks.

In the microfinance sector, client dispute resolution continues to be carried out informally outside the courts. The legal system is only feasible in dealing with larger credit claims. Moreover, in issuing microfinance loans, price disclosure practices are driven by competition from banks and political conditions within the sector, because regulations in the microfinance area, specific to this issue, do not exist (Economist Report 2012, 38).

2. IMPROVEMENTS IN THE LEGAL FRAMEWORK OF MICROFINANCE

As clarified above, the legal framework is inadequate to overseeing the efficient working of microfinance sector in Turkey. Unfortunately, it is unlikely that any immediate action will be taken in the near future.

The only development that could improve the regulation of microcredit system was the two draft laws presented by the Banking Regulation and Supervision Agency (BDDK) to the Turkish National Assembly in 2005 and 2007. In accordance with the EU harmonization process, BDDK submitted these draft laws to institute a new kind of banking institution, focused solely on microfinance services (Karataş and Helvacioğlu 2008, 11-12). The draft laws drew an outline of the scope of activities, capital requirements, deposit-taking rules, and organizational framework of microfinance institutions, as well as regulatory status within Turkey's financial system (Carter 2013, 79).

The draft laws also allowed Associations and other charitable institutions to carry out lending activities. According to the draft laws, MFIs would remain non-profit entities that had the ability to collect deposits from the general public (Burritt 2003, 40-41). This would yield two good results. Firstly, the dependency of MFIs on external funds and donors would decline. Secondly, there would

be a considerable increase in the number of new microcredit programmes made available to the poor and SMEs. Unfortunately, these two laws have not yet been passed in the Turkish Parliament due to political contention and opposition from commercial banks (Carter 2013, 80).

The only concrete step related to the legacy of microfinance is that MAYA Enterprise for Microfinance is recently undergoing reorganization through a change in its legal status (Economist Report 2012, 38). It will become a for-profit arm of a non-profit foundation which may set an example, once accomplished.

CONCLUSION

Turkey's desire to become a high-income country that is also a full member of the EU guided the nation's development policy throughout its recent history. In order to meet EU entry requirements and maintain its continued economic success, Turkey has focused on low income segments within its national development plans. Microfinance seems to be one of the significant strategies simultaneously dealing with poverty whilst supporting micro and small enterprises. However, Turkey's microfinance sector is still in its infancy, especially in issues of loan supply and legal framework. When compared to the early period of the 2000s, the sector appears to have enhanced the supply of financial services to the poor in cooperation with NGOs, some government agencies and international organizations. However, awareness of microfinance has to be raised so as to allow market actors to conceptualize policies for the development of an inclusive microfinance sector.

Although there are public actors such as state banks and credit cooperatives, two NGOs, MAYA and TGMP, dominate the market in supplying microcredit. Nonetheless, the long-term viability of such organizations is at risk due to the absence of a clear statutory or regulatory framework ensuring the legality of NGO activities and defining the rules. Unfortunately, there is as yet no formal government commitment permitting such foundations, associations, NGOs and other non-licensed organizations to provide microfinance services by collecting deposits from the public. If the two draft laws for the regulation of the sector were accepted, they would create a legal framework establishing the methods and principles of microfinance institutions in Turkey.

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3.12 MICROCREDITING OF SMEs IN UKRAINE

by

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ABSTRACT

The paper presents the deplorable situation of SME microfinancing in Ukraine in the last few years. It also expresses the hope that the nation will gradually harmonize its legislation in line with the European Union and adopt the long expected “Law on Microcredit for Small Businesses by Specialized Agencies”. The authors will examine the institutions providing microloans to businesses and analyze the conditions under which they offer credit to entrepreneurs. The paper also studies the other institutions’ reasons for no longer providing microcredit, looks at the factors preventing the development of microfinance and suggests ways in which microcredit can be supported in Ukraine.

Key Words: microcredit, microloan, microfinance of SMEs in Ukraine, legislative framework on microfinance in Ukraine.

JEL classification: D21, G21, L21, L26, O16

POLITICAL AND ECONOMICAL OVERVIEW

Introduction

2014 has been a very eventful and dramatic year for Ukraine. It will be remembered as the year of the Revolution of Dignity, which led to the overthrow of the former president after his refusal to sign the long awaited Association Agreement with the European Union (UN). 2014 has been the year where Crimea was illegally annexed by Russia, following Russian aggression in Eastern Ukraine. It was also the year where Ukraine elected its new pro-European President and first pro-European Parliament.

No one could have foreseen that hundreds and thousands of people would flock to Kyiv (also known as Kiev) from all over Ukraine to defend their European future, prove their willingness to live according to European standards, call for a police force that protects people instead of criminals, and demand for courts that stand for justice and not the interests of oligarchs. The Revolution of Dignity also called for transparent legislation, clear and understandable rules for business that are equal for everybody, decent education and healthcare, the opportunity to travel around the world without visas, and a non-corrupt government that serves the people instead of itself.

Never had Ukrainians been as united as they were in 2014. While thousands of people gave their lives for Ukraine’s right to be on the map of Europe as an independent state, many other Ukrainians became innocent victims of the armed conflict. The whole world followed Ukrainian news and supported Ukraine in many ways such as supplying the country with much needed equipment and food for the army, artificial limbs for wounded soldiers, and mobile houses for refugees from the Eastern Ukraine. Most countries introduced sanctions against Ukrainian executives responsible for the deaths of innocent people during the Revolution of Dignity; sanctions were also imposed on the Russian officials behind the annexation of Crimea and the war against Ukraine.

EU-Ukraine Association Agreement

Ukrainians elected their new President on 27 May 2014 and new Parliament on 26 October 2014. This was the first parliamentary election in Ukrainian history where pro-European deputies

received overwhelming majority votes. According to the TNS poll conducted in October 2014, 60% of Ukrainians support Ukraine's accession to the EU and more than 50% support its accession to the North Atlantic Treaty Organization (NATO). In 2013, prior to Russian aggression in Eastern Ukraine, the percentage of Ukrainians in favour of Ukraine's membership of the EU and NATO was considerably lower.

It has taken Ukraine two waves of mass protests to conclude a new agreement with the EU. One of the concessions to Ukraine, following the Orange Revolution of 2004, was to open negotiations on the EU-Ukraine Association Agreement in 2007. It took a second revolution and the senseless deaths of more than 100 people to pave the way for the signing of an agreement after President Viktor Yanukovich fled the country in February 2014.

Ukrainian and European parliaments simultaneously ratified the EU-Ukraine Association Agreement on 16 September 2014. This agreement unilaterally cancelled custom duties on the majority of industrial and agricultural products from Ukraine from 15 May 2014. As a result, exports of local goods to the EU increased 25% by October 2014. However, implementation of the free trade part of the agreement (the most important part of the whole agreement) was delayed until 2016 because of the enormous pressure Russia put on the EU leaders.

Without a doubt, integration into the European single market offers the **best chance for Ukraine to modernize and grow economically**. This provides a clear long-term vision that was so vividly expressed by the protestors in Euromaidan – economic integration with the EU will anchor reforms of the economy and the state apparatus, thereby transforming Ukraine into a normal European country.

The key parts of the EU-Ukraine Association Agreement focus on support for core reforms, economic recovery and cooperation in areas of the economy such as **energy, transport and environment protection, industry**.

Russia's attempts to keep Ukraine in its bloc shown to be non-productive

From the beginning of the people's movement towards a European Ukraine, Russia aimed to derail Ukraine's European choice and attract the country to its own bloc – the Eurasian Economic Union. Following the ousting of Yanukovich, Putin punished Ukraine by illegally annexing Crimea and starting military aggression in Eastern Ukraine under the pretext of "protecting the Russian speaking population". As a result, the high price that Moscow imposed on Ukraine for moving away from Russia further increased the costs of Ukraine's economic integration with the EU. As Swedish ex-Foreign Minister Carl Bildt pointed out, "The single most important thing we can do – make Ukraine succeed. This is a game for the future of Ukraine."

Doing business in Ukraine became easier

Ukraine entered the ranking of the top 100 countries in the world where it was easy to do business, as seen in *Doing Business 2015*. In fact, Ukraine **rose 16 places** and now ranks 96 out of 189 economies. These data in "Doing Business 2015" were compiled by the World Bank (WB) and International Finance Corporation (IFC), and published on Wednesday, 28 October 2014, in Washington, D.C.

The ranking is based on 10 indicators and covers 189 countries.

A number of business improvements were noted in Ukraine. Among them were:

- Simplifying the tax paying process for companies through the introduction of the e-filing system and the single social tax – Ukraine rose by 49 places;
- Registering property (a positive policy resulting in Ukraine rising 29 places in this area) through the introduction of a new State Register of Property Rights of immovable property, which provides state registration for both a plot of land and the property located on it in a single Register of Property Rights. (Before this register was in place, foreigners could only buy a property, not the land on which it was located).

Ukraine's improved performance in the Doing Business 2015 rankings signal positive changes in international assessments of its business environment.

Laws adopted by Ukraine to harmonize its legislation with the EU

In autumn 2014, the Ukrainian government passed several important laws that realized some of the terms of the Ukraine-EU Association Agreement:

- Anti-corruption Law, which established administrative and disciplinary responsibility for submitting false information in the declarations about incomes and bribes;
- Law “About the introduction of changes to some legislative acts in Ukraine on the simplification of business start-ups”. This law puts into place mandatory cancellation of stamps, cancellation of the registration fee for the state registration of legal entities and individual entrepreneurs.

Administration of businesses will be less bureaucratic with fewer authorities to contend with, less money to pay and less time consuming.

Foreigners in the new government of Ukraine

On 27 November 2014, Ukrainian President Petro Poroshenko submitted a law to Parliament that would allow foreign citizens to work in the Cabinet of Ministers of Ukraine. In allowing foreigners to work for the Cabinet, this law allowed the Ukrainian government to receive international experience and implement European standards.

Natives of the United States (US), Georgia and Lithuania were granted Ukrainian citizenship to allow them to become key ministers in the new government of Ukraine under this law. This law was approved by the Ukrainian parliament in the first week of December 2014. Natalie Jaresko of the US, former head of the Kiev-based Horizon Capital investment fund became the Ukrainian Finance Minister. The position of Health Minister went to Alexander Kvitashvili, who occupied a similar post in the Georgian government in 2009-2012. Lithuanian Aivaras Abromavicius, who used to be a partner at the \$3.6 billion-worth East Capital asset management group, was approved as the Minister of Economy.

Economic indicators

The Ukrainian foreign exchange market has been going through extremely hard times. The Hryvnia (UAH) exchange rate continues to drop rapidly against the dollar and euro. Every day, it is getting more and more difficult to buy euros or dollars in a bank or an exchange office, which results in the growth of a “black” market with its own rates. Since January 2014, the official UAH rate fell by more than 70% against the euro. In mid-November 2014, EUR 1 was UAH 20; while EUR 1 was UAH 11.5 a year ago.

Despite improvement in the state budget balance, the overall fiscal deficit forecast worsened to 7% of GDP and inflation reached almost 15% at the end of 2014. The cost of food, medicine and utilities increased by 50% from 2013 prices, petrol prices rose by 30-40%, central heating in houses rose by 40%, while gas costs 73% more.

Commercial banks continued to be under the stress of deposit outflows and capital deterioration. For nine months in 2014, Ukrainians withdrew UAH 34.3 m and USD 7 bn from banks. The total deposit portfolio in local currency decreased by 14%, and fell by 31% in hard currency.

Russia stopped supplying gas to Ukrainian consumers in the summer of 2013 because of a payment dispute. The political context is more than obvious: in response to the ousting of the Moscow-friendly regime led by Viktor Yanukovich, Russia cancelled the two gas price discounts that had been agreed upon with Ukraine in April 2010 and December 2013. This left Ukraine with over \$3 billion debt to Russia. Given halted production to almost half of all coal mines, delivery difficulties due to damaged infrastructure (railway lines, roads, bridges, etc.) and the absence of natural gas supplies from Russia, the Ukrainian energy market is experiencing a shortage of fossil fuels.

Ukrainian labour market

The Ukrainian labour market fell 22% by October 2014. Over the past 6 months, the number of job proposals has decreased because many companies have been minimizing their costs by reducing the number of staff, salaries, closing branches etc. On average, there are 10 applicants for every job. However, the official unemployment rate in Ukraine remained at 8.6% by the end of 2014, which is lower than the averages in EU countries.

Average salary dropped to EUR 184 in 2014, while living wage remained the same at EUR 72 per month. In 2013, average salary was EUR 203, and living wage was EUR 72 EUR per month. According to the Human Development Index 2013, Ukraine ranked 78th out of 186 countries.

According to UNDP, the number of people working for food in the Ukraine increased to 41.5% in 2013.

Economic collapse and chaos in the East of Ukraine

During April-August 2014, Ukrainian forces were gradually regaining control over part of the Donbas region occupied by pro-Russian forces. By mid-August, the Ukrainian military had recaptured almost three-quarters of the occupied territories despite Russia's increasing support of the rebels and mercenaries with weaponry, tanks and artillery. However, at the end of August, the conflict escalated again following an 'undeclared' invasion of Russian troops in Ukraine. In October 2014, Russian military equipment and personnel increased tenfold in the Donetsk and Luhansk regions.

Terrorists attacked banks, shops and private companies in Luhansk and Donetsk, threatening the economic situation as well as the well-being of civilians. Armed groups calling themselves the self-proclaimed defenders of Donetsk and Luhansk or the "People's Republics" fought not only on the barricades, but on the roads and in retail outlets. The region became very dangerous for residents and it was impossible to conduct business activities or purchase necessities. This is because goods and valuables were taken "for the needs" of the terrorists without any compensation. Key infrastructures and industries such as the airport, roads, utilities and pipelines were also destroyed. As a result of this unstable and dangerous climate, 80% of SMEs left the Donbas region.

Local police could not prevent or stop the chaos from gaining momentum because there were no mechanisms to resist vandalism and looting. Businesses either closed or were ruined from robberies as they tried to adjust to the "new order" of chaos and lawlessness.

CHARACTERISTICS OF THE SME SECTOR (BEFORE THE WAR)

According to experts, the share of small enterprises in the Ukrainian GDP never exceeded 15% since the country gained independence in 1991. This is considerably lower than the developed economies. For example, 60% of enterprises in Germany are small businesses, 70% of Italian businesses are small ones, 22% of Russian enterprises are small businesses and 23% of businesses in Belarus are small ones. Ukrainian private enterprises lag behind their regional counterparts because of the extremely difficult conditions for opening and running businesses, lack of affordable credit and low paying ability of citizens. However, Ukrainians are as willing to do business as citizens of other nations. According to the Institute of Sociology of the National Academy of Sciences of Ukraine, 30% of Ukrainians would like to open a business and 19% said they would "probably" be interested in starting a business.

According to the State Statistics Service of Ukraine, there were 1,600,127 business entities in Ukraine as of 1 January 2013. Of these, 698 were big enterprises (0.2%), 20,550 medium enterprises (5.5%) and 1,578,879 (94.3%) small businesses. During 2010–2012, these figures were practically the same. The trend towards quantitative growth was typical only for individual entrepreneurs.

Similar to previous years, the vast numbers of small and medium enterprises (SMEs) were concentrated in the regions of Dnipropetrovsk, Donetsk (the situation dramatically changed in summer 2014), Kyiv, Lviv, Odesa and Kharkiv.

At the beginning of 2013, the total number of individual entrepreneurs for every 10,000 persons in Ukraine was 271, which is 6.6% more than a year before. Sumy, Khmelnytskyi, Kyiv, Mykolaiv and Odesa had the most individual entrepreneurs, while Kirovohrad, Rivne, Volyn, Ternopil and Lviv had the least. SMEs employed 7.5 million people or 40% of the working population. Priority areas of activity for SMEs were the trade and service sector (60%), following by industry (20.3%), agriculture (5.5%) and construction (5.4%).

NEW LEGISLATION ON SMEs

Parliament passed the Law "About the introduction of changes to some legislative acts in Ukraine on the simplification of business start-ups" on 15 April 2014. In fact, the new law contains two noteworthy points. Firstly, there was the mandatory cancellation of stamps. Since one no longer

needed a stamp from the Ministry of Internal Affairs, it was now unnecessary to certify contracts, powers of attorney and copies of documents by stamp and so on. Most entrepreneurs agree that this change simplifies the procedure of starting a business and makes it easier to administer. However, pessimists say that it creates more temptation for raiders. Another change was the cancellation of a registration fee. Now, the fee is only required for making amendments to the registration documents. In addition, the possibility of registering legal entities and private entrepreneur electronically is a big step forward in simplifying the process of starting a business.

The “Law of Ukraine on Amending the Tax Code of Ukraine and certain other legislative acts of Ukraine” was adopted in July 2014. It introduced important changes to Ukrainian tax legislation, namely all value added tax (VAT) payments would now be made through specially designated bank accounts (known as VAT Accounts). VAT payments will be accumulated in these VAT Accounts. Each VAT payer is required to maintain their individual VAT Account with the bank designated by the Cabinet of Ministers. The Law oversees the electronic administration of VAT, which reduces opportunities for corruption, creates conditions preventing the illegal obtainment of budgetary compensation and increases budget incomings. Electronic VAT administration will become operational on 1 January 2015.

MICROFINANCE IN UKRAINE

Microcredit is a loan ranging from USD 100 to USD 50,000. The upper limit is different in each institution. In UkrSibbank, it is EUR 25,000. In the Finance Company “Nadiya Ukrainy”, it is EUR 4,000. In Microcredit LLC, it is equivalent to EUR 235. In most cases, banks provide loans from EUR 80 to EUR 40,000. Microcredit is provided only to businesses that are already operating.

Borrowing companies or individual entrepreneurs should have been in business for at least six months (for trade, it is a quarter of a year). The term of a microloan usually does not exceed 12 months.

Legislative Framework on Microfinance

The Draft Law on Microcredit for Small Businesses by Specialized Agencies has been awaiting Parliament’s consideration since 2000.

At present, entrepreneurs have very limited loan options. This is because commercial banks are not interested in issuing smaller loans or microcredit. Commercial banks’ lack of interest in microcredit is due to the fact that the cost of administering loans of EUR 2,000 and EUR 100,000 is the same. Additionally, the banks’ decision-making procedure for loans is very complicated. Also, collateral is a necessary requirement for the obtainment of credit in the domestic banking system. The collateral should be twice as large as the loan. In most cases, entrepreneurs often do not have such collateral. This significantly, and sometimes fatally, limits the development of small businesses.

Non-bank microcredit has already proved its efficiency in many transition economies. In Ukraine, such institutions have no legal basis because the existing legislation does not envisage lending by non-bank organizations. Back in November 2000, the Draft Law on Microcredit for Small Businesses by Specialized Agencies was submitted to Parliament. Unfortunately, it was not adopted. This law envisaged the creation of specialized, non-bank, non-government and non-profit financial institutions capable of providing microcredit to small business entities. According to experts, such a law would significantly increase the effectiveness of small businesses and accelerate their development. Indeed, the possibility of receiving state funds is extremely limited. As a result, it is much more realistic to rely on private investors, who can use microcredit to carry out certain investment projects.

The bill also regulates size of microloans, conditions for their provision, the format of credit agreement, and defines the main principles of credit policy for this specific type of financial institution. In 2005, the bill was sent for revision and the draft has since been lost. It is hoped that the new Parliament will understand the social and economic significance of microcredit, and approve the bill.

MAJOR MICROFINANCE INTERMEDIARIES/INSTITUTIONS

Despite its effectiveness in other Western countries, microfinance in Ukraine only began to actively develop in recent years.

It is important for Ukraine to provide microfinance to its SMEs for several reasons. The main ones include raising the minimum bank capital.

Another significant factor is the large size of the country. There are many settlements in which banks are absent. In these cities, microfinance could significantly raise the level of economic development and help new start-ups.

In the absence of state support for microfinance, there are a few institutions offering microcredit to SMEs. In our research, we found the following institutions filling the microfinance gap in Ukraine:

- ✚ German-Ukrainian Fund (GUF) via its 7 partner banks
- ✚ UkrSibbank
- ✚ Finance company “Nadiya Ukrainy” (Hope of Ukraine)
- ✚ Company “Ukrhroshi” (Ukrainian Money)
- ✚ Microcredit LLC

1.1. **German-Ukrainian Fund (GUF)**

The German-Ukrainian Fund (GUF) is a non-profit financial organization, founded by the National Bank of Ukraine, the Ministry of Finance of Ukraine and the German KfW Development Bank to promote micro, small and medium enterprises (MSMEs) in Ukraine.

The maximum loan amount provided is EUR 25,000 for individual entrepreneurs and microenterprises.

GUF's partner banks are Ukrgasbank, Zlatobank, Kyivska Rus Bank, Megabank, Bank Natsionalnyj Kredyt, Prokredyt Bank and Ukrainian Professional Bank (UPB).

Only 85 microcredit loans were provided by all the partners in 2013 (financed by GUF).

1.2. **UkrSibbank**

The maximum loan amount:

- UAH 200,000 in loans for working capital;
- UAH 400,000 in loans for the purchase of equipment, vehicles, special equipment and commercial real estate objects.

Loan security: commercial, residential property

Interest rate: from 21% in UAH

Fee for loan / line of credit: 2% of the loan amount.

Minimum credit fee is UAH 1,000.

1.3. **Finance company “Nadiya Ukrainy”**

Nadiya Ukrainy or Hope of Ukraine is a microfinance organization established in 1998 to support private entrepreneurs and their families. It has offices in twelve regions in Ukraine.

The company offers several types of credit, namely express loans, business loans, business loan investments, loans for training and agricultural loans.

Amount of loan: from UAH 1,000 (EUR 62) to UAH 60,000 (EUR 3,700)

Terms of credit: from one week to 24 months

Interest rate: 30-40% per annum (2.5% per month on condition of collateral, in the form of a car or apartment (house); and 3.5% per month with a minimum of 2 guarantors).

1.4. **Microcredit LLC**

While the company provides services to everybody including entrepreneurs, the conditions are draconian.

Maximum loan amount is UAH 4,000 (EUR 235).

Longest term – 48 weeks.

Amount to return – UAH 8,121.

Interest rate – more than 100%.

Documents required before entrepreneurs may be granted loans: passport, tax identification code and certification from the tax authorities on the payment of taxes.

1.5. **Company “Ukrhroshi”**

The company provides loans ranging from UAH 250 to UAH 2,500 for a period of 7 to 17 days, and the interest rate on the loan is 2% for each day. Loans are granted to individuals who have permanent employment and are aged 21-65.

Required documents for registration: Ukrainian passport and tax identification number.

In the event that the terms of repayment are violated, a lump sum fine of UAH 250 and 2% of the outstanding amount are applied per day as penalties. Payment of loans and interests are made in cash at branches serviced by Ukrhroshi or by bank transfer.

We discovered that a number of institutions offering microcredit to SMEs in 2013 no longer do so. Some of the institutions no longer offering microcredit are the Ukrainian Fund for Entrepreneurship Support, Ukrainian Bank for Reconstruction and Development, OTP Bank, PrivatBank, Unex Bank and Credit Agricole. They stopped providing microcredit because of the rapid devaluation of the national currency, high risk of non-repayment of credit, war in Eastern Ukraine, uncertain economic situation of clients, and the Ukrainians' fear of borrowing.

SUMMARY

Microcredit is considered the world's recognized method of combating social poverty and unemployment. It is also regarded as a tool for job creation. It is painful for entrepreneurs to be plagued by lack of funds for business development. Ukraine still has much to do to encourage the development of small businesses. According to official statistics, the innovativeness of domestic small business falls behind the innovativeness of the national economy. Official statistics also note that the innovativeness of domestic small businesses lags behind that of small businesses in other developed countries. One way that small businesses can be encouraged to develop in Ukraine is to support their activities through microcredit services.

The factors preventing the development of microcredit in Ukraine are:

- Banks' inactivity in providing microcredit services;
- Low level of demand for these services by small businesses;
- Low profitability of this business for banks.

In order to ensure the development of microcredit in Ukraine, it is necessary to implement the following:

- Adopt legislation on microcredit regulation, which will ensure state support;
- Simplify the procedure of getting credit;
- Motivate commercial banks to engage in microcredit;
- Educate entrepreneurs on the methods of obtaining microcredit;
- Make interest rates more reasonable.

According to the experts of the World Bank, the business climate in Ukraine is gradually improving. Ukraine has achieved substantial success, rising from 112nd to 96th position in ease of doing business in *Doing Business 2015*. Thus, Ukraine has finally returned to the top 100 of the World Bank's rating of 189 countries. Ukraine has achieved the greatest success in two ranks: registration of property and taxation. In those two features, Ukraine improved and climbed 25 places.

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4. BEST PRACTICE IN MICROFINANCE IN ROMANIA

4.1 FINANCE PROBLEMS FACED BY ROMANIAN SMEs IN 2014

by

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Economic University of Bucharest

ABSTRACT

The objectives of this paper are to present the main financial problems faced by Romanian SMEs and to formulate a set of financial improvements for SMEs.

This paper is based on extensive empirical research culled from 1,568 interviews with Romanian entrepreneurs in the spring of 2014 (Nicolescu 2013, 12-14). In the paper, the main characteristics of SME finance in 2014 are presented. It also presents a set of recommendations to increase enterprises' access to finance and improve their business performances.

Keywords: SME, entrepreneur, bank credit, self-financing, business environment, performance.

JEL classification: L26, G21

1. STRUCTURE AND DIMENSION OF THE SMALL AND MEDIUM ENTERPRISE SAMPLE

During March-April 2014, the author conducted interviews with 1,568 Romanian entrepreneurs from all over Romania. These entrepreneurs were selected as a representative sample of small and medium enterprise (SME) entrepreneurs because of their size or structure. Figures 1, 2, 3, 4 and 5 present the main characteristics of the sample (Nicolescu 2014, 10-15).

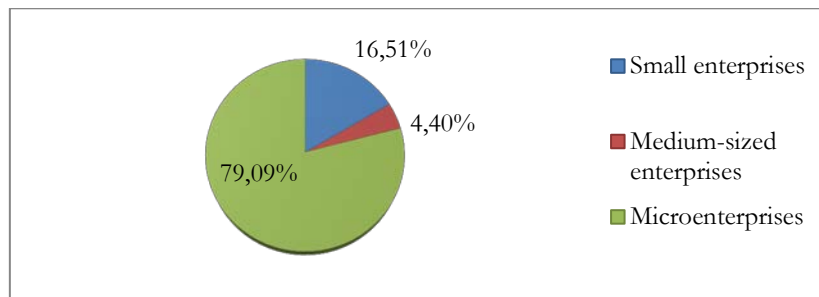


Figure1: Structure of the sample SMEs by size

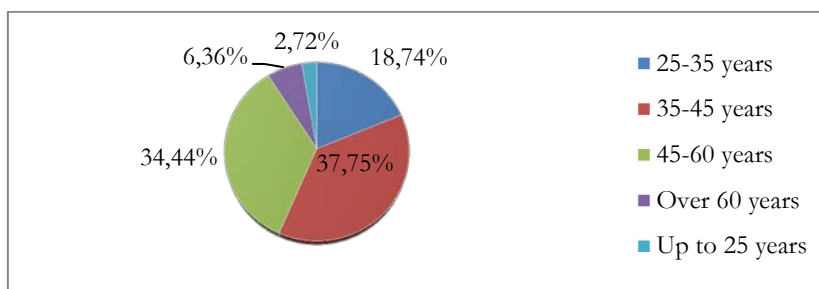


Figure 2: Entrepreneurs in the survey according to the age

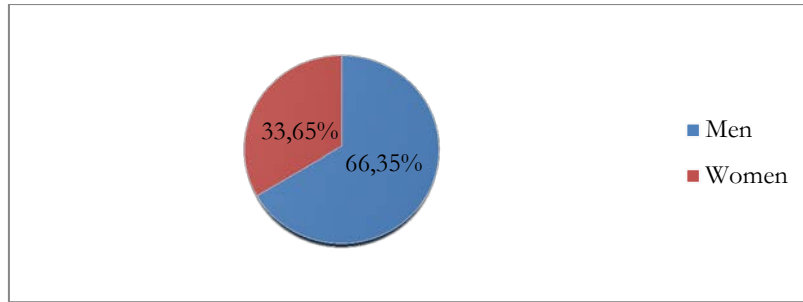


Figure 3: Sample of entrepreneurs according to sex

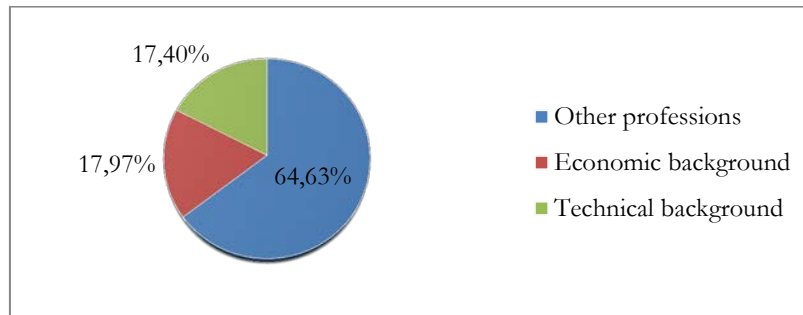


Figure 4: Sample of entrepreneurs according to professional background

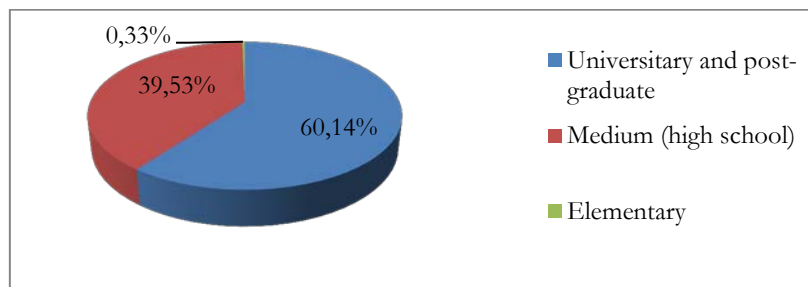


Figure 5: Sample of entrepreneurs according to education

2. MAIN CHARACTERISTICS OF SME FINANCE

Before the main features of SME finance are presented, Figures 6 and 7 (Nicolescu 2014, 23) evaluates the overall business environment in Romania in 2013 and 2014 according to the entrepreneurs interviewed. The business environment, which is a main component affecting the finance of companies, is deemed by most entrepreneurs to be unfavourable to business. However, 2014 figures show a slight improvement from that of 2013.

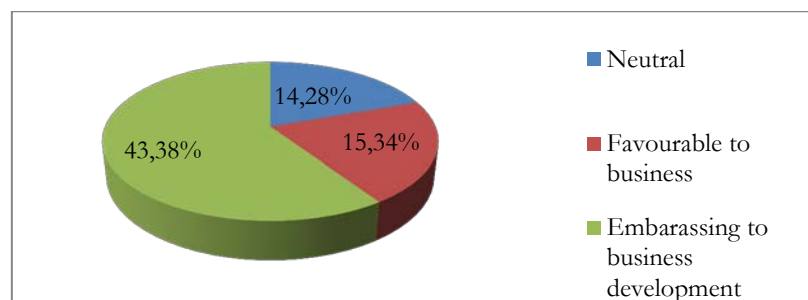


Figure 6: Entrepreneurs' overall assessment of the current economic environment in 2013

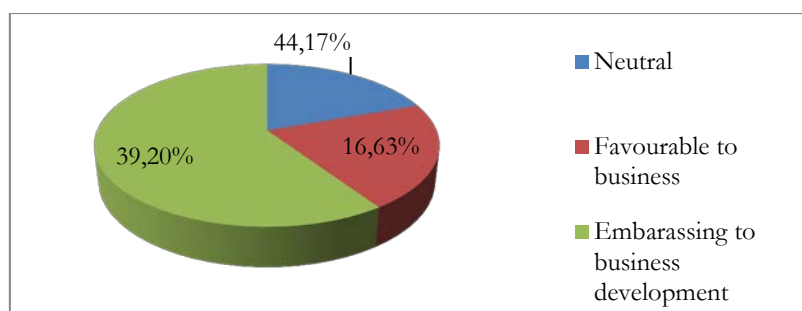


Figure 7: Entrepreneurs' overall assessment of the current economic environment in 2014

To better understand SMEs' finance, the author analyzed their financing methods. According to the information in Tables 1 and 2, most entrepreneurs in SMEs rely on self-finance. Self-financing is used in almost 90% of SMEs. Microenterprises use it more often than small and medium companies. While bank loans are the second most popular financing method, it is used by less than 30% of SMEs. The bigger the company, the more likely they are to use bank loans. For example, 34.59% of small companies and 46.97% of medium companies use bank loans.

Credit suppliers are the third most popular financing method for SMEs. On average, one out of every nine companies uses credit suppliers. Again, the bigger the company, the more likely they are to use credit suppliers. The other financing methods, used by more than 1% of SMEs, are leasing and loans from specialized financial institutions.

No.	Financing Methods	Company Size		
		Micro	Small	Medium
1.	Self-finance	92.47%	85.71%	86.36%
2.	Bank credit / Bank loans	23.27%	34.59%	46.97%
3.	Credit suppliers	9.65%	10.90%	15.15%
4.	Leasing	2.18%	6.39%	12.12%
5.	Loans from specialized financial institutions	1.32%	2.63%	0.00%
6.	Non-payment of invoices	0.73%	0.38%	0.00%
7.	Guaranteeing under National Credit Guarantee Fund for SMEs (FNGCIMM)	0.66%	2.26%	1.52%
8.	Non-reimbursable funds	0.53%	3.01%	4.55%
9.	Customers' credit	0.46%	0.75%	1.52%
10.	Factoring	0.13%	0.00%	3.03%
11.	Emission of shares on the capital market	0.33%	0.75%	3.03%

Table 1: Differentiation of SMEs' financing methods by business size

No	Financing Methods	SMEs by fields of activity					
		Industry	Construction	Trade	Transportation	Tourism	Services
1.	Self-finance	83.41%	90.12%	92.26%	93.42%	95.52%	95.80%
2.	Customers' credit	0.91%	1.23%	0.79%	0.00%	0.00%	0.00%
3.	Credit suppliers	13.18%	14.81%	11.06%	7.89%	4.48%	6.57%
4.	Bank credit / Bank loans	26.14%	34.57%	24.80%	21.05%	23.88%	26.09%
5.	Emission of shares on the capital market	0.91%	0.00%	0.47%	0.00%	0.00%	0.36%
6.	Non-reimbursable funds	2.27%	1.23%	0.47%	1.32%	0.00%	0.73%
7.	Guaranteeing under FNGCIMM	1.36%	0.00%	0.32%	0.00%	0.00%	1.64%
8.	Loans from specialized financial institutions	2.50%	1.23%	1.11%	0.00%	0.00%	1.46%
9.	Leasing	4.09%	3.70%	3.00%	1.32%	10.45%	1.82%
10.	Factoring	0.23%	0.00%	0.16%	0.00%	1.49%	0.18%
11.	Non-payment of invoices	0.91%	4.94%	0.32%	0.00%	0.00%	0.36%

Table 2: Differentiation of SMEs' financing methods by fields of activity

Analysis of the differentiation of SMEs' financing methods by field of activity in Table 2 reveals that self-financing is mostly used by services and tourism companies and less often by industrial enterprises. Construction and industrial companies prefer to use bank credit. There are some very large differences in SMEs choice of financial method. (Nicolescu 2014, 130).

Another element analyzed in this study is the main use of SMEs' finances. According to the information presented in Figure 8, in 2014 and 2013, most companies used finance for working capital (more than 60%), followed by investment (more than 40%) and innovative projects. When compared to 2013 figures, finance for working capital in 2014 increased while finance for investment and innovative projects decreased.

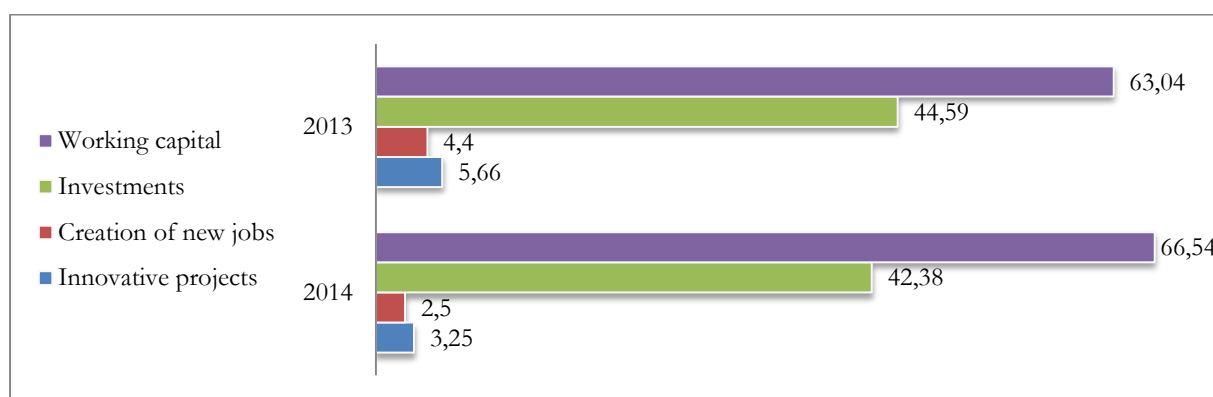


Figure 8: Main uses of SMEs' finance

As seen in Table 2, SMEs of different sizes use finance in significantly different ways (Nicolescu 2014, 131). Usage of financial loans for working capital decreases with the size of the enterprise, but increases with company size when it comes to investment, creation of new jobs and innovative projects.

No.	Financing needs	Enterprise size		
		Micro	Small	Medium
1.	Working capital	68.09%	61.78%	56.52%
2.	Investments	38.84%	55.21%	57.97%
3.	Creation of new jobs	5.00%	6.56%	8.70%
4.	Innovative projects and R&D	2.18%	4.63%	17.39%

Table 3: Main uses of finance according to SME size

3. RECOMMENDATIONS ON IMPROVING ACCESS TO FINANCE IN ROMANIA

Taking the empirical research and analyses of the specialists of the National Council of Romanian SMEs into consideration, the author has formulated a set of recommendations (Nicolescu 2014, 501-504) focused on the improvement of financing for SMEs. These recommendations have been grouped into four categories, namely:

- Increased transparency and competition in the banking sector
- Reduction of bureaucracy
- Stimulating business funding through alternative instruments
- Reducing the lending risks

3.1 Increased transparency and competition in the banking sector

- Measures to mitigate the imbalance in the negotiating power of lenders include the introduction of a credit ombudsman (based on the positive experience of France), stronger involvement of consumer protection organizations, and getting the Competition Council to regulate and develop the relations between banks, entrepreneurs and households.
- Measures to increase the competence level of the parties involved in banking relations. To do that, human resources in corporate banking divisions of commercial banks should improve in the following areas: analysis of business plans from an entrepreneurial perspective, examination of specific emerging sectors of the economy, conceptualization of dynamic models for forecasting etc. Entrepreneurs in need of funding should improve their knowledge and skills in the following areas: management, marketing, finance and accounting.
- Eliminating current information asymmetry by centralizing the data on financial products offered by commercial banks (AER, ceilings, eligibility requirements, etc.) on a public portal. This would enable visualization and comparison of several products in real time. It would ensure more transparency and competition in the banking sector.

3.2 Measures for reducing bureaucracy

- Organizing the banking system requirements according to the assessment criteria, without excessive inquiries.
- Eliminating all additional declarative obligations by limiting the documents and information banks require from entrepreneurs to the essential ones. These essential documents should then be directly taken into the credit evaluation process.
- Establishing and promoting SME credit ombudsmen in each country, according to European best practices. The European best practices credit ombudsman should be based on the French model to improve SMEs' access to finance.
- Providing specific simplified solutions for SMEs so that they can get funding from banks.

3.3 Measures to reduce the lending risk

- Increasing and diversifying guarantee services and facilities in compliance with European Union (EU) rules on state aid.

- Increasing and diversifying counter-guarantee services and facilities in compliance with EU rules on state aid.
- Improving the lending policies of state-owned banks such as CEC Bank and Exim Bank. State-owned banks should implement strategies that are friendly and stimulating for SMEs. They should also significantly lower practice fees and interest rates. When these rates are lowered, they should be lower than that of other commercial banks. Banks should do this while respecting EU competition laws and regulations on state aid.

3.4 Measures for stimulating business funding through alternative instruments

- Providing seed capital, especially for the disadvantaged categories such as youths, women, etc.
- Providing venture capital for innovative ideas and cutting-edge industries through the creation of special funds that are partially funded from European funds and the state budget.
- Providing microcredit, particularly to entrepreneurs whose businesses are similar to that of freelancers and craftsmen, thereby ensuring a better penetration of funds.
- Diversification and amplification of guarantee and counter-guarantee services for businesses (particularly SMEs) in line with EU best practices.

4. CONCLUSIONS

Of course, many other measures can be implemented to improve SMEs' access to finance, generate more jobs and foster better business performance. The measures highlighted by the author are ones that should be taken into consideration and implemented urgently.

Romania should integrate the improvement of SMEs' access finance with its strategic reconsideration of the business environment. Romania can do this by using the opportunities provided by the EU 2020 Strategy and Juncker's strategic Initiative to increase microfinance in Europe and the Romanian economy.

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4.2 SUSTAINABLE GROWTH IN TURBULENT TIMES

by

Bogdan Merfea

CEO, Patria Credit IFN S.A.

ABSTRACT

This paper analyzes the evolution of Patria Credit in the last 6 years in the economical environment. It also presents the factors contributing to sustainable growth and profit. These success factors developed within the last 6 years are linked to sales culture, risk management, knowing one's customers and operational efficiency.

Keywords: GDP, assets, profit, ROA, ROE, cost to income ratio

JEL classification: G21

1. INSTITUTIONAL BACKGROUND

Patria Credit IFN was set up in 1996, as a Foundation of World Vision. Due to changes in the legal framework, it later became a non-bank financial institution known as Capa Finance.

In 2007, the Romanian-American Enterprise Fund (RAEF) and Balkan Accession Fund (BAF) became the main shareholders, and they invested EUR 17 m in capital and USD 15 m as credit line to increase Patria Credit's microcredit portfolio. Figure 1 presents the institutional evolution of Patria Credit since its establishment in 1996.



Figure 1: Institutional evolution of Patria Credit Romania

RAEF is a private equity fund established by the United States (US) Government to support economic development in post-communist Romania. RAEF has built and developed a number of successful companies in various fields in Romania, especially in financial services. Some of RAEF's most notable financial services are: the RAEF portfolio owned banks (Romanian Bank, Banca Agricola), non-bank financial institutions (Estima Finance, Motoractive, Domenia) and other financial institutions (Intercapital).

In addition to the investment and financing from RAEF, Patria Credit received funding and guarantees from the European Bank for Reconstruction and Development (EBRD) and the European Investment Fund (EIF) through the EU-funded Progress Microfinance Programme, and technical assistance through the JASMINE programme.

Patria Credit is the largest non-bank microfinance institution in Romania. It is a member of the European Microfinance Network (EMN) and Microfinance Centre (MFC).

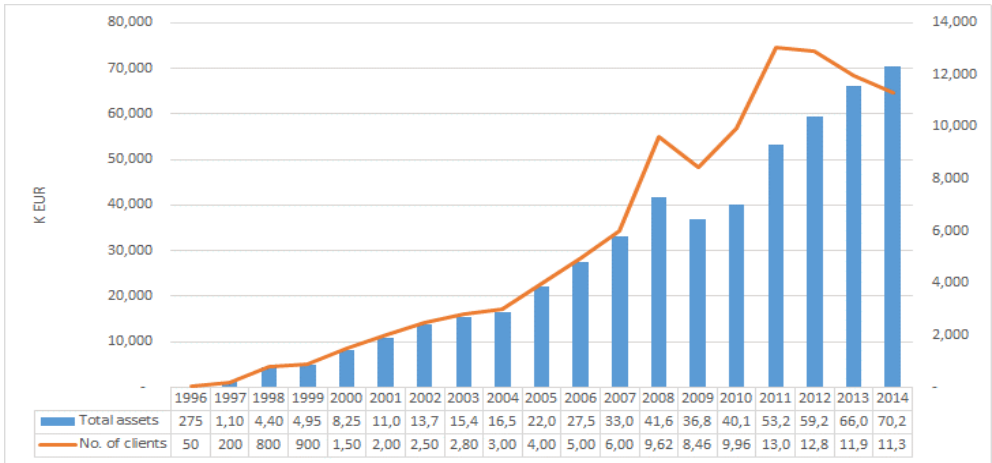


Figure 2: Growth of Patria Credit in figures

Romania experienced an economical boom until 2008. It then went through a turbulent time from 2009 onwards where GDP fell by 27% [1], non-performing loans (NPL) increased more than 300% in 2009 – 2012) [2], and unemployment rate soared by 10% in 2009 – 2010. [3]

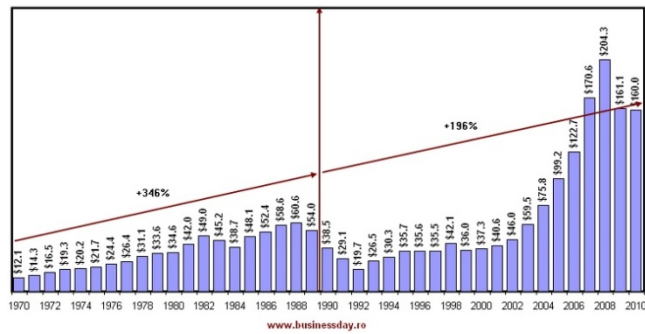


Figure 3: GDP evolution

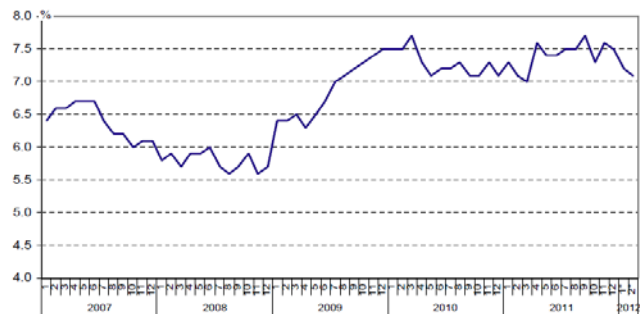


Figure 4: Unemployment rate

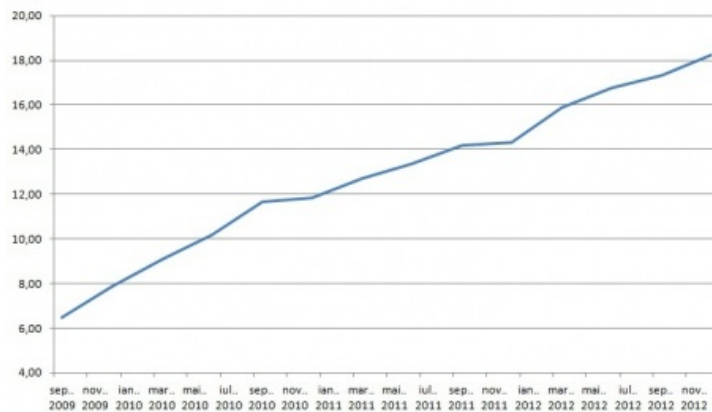


Figure 5: NPL development

Patria Credit hit turbulent times in 2009 when the global economic crises affected many active clients' ability to repay their loans. As a consequence, NPL increased within a short period of time from 2.9% to 8.1%, and the cost to income ratio rose from 77.5% to 91.6%. This, in turn, led to losses for the shareholders.

2. HOW DID PATRIA CREDIT COPE WITH THE CHALLENGES OF THE FINANCIAL CRISES?

It was imperative for Patria Credit to adapt to the turbulent times, as the risk of losses was high.

Many analyses were conducted and a new risk culture was implemented in Patria Credit.

Risk culture defined, segmented and sub-segmented Patria Credit's clients by identifying needs and risks. Patria Credit focused only on small agro-producers and small businesses that had a turnover lower than EUR 500,000.

About half the businesses Patria Credit finances are individual agro-producers (small and micro-farms in rural areas) that are not incorporated. Instead, they sell their produce (mainly vegetables and fruits) in markets around the country. Patria Credit helps financially excluded agribusinesses that are isolated for both geographical reasons (low banking infrastructure in the rural area) and financial reasons (informal, low and seasonal income).

Intelligent sales incentives were created and correlated with risk indicators.

This led to the **centralization** of most of the processes (approval, credit management, legal etc).

Sales culture was defined as intelligent budgeting related to the market potential of every branch office, efficiency, a strong push strategy and a strong pull strategy.

Strong push strategy was defined as the development of many originating channels like brokers, partners, the Internet etc. A strong pull strategy was defined by marketing campaigns, training projects and assisting clients in the vicinity of the branch office.

Operational Efficiency sought to create and encourage competitive and sustainable growth.

This evolution can be seen in the figure below.

K EUR	2008	2009	2010	2011	2012	2013	End of Oct 2014
No. of clients	9,622	8,464	9,968	13,063	12,889	11,971	12,000
Outstanding	36,962	32,157	37,575	47,054	53,947	58,902	62,833
Disbursement	22,000	7,000	18,000	30,600.0	31,300.0	35,400	32,350
Total assets	41,607	36,893	40,179	53,216	59,289	66,005	70,294
Equity	14,117	11,788	16,224	16,891	18,496	20,327	22,725
Cost to income ratio	77.5%	78.7%	91.6%	78.5%	66.0%	64.3%	58.2%
Cost of risk	2.9%	8.1%	4.9%	2.0%	1.8%	1.8%	2.0%
After-tax ROA	-2.7%	-4.2%	-3.1%	1.5%	3.6%	3.2%	4.0%
After-tax ROE	2.6%	-13.1%	-10.5%	4.9%	11.6%	10.6%	12.7%
Profit	373	(1,500)	(1,200)	800	2,000	2,093	2,293

Figure 6: Growth of businesses

As seen in Figure 6, Patria Credit experienced sustainable growth and competitive risk cost. Patria Credit managed to succeed in turbulent times by very efficiently increasing sales and lowering the cost to income ratio.

The structure of outstanding payments by customer segment is presented below in Figure 7.

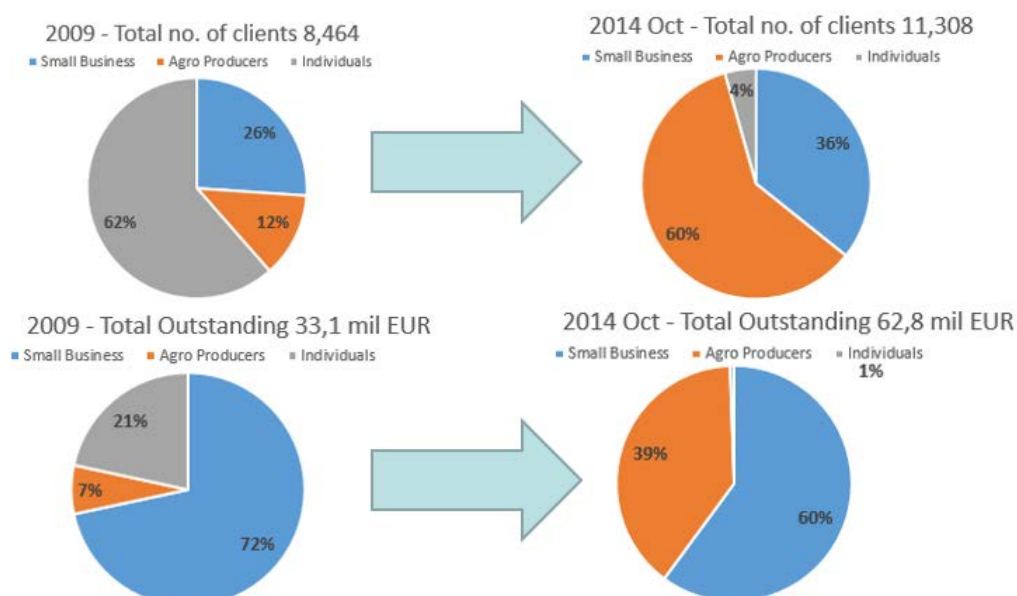


Figure 7: Structure of outstanding payment by customer segment

Patria Credit has a national presence across 43 territorial units in Romania.

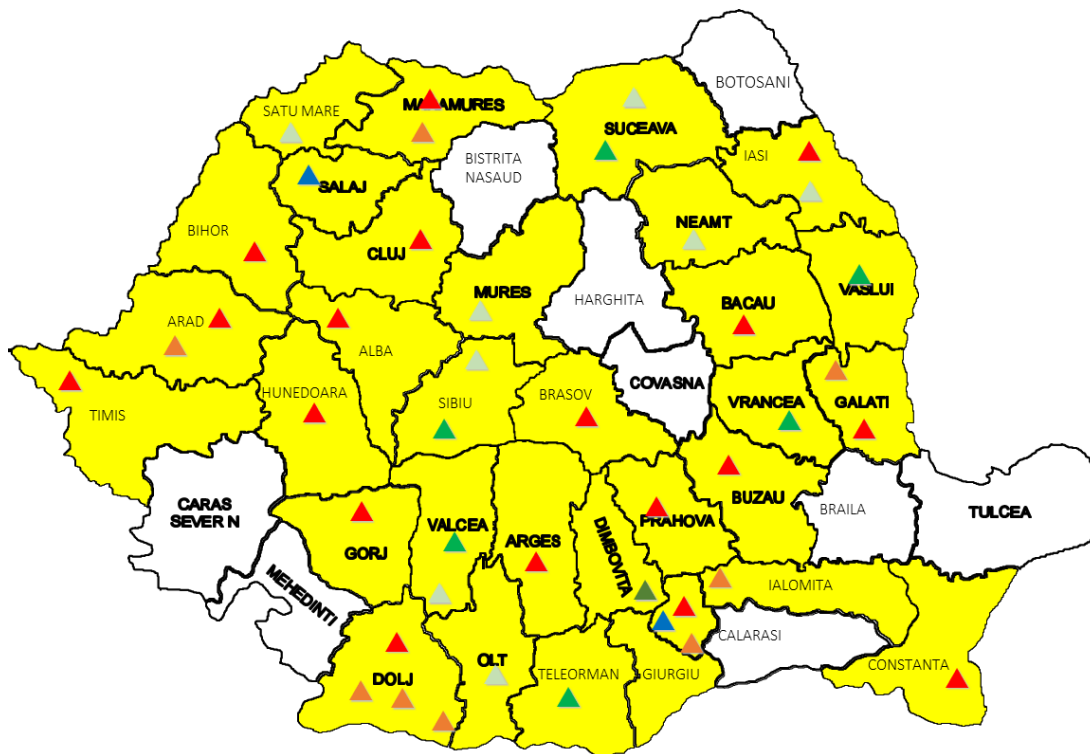


Figure 8: Network overview

With national coverage, Patria Credit's market share is 5.8% of small businesses deemed to be agro-producers.

3. PATRIA CREDIT SUCCESS FACTORS

In order to assist small business and small agro-producers, Patria Credit developed new products. Some products that Patria Credit developed for agro-producer clients include seasonal payments, cash-flow based lending, and specific warranties or pledges.

Patria Credit assists clients through:

- Establishing risk culture and operational efficiency
- Establishing sales culture and knowing the needs of the customers

Risk culture:

- Competitive cost of risk (2%);
- Intelligent sales incentives correlated with risk indicators;
- Centralized processes and manpower specialization.

Sales Culture:

- Strong push strategy with diversified originating channels such as direct sales agents, promoters, brokers and intermediaries, as well as partnerships and the Internet;
- Strong pull strategy with marketing campaigns and tools, business education for clients and potential clients, and involvement in community projects;
- Intelligent budgeting correlated with market potential, market share and seniority.

Knowing our customers:

- By segmenting and sub-segmenting client activities and business interests;

- Manpower specialization and processes that are correlated with customer sub-segments to increase flow from their originating source, improve efficiency and strengthening the relationship with the potential customer before their first sale;
- Separate monitoring.

Operational Efficiency:

- Intelligent monitoring and sales force effectiveness (SFE) programmes
- Front office systems for customer analyses
- Procedures aligned with efficiency

4. FINANCIAL PRODUCTS

CREDIT WITH EUROPEAN GUARANTEE – EUROPEAN PROGRESS MICROFINANCE FACILITY

The *European Progress Microfinance Facility (Progress Microfinance)* is a loan product offered to microenterprises with an annual turnover that is under EUR 0.5 m. This loan does not require any hard collateral from the customer. Progress Microfinance covers 75% of the credit amount, while the remaining 25% comes from Patria Credit.

The product also offered financial inclusion and support to microentrepreneurs in micro, small and medium enterprises (MSMEs).

Loans are offered to microenterprises for their working capital or small investment needs in amounts ranging from EUR 100 to 25,000. In contrast to normal bank loans, the final beneficiary (the business or the entrepreneur) does not need to produce collateral to contract such a loan.

Progress Microfinance is administrated by EIF (see www.eif.org/progress and www.ec.europa.eu/epmf). Patria Credit's guarantee facility aims to finance 300-500 microenterprises in Romania over a period of two years.

This guarantee bears no cost for the final beneficiary (the MSME borrower) and it has a lower price than standard loans from banks. By participating in Progress Microfinance, Patria Credit has shared the risk for 25% of the loan to microenterprises without securing collateral. In so doing, Patria Credit has lowered the risk premium and reflected the free guarantee for 75% of the loans from Progress Microfinance.

Microfinance products from previous years such as loans issued with FNGCMM and FGCR guarantees continued to be offered.

80% of the credit is guaranteed by the National Credit Guarantee Fund for SMEs (FNGCMM) or the Rural Credit Guarantee Fund (FGCR). The MSME customer only needs to provide the difference in collateral. Patria Credit entirely supports the annual guarantee commission charged by FNGCMM or FGCR, and the customer bears no fee beyond regular credit fees and interest. The FGCR guarantee loans are dedicated to MSMEs active in the agricultural sector, most notably, small farming businesses that are incorporated as SMEs.

The “Prietenul la nevoie ..se ajuta!” campaign

The “helping a friend in need” programme or “members getting other members” campaign started in mid-2011 and was extended in 2012 to allow Patria Credit's customers to receive free instalments against (successful) leads provided. Each customer recommending a new client to Patria Credit would be rewarded when the new client takes out a loan. The existing customer's reward for this successful recommendation would take the form of a reduced or free instalment. The amounts awarded as incentives were taxable income and the tax is deducted from the incentive.

Factoring – launched in December 2012

While all SMEs were affected by lack of funds, microenterprises were the hardest hit. This was due to the increasing arrears in trade, and an epidemic of insolvent and bankrupt trade partners.

This led Patria Credit to launch a factoring product dedicated to MSME customers with an annual turnover of under EUR 2 m.

CONCLUSIONS

In order to overcome the turbulent times, Patria Credit increased its outreach and scale through innovative and cost efficient distribution channels. As it did so, it kept in close contact with its customers in microenterprises and small agribusinesses.

Patria Credit managed to increase its outreach, and maintain and increase its MSME portfolio. With its motivated staff and growing MSME portfolio, it reached a EUR 2 m net profit for the year. This shows that Patria Credit's two target market segments of microenterprises and individual agro-producers contributed to its success, and confirmed Patria Credit's business model as one of cost effective distribution and community involvement. In 2011, Patria Credit had its first positive year since the global economic crises, for it had a net profit of EUR 830,000.

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4.3 MICROFINANCE IN PRACTICE - OPPORTUNITY

by

Simon-Piers O'Mahony

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Board Member, Opportunity Bank Serbia

ABSTRACT

This paper considers the role of microfinance in delivering social impact through financial inclusion, providing specific information through the experiences of two long established microfinance institutions in the BSEC region.

Keywords: microfinance institutions, financial inclusion, social enterprises, social performance management, sustainability, outreach, debt collection

JEL classification: G21

INTRODUCTION

Microfinance began in the 1970s in Latin America and Southeast Asia based on the concept that "it is better to teach a man to fish than to give him a fish". [1] Since then, it has grown into a multibillion dollar global industry of EUR 45-75 billion, serving more than 130 million clients. [2] From these humble beginnings, main modern-day microfinance players deliver solutions to social and financial inclusion through non-governmental organizations (NGOs). In fact, modern-day microfinance players examine the profit motive against social impact motive in the microfinance sector. This dichotomy has been discussed by two leading European Microfinance Associations, namely the European Microfinance Network (EMN) [3] and the Microfinance Centre (MFC) in recent years. It appears that the social impact of microfinance is the overriding purpose of microfinance. It was also acknowledged that the sustainability of each microfinance institution (MFI) is essential to greater outreach. International Finance Corporation (IFC) suggests that MFIs are only reaching 20% of their potential market globally, thus confirming the need to deliver services to more clients. [2]

OPPORTUNITY INTERNATIONAL

Opportunity International is one of the most original and largest microfinance networks in the world, operating in 22 countries and possessing combined assets of EUR 666 million (USD 883 million) in December 2013. In 2013, 4.24 million loans were disbursed by 17,446 employees. Members of the Opportunity International Network provide financial services including loans, savings and insurance through banks, non-banking financial institutions and NGOs. Members of the Opportunity International Network are also focused on clients who are excluded from the mainstream financial sector in their respective countries.

Opportunity International is a social enterprise [4] defined and inspired by its vision, mission and values:

Vision

A world in which all people have the opportunity to build a fulfilling life of dignity & purpose

Values

Commitment Humility Respect Integrity Stewardship Transformation

Mission

By providing financial solutions & training, we empower and sustain underserved & financially excluded people to transform their lives, their children's futures & their communities



Opportunity International hopes to help clients through the creation of 20 million jobs by 2020, impacting 100 million lives.

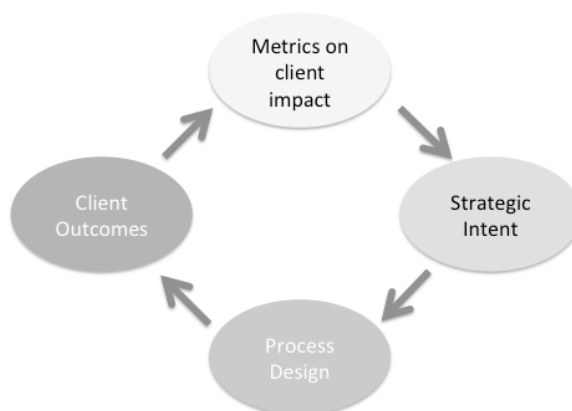
REGIONAL PRESENCE – ROMANIA AND SERBIA

Opportunity International is present in Europe in Romania and in Serbia:

Opportunity Microcredit Romania was established as an NGO in 1995. It transformed into a regulated non-banking financial institution (IFN) in 2007. Since its inception, the company has disbursed 17,000 loans worth €60 million in 20 counties of Transylvania, with headquarters in Târgu-Mureş and 8 branches throughout the country. 65% of its clients in 2014 are in rural areas. It offers financial services, such as investment and working capital loans, credit lines and housing improvement products, to agri-smallholders and micro, small and medium enterprises (MSMEs).

Opportunity Bank Serbia was established in 2002 in partnership with USAID. It has been a regulated bank since 2007. Throughout its existence, 70,000 loans worth €245 m were disbursed across the country. Its headquarters are in Novi Sad. 60% of its clients are in rural areas. Investment and working capital loans, credit lines, housing improvement products and innovative savings products are provided to agri-smallholders, MSMEs and pensioners.

Both Opportunity Microcredit Romania and Opportunity Bank Serbia focus on delivering financial inclusion, that is, serving clients whom others do not, such as traders, those made redundant or bankrupt, pensioners and small farmers. Social performance management (SPM) [5] is a priority across the Opportunity International Network. SPM is implemented in both organizations, with Opportunity Bank Serbia leading the way and becoming smart certified in 2014 [6], and Opportunity Microcredit Romania following suit in 2015. SPM is the effective translation of an institution's mission into practice and is in line with accepted social values.



SOCIAL PERFORMANCE MANAGEMENT IN PRACTICE

Both institutions experienced a high level of delinquency (PAR>30d). PAR>30d is Portfolio at Risk of loss due to delayed payment of an instalment of more than 30 days, and is the MFI standard measure of delinquency. PAR occurred due to inappropriate strategic decisions and market crises in 2007-2009. The highest levels of PAR were 13.3% in Opportunity Serbia in September 2010 and 34.1% in Opportunity Romania in February 2011. After extensive discussions at Board and Network level, the critical decision was made to keep the bad loan portfolios in house and manage collections through dedicated teams rather than dispose of them to a collections company. The rationale was based on two criteria:

Application of values – There was concern that the unscrupulous nature of the debt collection sector would unjustly harm clients facing difficulties. Thus, it was essential for the companies to match their actions to their fine words; not doing so would undermine the very essence of Opportunity as a social enterprise.

Financial benefit – Returns from a bad debt portfolio handed to a debt collection agency were in the range of 5-15%, whereas the returns from a similar portfolio processed correctly in house were likely to be higher.

Workout Units were created for all loans with PAR>30d in Opportunity Romania and PAR>35d in Opportunity Serbia. These Workout Units have had a comprehensive methodology developed and implemented, comprising the following features:

- ✓ Dedicated teams
- ✓ High incentives for collections staff, matched to the industry's norms
- ✓ Team targets linked
- ✓ Detailed assessment of each client's situation and categorization of client type, namely "can pay/won't pay", "can't pay/won't pay", "can't pay/wants to pay"
- ✓ Firm and fair dealings with clients
- ✓ Stepping into the client's trouble (discounting exposure to achieve closure)
- ✓ Never wiping out a client completely
- ✓ Legal enforcement considered a tool, rather than a means in itself

This social performance management approach to debt collection has resulted in the following outcomes for Opportunity in Romania and Serbia:

	Non-Performing Loans	
Romania	17.2%	PAR>90d for commercial loans in Aug14
Opportunity	4.2%	
Serbia	22.2%	PAR>90d for all loans in Mar14
Opportunity	4.2%	

CONCLUSIONS

The role of microfinance over the last fifty years has been the delivery of social impact through financial inclusion. The industry has matured from well-meaning social leaders into mainstream financial services delivering critical and much needed solutions for the more vulnerable in society. In Romania and Serbia, Opportunity leads the way in serving those most affected by the transition from central to free market economies by using social performance management to ensure clients' businesses are sustainable and fit to grow. In so doing, Opportunity has reached out to more clients.

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4.4 CREDIT GUARANTEE PROGRAMMES FOR SMEs - ROMANIAN EXPERIENCE

by

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ABSTRACT

Credit guarantee funds represent a very valuable instrument for improving SMEs' and undercapitalized enterprises' access to loans.

Keywords: guarantee, fund, collateral, SMEs

JEL classification: G21

1. BACKGROUND

Guarantee institutions began to develop in Romania in the early 1990s. During this period, they mainly sought to guarantee loans that were used for buying the shares of companies undergoing privatization. In time, this component was reduced to a minimum, largely due to the completion of various privatization processes.

Due to the lack of sufficient cash or collateral, the government's strategy for the development of small and medium-sized enterprises (SMEs) in 2001-2013 prioritized SMEs' improved access to finance. The consolidation of guarantee funds for SMEs was also proposed to achieve this specific objective.

Currently, most of the loans guaranteed are used as working capital or for financing investment projects.

The government established guarantee and counter-guarantee arrangements of loans in two steps (in 2001 and 2010 respectively) to facilitate SMEs' access to bank loans and reduce the cost of financing. In so doing, the government instituted an operational system consisting of banks, guarantee funds and counter-guarantee funds. Through this mechanism, nearly 20,000 SMEs were the direct beneficiaries of loans.

In Romania, there are the following guarantee funds:

1. National Loan Guarantee Fund for SMEs (NLGFSME), also known as the National Credit Guarantee Fund for SMEs (NCGFSME)
2. Three affiliates of NLGFSME, such as Local Guarantee Funds, conducting the same activity as NLGFSME at the local/regional level
3. Rural Credit Guarantee Fund (FGCR)
4. Romanian Loan Guarantee Fund For Private Entrepreneurs (FRGCIP).

The Romanian Counter-guarantee Fund (FRC) was established to share the risk of guarantee funds.

2. NATIONAL LOAN GUARANTEE FUND FOR SMES (NLGFSME) - SHORT DESCRIPTION OF ACTIVITIES⁸²

The establishment of the National Loan Guarantee Fund for Small and Medium-Sized Enterprises (NLGFSME) was motivated by the importance of the SMEs sector in the national economy. NLGFSME acknowledged SMEs' potential to increase gross domestic product (GDP), exports and create new jobs. NLGFSME was set up in December 2001, with the declared goal of facilitating SMEs' access to financial sources by granting them guarantees to borrow from commercial banks or others sources.

⁸² All the data in this presentation are available on the NLGFSME site (www.fngcimm.ro), and are included in its Annual Report as well as the European Mutual Guarantee Association (AECM) website (www.aecm.org) and personal comments.

The only shareholder of NLGFSME is the government of Romania.

Since 2002, the company has registered profit. The guarantee fee income and other financial revenues from NLGFSME's own funds cover operating expenses as well as guarantee payments.

NLGFSME, as a non-banking financial institution, is subject to both the prudential limits for its risk policy (such as maximum leverage or minimum criteria for portfolio diversification) and compulsory risk management requirements under the regulations of the National Bank of Romania (NBR).

NLGFSMEs' maximum exposure to a bank may not exceed 40% of the fund covered.

Exposure to single SMEs may not exceed 10% of the equity of the Fund.

NLGFSME issues partial guarantees (up to 80%) for SME loans granted by partner lenders (25 commercial banks, of which 4 are non-bank financial institutions, at the end of 2012), on bank request based on a framework-guarantee (risk-sharing) agreement.

The guarantees granted to SMEs are not part of state aid, in accordance with European Commission Communication 2008/C 155/02.

The state equity participation was RON 931.3 m (~ €210 million) at the end of 2011.

2.1 Guarantee instruments managed by NLGFSME

Guarantees granted by NLGFSME from its own funds are:

- individual SME guarantees (up to EUR 2.5 m) granted following a thorough guarantee (credit) risk evaluation (duration of a maximum of 7 days);
- standardized small guarantees granted under a simplified procedure (scoring-type assessment of SME risk with a 24 hour acceptance/rejection of the request) under a specific "framework-ceiling guarantee agreement". The SME pays the guarantee commission via the lending bank at the beginning and, for longer maturities, in annual instalments.

Tens of thousands of beneficiaries have benefited from guarantees granted through governmental guarantee programmes. These guarantees are:

- state guarantees on behalf of the Ministry of Economy or Public Finance ("Mihail Kogalniceanu" Programme for short term financing of small businesses, in effect since 2011; "First House" Programme, in effect since 2009; the Programme for local governments, regional water utilities and research entities as beneficiaries of priority programmes with EU funding, in effect since 2010; and the Programme for housing thermal rehabilitation, in effect since 2010);
- guarantee funds on behalf of the Ministry for Agriculture for rural development (2006-2010) and fisheries (since 2011).

2.2 How NLGFSME works with financial institutions and SMEs

The working relationship between NLGFSME, financial institutions and SMEs is presented in Figure 1.

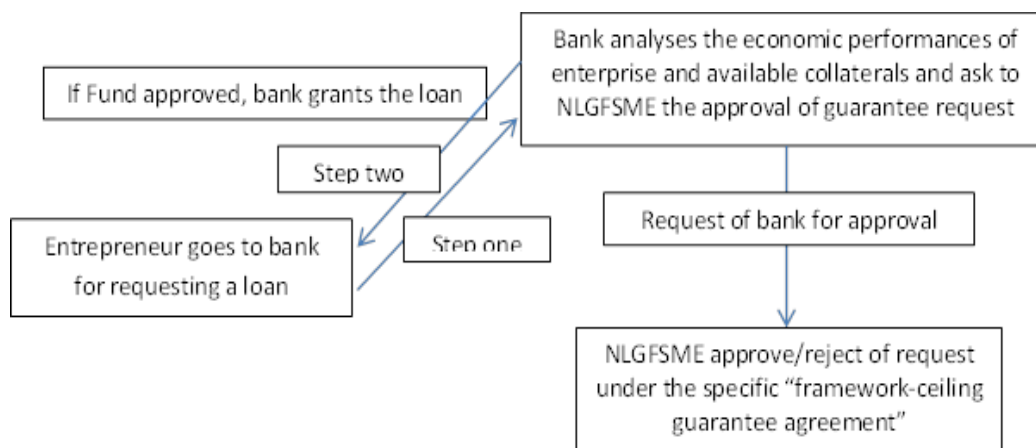


Figure 1

Figure 1 shows that the entrepreneur has no direct relation to NLGFSME. The guarantee is granted only in the agreement framework of the bank and the fund.

2.3 The benefits of using guarantee products

For SMEs	For financing institutions
<ul style="list-style-type: none"> ▪ eliminate the main causes of rejection of loan application (lack of guarantees) using the guarantee fund, in addition to personal guarantees ▪ possibility of establishing a direct relationship, useful to clarify all elements that could lead to delays in obtaining financing; ▪ reducing uncertainty in granting credit / letter of guarantee; ▪ additional cost reductions of credit / letter of guarantee by reducing / eliminating estate collateral; ▪ optimization, flexibility of funding required to the banks, without additional guarantees; ▪ time saving of a minimum of 7 days compared to mortgage guarantees 	<ul style="list-style-type: none"> ▪ NLGFSME shares assumed credit risk by taking up to 80% of credit risk by irrevocable and unconditional guarantee, which is the most liquid warranty. The guarantee is payable in a maximum of 90 days from the initiation of judicial proceedings against the minimum 2 years, the average duration of execution of a mortgage; ▪ reduction of loan provisioning; ▪ increasing the volume of lending to creditworthy customers that have insufficient guarantees; ▪ increase the volume of loans already granted to a creditworthy customer, without requesting additional collaterals.

2.4 NLGFSME - Essential support for the beneficiaries of structural funds

NLGFSME stands by the final beneficiary throughout all the phases of the projects funded by European funds.

NLGFSME caters to the needs of SMEs through the creation of financial products specific to each phase of the cycle. This ensures that the SMEs are in a position to access European funds as soon as they submit the application form. NLGFSME also enable SMEs to continue their current

activities in their new completed investment. NLGFSME is committed to the SMEs for the whole period of their loan until the end of monitoring.

2.5 Statistics regarding the activity of NLGFSME in 2005 - 2011

Preliminary data for 2011 (as of February 2012) are presented in the Table 1 and Figure 2.

Table 1 (Thousand EUR)

NLGFSME	2005	2006	2007	2008	2009	2010	2011
Equity	24.705	88.354	100.781	90.727	62.970	166.515	225.208
Portfolio guarantees	38.113	125.384	215.633	298.035	458.401	505.451	580.732
Guarantees granted per year	35.617	130.835	218.429	227.034	427.277	493.497	513.085
Average exchange rate Ron/Euro	3,6234	3,5245	3,3373	3,6827	4,2373	4,2099	4,2379

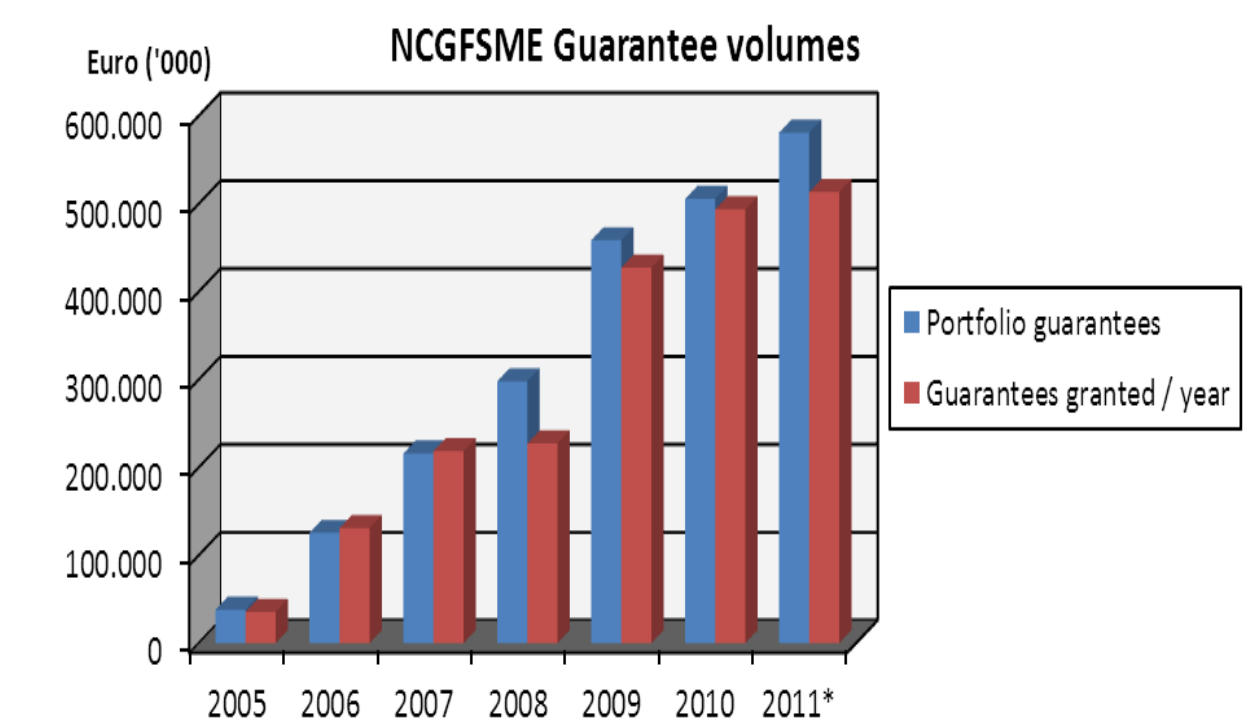


Figure 2: Evolution of NCGFSME activity in 2005 – 2011

Table 1 and Figure 2 show that NCGFSME's activity surged in 2005-2011, as seen in the fifteen-fold increase in portfolio and number of guarantees.

The annual number and volume of guarantees issued to SMEs, including microenterprises, is shown in Table 3. These figures also indicate that NCGFSME concluded agreements with microcredit companies.

Table 3

Year	2007	2008	2009	2010	2011, 30 June	Total
Own funds:						
Guarantee value, EUR	146,533,695	172,597,398	382,516,129	44,354,3866.1	231,904,680.2	1,377,095,768
Guarantee number	2,014	1,528	6,548	8,472	4,467	23,029
Funds under management:						
Guarantee value, EUR	44,312,012.5	20,857,678.3	14,657,450.3	31,242,090.91	34,595,249.81	145,664,481.8
Guarantee number	152	50	67	90	39	398

Table 3 shows that the annual number of guarantees increased.

2.6 Latest statistics published by NLGFSME in August 2014

- In the first eight months of 2014, FNGCMM granted about 6,200 guarantees with a value of over RON 1,800 million to SMEs as working capital (88%).
- Of the total number of outstanding guarantees, 52% were for microenterprises, 38% for small enterprises and 10% for medium enterprises.
- Average value of guarantees was RON 297,000 (EUR 67,000);
- The Fund manages a portfolio of 14,000 guarantees with a total value of RON 3.4 bn (EUR 760 m).

3. THE ROMANIAN RURAL CREDIT GUARANTEE FUND (FGCR)⁸³

3.1 General Presentation

- The Rural Credit Guarantee Fund (FGCR) was established in February 1994, in accordance with Law No. 31/1990, as a commercial company, following negotiations between the European Community and the government of Romania. It is represented by the Ministry of Agriculture and Rural Development;
- FGCR is a non-bank financial institution managed by the National Bank of Romania (NBR);
- FGCR has been a member of the European Mutual Guarantee Association (AECM) since 2006.

3.2 Shareholders

- Three banks

3.3 Objectives

- supporting the absorption of European funds
- boost financial access for agricultural private producers and communal bodies, ensure that they have access to loans and other financial instruments
- facilitate investors' penetration in the private agro-food sector by allowing them to grant loans to microenterprises in the agro-food industry for production, stocks, working capital and investments.

⁸³ All the data in this presentation are available on the NLGFSME site (www.fgcr.ro), the AECM website (www.aecm.org) and personal comments.

3.4 Beneficiaries

- legal persons and natural persons
- farmers
- processors of agricultural products;
- beneficiaries of the European Agricultural Fund for Rural Development and European Agricultural Guarantee Fund

3.5 Guarantee instruments managed by FGCR

- guarantees for working capital
- guarantee for loans for acquisition of land
- guarantees for loans incurred by the beneficiaries of European Forum for Agricultural Research (EFARD) in the framework of the Export Financing Guarantee Act (EFGA)

3.6 Characteristics of guarantees granted

- FGCR covers 80% of the loan
- Maximum value of guarantee is EUR 2.5 m

4. THE ROMANIAN LOAN GUARANTEE FUND (FRGC) FOR PRIVATE ENTREPRENEURS⁸⁴

4.1 General presentation

- The Romanian Loan Guarantee Fund (FRGC) for private entrepreneurs was established in February 1994, according to Law No. 31/1990, as a commercial company and entered into force in 1994.
- FRGC has been a member of AECM since 2002.

4.2 Shareholders

- banks and the Romanian government

4.3 Partners

- 13 banks

4.4 Beneficiaries

- SMEs, liberal professions, individual enterprises and family enterprises

4.5 Value of services

- Analysis commission
- Guarantee prime depends on risk class.

5. ROMANIAN COUNTER-GUARANTEE FUND (FRC)⁸⁵

5.1 General Presentation

⁸⁴ All the data in this presentation are available on the NLGFSME site (www.frgc.ro), AECM website (www.aecm.org) and personal comments.

⁸⁵ All the data in this presentation are available on the NLGFSME site (www.frcg.ro), AECM website (www.aecm.org) and personal comments.

- The Romanian Counter-guarantee Fund (FRC) is a specialized financial institution, operational since April 2010. It is a commercial company; its main shareholders are the Romanian Ministry of Public Finances (68%) and the Post-Privatization Foundation (32%);
- Its main activity is providing **counter-guarantees to the guarantees** issued to SMEs by the guarantee funds;
- Member of AECM since 2010.

5.2. Principles of granting counter-guarantees

- Non-discriminatory treatment of SMEs as beneficiaries of the counter-guarantees;
- Transparent criteria in the granting and payment of counter-guarantees;
- Efficient use of funds to increase financing volume for SMEs;
- Spread of the risk, using reduction counter-guarantee risk techniques related to exposures held by FRC;
- Subsequent intervention of FRC in the payment of a guarantee from guarantee funds;
- FRC and guarantee funds act *pari passu* (without partiality) to subsequent recoveries of the amounts paid for credit risk incurrence.
- Counter-guarantees are granted under the *de minimis* schemes.

a. Instruments

- **Counter-guarantee** represents the express, irrevocable and unconditional engagement through which FRC takes over part of the risk of the guarantee funds within the issuance of a guarantee to an SME;
- **De minimis aid as a counter-guarantee** represents FRC's support of SMEs by taking over the risk assumed by the guarantee funds. It is expressed as a gross grant equivalent to the counter-guarantee.

5.3. Products

- FRC counter-guarantees up to 80% of the guarantees of credit, letters of guarantee and other financial instruments used in financing investments, operating cycles, projects co-financed from Structural Funds, innovative projects, research and development, environmental entrepreneurship and young entrepreneurship.

5.4. Institutional partners

- National Loan Guarantee Fund for SMEs (FNGCIMM);
- Local guarantee funds that are branches of FNGCIMM have been set up in the developing regions of Romania. It has offices in Moldavia (Focșani), Transylvania (Sfântu Gheorghe) and Oltenia (Craiova);
- Romanian Loan Guarantee Fund (FRGC);
- Rural Credit Guarantee Fund (FGCR);
- Counter-guarantees granted by FRC are approximately 50% of the portfolio of the guarantee funds partners.

5.6. Present statistics 2010 – June 2013

From the start of its operations to the present, FRC has granted **18,500 counter-guarantees to 10,200 SMEs**, totalling **EUR 719 million**. These counter-guarantees and guarantee funds have a financing volume of **EUR 2.301 million**. These funds are instrumental in generating new work places and maintaining existing ones. Thus far, **173,000** work places have either been created or maintained in this way.

Within the approved ceiling exposure of EUR 428 m, the active portfolio of counter-guarantees is EUR 304 m or 8,199 counter-guarantees.

The total value of de minimis aid granted by FRC is **EUR 12.8 m**. This represents the decreasing effect of guarantee fees on SMEs' financing costs.

5. FINAL DISCUSSIONS AND RECCOMENDATIONS OF THE WORKSHOP

5.1 CONCLUSIONS

The following points were made in conclusion:

1. Microcredit addresses the need to provide access to credit to the unemployed, self-employed, business start-ups, and micro and small enterprises.
2. Microcredit is a key policy tool for job creation, employment creation and poverty reduction. It does so by providing loans and business development services to entrepreneurs that can benefit from them.
3. Microcredit is an instrument of democratization and economic development, as it allows people to manage their destinies.
4. Through microfinance intermediary institutions, microcredit is a bottom-up approach of the local economic development process.
5. Commercial banks are reluctant to give loans to the poor because they are deemed to be unbankable and unlikely to repay loans.
6. There is a paradigm change in economic and social activities: microcredit can make the unemployed and poor creditworthy. Credit can help these people achieve economic power, generate income and lift them out of poverty.
7. Specialized financial intermediaries created by private investors and charity organizations, socially committed help desks, group banking corporations, ethical banks and non-bank financial institutions use microfinance to fund the unemployed and enable them to become self-employed, business starters and microentrepreneurs.
8. There is no single policy model for microfinance promotion.
9. In some BSEC Member States, there is no special law on microfinance. In others, it is part of a nationwide financial policy.
10. Microcredit is not a panacea for job creation and poverty alleviation.

5.2 RECOMMENDATIONS

The following recommendations were made:

1. Policymakers, especially Members of Parliaments in Member States, high-level officials of government institutions and the financial elite are urged to understand the important ways in which microfinance can contribute to job creation, self-employment and income generation.
2. Existing microfinance and micro-guarantee schemes should be better promoted by relevant government ministries and microcredit development agencies. Information on microfinance schemes should also be better disseminated.
3. Governments are urged to create transparent laws or regulations on microfinance so as to limit risk-taking by the borrowers and financial intermediaries.
4. The collection of microcredit statistics is to be encouraged in each BSEC Member State in order to devise better microfinance support policies.
5. The exchange of best practices should be continued. This could include setting up website databases on strategies, financial models and good practices from government institutions, microfinance institutions (MFIs) and banks.
6. Banks should consider providing microcredit without collateral within the framework of their national banking regulations. Special comprehensive service supplies should be organized for such loans to decrease the costs of managing the loan and monitoring the borrower.

7. Governments and banks should elaborate on the development of incentive programmes. They should also have better financial support for grant schemes catering to the self-employed, start-ups as well as disabled, youth and women entrepreneurs.
8. The Konrad-Adenauer-Stiftung is to publish the SME microfinance national policies and best practices in the BSEC region.

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