Microfinance,
what is it all about?

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Microfinance - what is it all about?

People want to participate and not remain on the side-lines. Most people have good ideas for how to participate, but making those ideas a reality requires money, as well as knowledge, information and an enabling environment. There are, in fact, people amongst the lesser fortunate in society who want to be able to borrow money, take out insurance, transfer money and set aside money as savings at affordable prices and ideally as close as possible.

An increasing number of people seized such opportunities empowered by microfinance. Today, a network of microfinance institutions is providing all kinds of services in many countries, ranging from micro loans (microcredit), micro insurance, micro savings to micro pensions. All of those services are offered in a way different to that which banks were used to. A new way of handling money and bringing people and finance together has developed. A network of new organisations has emerged that has gained attention.

The success of microcredit has been given the attention it deserved, yet microfinance is now facing criticism. Does the money reach the right people? Why are the interest rates so high? Who actually benefits from it? Why are private investors interested to join? And why are microfinance organisations once set up with clear, social goals sold to private parties on the market? The question is rightly tabled whether *financial inclusion* is still being pursued. In order to contribute to that discussion, one needs to know what micro-credit or microfinance actually is all about. What do we understand by these terms?

This book is a translation of the Dutch version *Microfinanciering, waar gaat het dan over*[1]*?* We have also updated as much as possible data used and referred to. This book challenges the reader to actively seek answers. We hope that those answers will add value to the debate on microfinance and result in a more effective use of microfinance. We owe it to the people using microfinance in their desire to actively participate in society.

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Julie-Marthe Lehmann

The Hague, February 2016.

[1] That Dutch version was written in close collaboration with *Guus Heffelaar (1949)*, former researcher in the Microfinance and Small Enterprise Development at the Inholland University of Applied Sciences.

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1.

MICROFINANCE – SOMETHING NEW?

... from the Franciscan monks who founded the community-oriented pawn-shops of the 15th century, the founders of the European credit union movement in the 19th century to inclusive finance today...

Microfinance is being embraced by many and is attracting ever more attention. The United Nations declared 2005 the International Year of Microcredit, the European Union has made microfinance part of its Europe 2020 strategy and in 2006 Muhammad Yunus received the Nobel Peace Prize for his pioneering work in this field.

But is microfinance actually new at all? Over centuries, many forms of credit and savings schemes have been developed all over the world providing finance to people who would otherwise had not even access to such services.

- In the Middle Ages, an apprentice of the guilds was able to borrow money from his master to set up his own trade after training. This was the cheapest way for apprentices to borrow money. Apart from this solidarity among people in the same trade, there were no other options available, except the local moneylender or the church. What is more, without this sense of solidarity, it was practically impossible for a young starter to set up a business and acquire orders.
- In the 15th century Franciscan monks were already setting up pawn shops. They developed this form of lending out of sympathy for the poor. This showed that even at that time, those in real poverty had no access to 'normal' credit providers but solutions were at hand and depended on private initiatives.
- In the 18th century, a local loan fund was introduced by the Irish reverend and writer Jonathan Swift. He wanted to do something to fight poverty following yet another famine in his country[2], and set up the Irish Loan Fund in 1720, which provided loans of five to ten pounds to the very poor. This money had to be repaid in instalments, two to four shillings every week, without interest. The success of the fund resulted in the establishment of similar funds that collectively provided over 500.000 loans. Ireland gradually recovered after the famine and the number of loans from the funds also gradually decreased. By the middle of the 20th century, all funds had closed
- In 1895, Raden Wiriamaadya set up the Priyayi Bank was set in Indonesia (by then a colony of The Netherlands. With this initiative he wanted to help his friends pay off their debts to local (Chinese) loan sharks. This idea later gave rise to thousands of local village banks. The Priyayi Bank is the predecessor of the modern Bank Rakyat Indonesia (BRI), the second largest bank in Indonesia and specialised in microcredit.

[2] Ireland had faced several periods of major famine and poverty during the 18th and 19th century. The Great Irish Famine occurred between 1845 and 1850, when over one million Irish people starved to death as a result of five years of unsuccessful harvests.

- During the industrial revolution (in the late 18th century), Friedrich Raiffeisen developed local cooperative saving and loan schemes that were set up by and for impoverished farmers. The aim was to help them to free themselves from exploitation by loan sharks, merchants and trading companies. In 1864, he founded the first credit and savings bank on a cooperative basis in Germany. Its success inspired many others to deploy similar initiatives and culminated for instance in the establishment of the Boerenleenbank and Raiffeisenbank in the Netherlands and the Volksbank-Raiffeisen in Germany. In the Netherlands, those local cooperative banks merged several times to become eventually the Rabobank, for years one of the few Triple-A rated[3] banks in the world[4].

Who first came up with the concept of microfinance?

Jonathan Swift
(1667-1745)

Friedrich Raiffeisen
(1818-1888)

Muhammad Yunus
(1940 - present)

- In the 19th century, when a haystack or farm burnt down it seriously affected the income of farmers. They soon understood that they could bear these risks by acting together. In 1811, the Netherlands' first mutual insurance association (insurance company) was set up in Achlum, Friesland. Local leaders convinced a group of 39 farmers that joining forces and collectively depositing money in order to help one another would be a way to cope with such emergencies. This first mutual later merged with many others out of which grew one of the largest insurance companies in the Netherlands, Achmea.
- In 1820, the "Maatschappij tot Nut van 't Algemeen" established the first public welfare savings bank (Nutsspaarbank) in Workum in the north of the Netherlands. The safekeeping of deposits protected people from losing their money and guaranteed that their savings were available when needed. The name of the organisation already indicates that it was concerned with more than just serving 'economic interests'. In fact, the inspiration to establish these banks stemmed from solidarity with the least fortunate in society and the conviction that it was necessary to enable these people to participate actively in society. These small savings banks also later grew (into fully-fledged banks such as SNS Bank and Fortis Bank).

[3] Triple-A is the highest rating that can be given to a bank. It indicates that the bank has a high creditworthiness, which means that the bank itself is able to borrow money at the lowest rate; money that the bank needs to be able to lend it again.

[4] A status it lost when it became public that Rabobank was involved in the so-called Libor scandal; in 2016 the cooperative bank even lost its real cooperative character with the central office taking over decision making authority form the local – primate- member cooperatives

- Since centuries, also people in developing countries have invented many different forms of informal saving, borrowing and insuring, often in the forms of groups and based on mutual support and trust. Well-known forms of informal mutual saving and borrowing within a group are the Rotating Saving and Credit Associations (ROSCAs) and Accumulating Savings and Credit Associations (ASCRAs). ROSCAs and ASCRAs can be found in nearly all developing countries, under different names such as 'Iqqub' (Ethiopia), 'Susu' (Ghana), 'Chit fund' (India), 'Kasmoni' (Surinam) or 'Sitanani' (Swaziland). In ROSCAs individual group members periodically and regualrly deposit money in order to save, borrow or insure themselves. The participants usually deposit an agreed sum into a joint kitty at a prearranged time. The total sum saved monthly is paid out to one of the participants. In ROSCA's normally no interest is charged to or received by members. Other than with ROSCAs, the money of the ASCRAs is not paid out every time: the participants in these groups wait until the end of the cycle for payment of the money they paid in. Participants *can* get their money paid out earlier in the event of setbacks. The savings system of an ASCRA makes it possible to issue low-interest loans to members or non-members. As such, ASCRAs are more complex in terms of saving and borrowing, and therefore require more supervision, more compulsory rules and detailed accounts.

All initiatives have a number of common characteristics:

- In all cases, these initiatives were focused on creating *access* to financial services for people who would otherwise not have had such access;
- Financial services were provided *on the basis of trust*. Collateral was not required;
- These services were not just offering smaller loans (known as microcredit); they related to all *financial services* that people needed, including savings and insurance, pensions and guarantees. All of these services are covered by the term 'microfinance';
- The initiatives created opportunities to *participate* in society ;
- Many organisations were based on the principle that the owners of the funds (depositors) would have *control over decision making*;
- But also, what started out as *socially-orientated, locally established* initiatives gradually grew into nationally operating financial institutions. Organisations that provided microfinance were originally non-commercial institutions, but developed gradually into commercial organisations, like banks and insurance companies with less contact with their original members/ founders. Such transformation processes in the past reveal many parallels with current trends in developing countries.

Thus, microcredit did not emerge in the last few decades. It was not invented from the scratch by Muhammad Yunus from Bangladesh (and his Grameen Bank) or by Maria Nowak [5] from France (with ADIE). What Yunus did and others later as well, however, was to bring many of these old initiative back to our attention and demonstrate again that the poor can also be good borrowers and even good savers. Microloans can enable the poor

[5] Maria Nowak is the founder of ADIE (Association pour le Droit à L'Initiative Economique), one of the large microfinance institutions in France. She is also one of the founders of the European Microfinance Network (EMN), the leading European network of microfinance organizations in the EU Member States.

to improve their living and working conditions. Yunus established the Grameen Bank[6] in 1976, a local organisation that grew over the years into a fully-fledged bank with millions of clients; it was a concept that inspired similar initiatives in other countries. Since the success story of the Grameen Bank, numerous microfinance institutions across the whole world have been offering microloans, micro savings products and micro insurances. They offer millions of the poor the opportunity to participate in society by creating *access* to financial services that the formal banking system denies them[7]. And in turn, those microfinance institutions have become fully-fledged players within the financial system. And people like Maria Nowak made it clear that microfinance is also an effective tool within Europe to give the 'socially excluded' the opportunity to participate in society and win back their dignity.

Many microfinance institutions (MFIs) have shown significant growth over the last decades, and not just in terms of numbers of clients. The institutions have also grown alongside their clients. The range of services on offer has expanded (savings products, insurance, guarantees and payment services are also being offered alongside loans) and the average loan amount has risen. That sounds positive, but the growth of microfinance has also created a 'new' remoteness from society. Specifically, microfinance institutions are increasingly focusing less on the poorest of the poor, making it seem as if history is repeating itself. The least fortunate are once again at risk of being excluded from society. In some countries again they have difficulty in accessing general funding sources, despite the existence of a well-developed microfinance sector now being part of by the overall banking system. The persistent banking crisis is also contributing to the fact that the poorer members of society are being overlooked again. Financing institution consider small loan amounts evidently still not interesting, even if there are thousands of people who want to borrow, save or transfer such small amounts. Will this give rise to new initiatives? Will people once again seek their own solutions?

[6] 'Grameen' means village.

[7] The size of the microfinance (lending) market can only be estimated. The more reliable source is the Mix Market, where over 3.000 MFIs report to. Based on MiXMarket data MFIs are attending at least 94 million clients and have a portfolio of outstanding loans of more than 81 billion US$ (2012). This must be seen as the absolute minimum size of the market Many organisations (mainly the smaller and newer ones) are not (yet capable to) report on their performance. In most reports the size is set at 120 million clients per annum and a portfolio of about 150 billion US$.

NOTES

2.

JUST A PRODUCT OR A MOVEMENT?

...access or size...

When we hear people talking about microcredit and microfinance on radio, T.V. or at a conference we appear to know what they refer to: they talk about very small (micro) loans for poor people. It might be a loan of €200 to a single woman in Kenya, which she can use to purchase a treadle sewing-machine; with that sewing machine she can make school uniforms at home for her own children and for children in the neighbourhood. Hence she earns some additional income. And we know then: microcredit means micro loans. But if you listen carefully, people are also talking about systems and organisations that apparently form an integral part of society. And they then seem to refer to other services as well such as micro-*insurance*, micro-*pensions* and even micro-*savings*.

Thus, what are we actually talking about when we refer to micro*credit* or do we talk about a product/ service or *movement*? Does it solely concern those very small amounts? Why have organisations been established that provide very small loans to men or women? What do those organisations want to achieve and what have they achieved in the end? Do we see money differently now in our society? How was it possible for the local initiative by Muhammad Yunus - extending loans to a group of impoverished women in Bangladesh - to expand into a fully-fledged bank? And why did he receive the Nobel *Peace* Prize in 2006? And why was he later ousted by his own Bangladeshi Government?

Apparently it is not just about "*small*" things only. Not only about supporting micro businesses. It is also about "*access*" and "*participation*" and about a changing focus on financing. It refers to access to loans, but also to access to savings facilities, insurance, pensions and guarantees. The term 'microfinance' refers to that broader spectrum. If banks had been open to all people in society, microfinance in its current form would not have come into existence. And, microfinance is related to another way of looking at finance and financing. When people are excluded, they will – consciously or unconsciously – accept that for some time. But at a given moment, they will take steps themselves to (re)gain access and participate again. And that applies even more to entrepreneurial and enterprising people in need of money to set up or expand their businesses. History shows that if people are denied such opportunity, they eventually take steps to overcome such barriers. They will then form their own informal savings and loan groups or set up cooperative insurance systems. They will establish all kind of microfinance institutions (MFIs) with different legal structures such as associations, foundations, NGOs, cooperatives, or self-help groups. Those initiatives have in common that they create indeed access to

initially small, micro loans and later on, to other financial services as well such as the opportunity to save, buy insurances, obtain guarantees and even become part of pension funds. And community based organizations first just experimenting with extending one or more of such services at local level may even become specialized micro banks. Enterprising people will always seize such opportunities and take action, not just in developing countries, but in the European countries; and apparently quite successfully indeed.
Microfinance has proven to be highly successful. Having started small and operating mainly locally, non-governmental organisations in some countries have become specialised microcredit providers and some have even grown into regulated and licensed financial institutions that have gained a fully-fledged position within the financial system. Many of them have become organisations that employ not only a relatively high number of people, but also reach impressive numbers of clients and manage an extensive loan portfolio. (See Table 1).

Table 1 Ranking microfinance institutions - they are not that small anymore

Name of MFI	Country/ year of establishment	Ranking on basis of no. of employees	No. of employee	Ranking on basis of no. of clients (borrowers)	No. of clients	Ranking on basis of portfolio	Portfolio (2011)
BRAC	Bangladesh (1972)	1	44,306	4,5	Over 5 million	8	$646 million
Grameen Bank	Bangladesh (1983)	2	25,283	2	Over 8.3 million	3	$939 million
SKS Microfinance	India (1998)	3	22,733	3	Over 7.3 million	4	$925 million
ASA	Bangladesh (1978)	4	21,298	4,5	Over 5 million	9	$531 million
Compartamos Banco	Mexico (1990)	5	13,298	8	$2.3 million	5	$840 million
BASIX	India (1996)	6	10	9	Over 1.5 million	10	$281 million
Bandhan	India (2001)	7	9,754	7	$3.8 million	7	$733 million
Vietnam Bank for Social Policies	Vietnam (2003)	8	8,9	1	$8.5 million	1	$4.9 billion
Spandana Sphoorty Financial Ltd.	India (1998)	9	8,328	6	Approx. 4.2 million	6	$778 million
ACLEDA	Cambodia (1993)	10	7,34	10	272.3	2	$1 billion

Source Devex, Eliza Villarino, (2012) edited by the Financial Inclusion and New Entrepreneurship Research Group (2012, 2015)

Artichoke, aniseed, blackberry, strawberry, chamomile; the herbal tea producer Larix in the Romanian town of Sovata produces around 50 types of tea. Ten years ago, a micro loan helped the company to modernise. Since then, Larix has become a blossoming company, exporting tea to other countries within the European Union.
Larix was established in 1995 as a 'two-man enterprise' by Iona Fazakas and Andrei Munteanu. In 1998, Larix received a capital injection of US$30,000 from the Romanian-Swiss microcredit organisation FAER. A normal loan was not a real option, as banks in Romania at the time were asking for enormous interest rates of 60%.
Fazakas and Munteanu used to make marginal profits, but today they do business with well-known European companies such as Biohorma and Weleda.

Would Larix have become so large without the microloan? "*That's difficult to say*," said director Andrei Munteanu. "*It certainly provided valuable support in getting our business started.*"
Source: RNW, Dossier Microfinance

Microfinance institutions are taken nowadays seriously the governments. A growing number of them are now monitored by regulatory authorities and institutions just as the 'normal' banks. Many microfinance organisations have been so successful that they attracted the attention of private investors as well. These investors in turn make relatively large sums of money available via special investment funds. This allows MFIs to expand their programmes, from which the investors expect a high social and financial return.

Microfinance institutions might be seen as enterprises as well. Since they operate with a 'Bottom of the Pyramid" (BOP) perspective, they can be considered social enterprises[8]. Some of them have taken a step further and developed new initiatives not directly related to their core business (e.g. rendering financial services to the excluded in society); via partnerships with larger companies they now seek ways to provide other services or even consumer goods to the poor (and poorest of them). Grameen Bank, for example, has done so by collaborating with Danone and Adidas; the latter have helped Grameen to develop new, cheaper quality products (yoghurt and sports shoes repectively) for the poorest people in Bangladesh.

[8] 'Social enterprises are making money while at the same time addressing social issues'. 'Real trade with paying customers is at the heart of things'. 'Thriving business, part of the enterprising economy, generating services and products which reduce inequality and create new opportunities for people who are usually left out.' (Black, L. & Nicholls, J. (2004) *There is no business like social business. How to be socially enterprising?* UK: The Cat's Pyjamas)

What began as a 'micro-organism' has henceforth developed into a larger movement and has become an integral part of the financial system. And with that evolution came as well unexpected problems such as less personal contacts with loan officers, less control over the organisation, uniform products offered (not target group tailored), or less transparency in costs and prices. Operations are no longer confined to rendering financial services to small, informal (groups of) savers and borrowers exclude from mainstream banking services. It has turned into selling new products in large quantities at indeed small margins to the numerous people, the poor and especially those at the bottom of the pyramid as well. One may state that the market has become a mature one and that we are not talking about offering a single service anymore but that we are dealing with a movement. The question remains whether that movement really has an influence on the behaviour of financial institutions. Have the latter learned from microfinance? That control over one's own money and putting the (poor) client first must be the core principles in business and might be the basis of survival and continuity? Or is the behaviour of financial institutions - even after the banking crises - still the same as before showing us that little has been learned yet and that the movement still needs to go on? Or is it microfinance sector still too small to make a difference taking into account that the total volume of micro loans outstanding globally by over 12.000 MFIs of approximately €120 billion is still rather marginal in comparison with the balance sheet total of €1,708 one single bank such as Deutsche Bank (2014)?

NOTES

3.

TOO BIG FOR THE CLIENT?

...they are big and we are small...

A great deal is being said and written about microfinance and microcredit. Not a month goes by without an article in a daily or weekly publication claiming that microcredit is a successful development too offering better prospects for the poor or – especially in the recent years – that microfinance has failed to fulfil its promises in the end. Just by reading these pros and cons, one gets the impression that after all a great deal is known about microfinance but not yet what the future will bring. But is that really the case? What are the facts? Are all specialised microfinance institutions indeed well-known? How many people use them? How many people do save small amounts? And for what amounts do people take out micro-insurance policies? The over-arching questions are indeed: how much money are we talking about and how many clients are served?

Micro-credit, micro-savings, micro-insurance, micro-pension schemes, micro-leasing, micro-guarantees, micro-transfers – all these services can be offered nowadays by microfinance institutions (MFIs). And when we refer to those MFIs, we think of modest local organisations that provide financial services to the poor, services that again are provided on a small scale. But the latter is not the case (anymore): there are MFIs that serve millions of clients and employ thousands of co-workers. And overall, it appears to be a sector worth billions of dollars not only operating in the poorest developing countries, but everywhere, including Europe.

Of the well-over 12,000 MFIs that are assumed to operate in more than 100 (developing) countries, only a limited number (approximately 3,000) are able to publish their data periodically. Those are stored in special databases that provide reliable data for a particular region. The most well-known database is the MixMarketExchange (*www.mixmarket.org*). In a systematic way it collects data related to micro loans micro savings operations by (nongovernmental) organisations and institutions (primarily) operating in developing countries. However, there are also regional databases, such as that of the European Microfinance Network (EMN; *www.european-microfinance.org*), containing data about the performance of MFIs in the member states of the European Union. And in some countries (ranging from India, Kenya to Italy) records of national data are produced in a structural manner as well.

Based on the aggregate data at hand, we may conclude that the MFIs active worldwide as providers of microcredit and related services attend to around 150 million clients. By the end of 2014, the major microfinance institutions had collectively lent over $81.5 billion in microloans[9] while it may be estimated that the sector was worth 100 to 150 billion dollars in total.

The situation may vary significantly between different parts of the world and regions. Most clients (56% of the total) live in Asia and have average loans of €500 per person (client).[10] The greatest volume of loans relates to East Asia and the South Pacific, equal

[9] Source: MixMarket (2009) Centrum voor Microfinanciering Inholland (2011), and Microfinance Barometer (2013 and 2014)

[10] Source: Mix Market 2009, and adjustments by Centrum voor Microfinanciering Inholland (2011)

to more than $ 47 billion. (Convergences, Barometer 2015[11]). Both the number of borrowers and the total size of the loan portfolio are still growing every year by about 10%. Although the percentage growth is decreasing somewhat, these are still quite impressive figures, of course. Even so, a little modesty would not be out of place here. If we compare the total in outstanding microloans against the total balance of private financial institutions such as Citibank (balance total over €2.000 billion) or Deutsche Bank (well in excess of €1,700 billion), the figures of the entire microfinance sector seem pale. The fact is, however, that those 150 million clients of the MFIs, who were rejected by the major banks and are socially and economically less privileged, now have access to financial services, are treated as clients (not beneficiaries) of those MFIs and feel valued members of society at large.
In Europe, around 400 MFIs are active and that number is increasing relatively rapidly. In 2013 about 145 of them reported to EMN (EMN 2014). They collectively reached around 300,000 clients. A more detailed analysis of the data reveals that the average loan in Europe is approx. $ 11.500 (€9,600). That is a completely different order of magnitude from the average sizes of microloans in South America, Africa or Asia, which amount to $916, $334 and $140 respectively!

France is one of the countries in Europe where the microfinance activity has developed significantly as well. A variety of organisations render services: In 1985, France Initiative was created. It is a federation of organisms whose mission is to facilitate business start-ups at the local level with the support of the Local Authorities and in connection with the banks. In 1988, the Association France Active was established, supported by the Fondation de France, the Caisse des Dépôts et Consignations, l'Agence Pour la Création d'Entreprise (APCE) and the Crédit Coopératif. In 1989, Maria Nowak created ADIE (Association pour le Droit à l'Initiative Economique) whose fundamental mission is to grant microcredit to socially and financially excluded persons. ADIE has more than 400 employees and 1,200 volunteers. In 2008, its microcredit activity jumped by 30% relative to the previous year, and in 2009 by 9%, with 13,997 loans granted in 2009. It has at the moment more than 26,500 active clients. Other significant associations work at the local or national level. The France Initiative association, which has a decentralized network, has a highly developed activity with regard to so-called "honour loans" ("*prêts d'honneur*"), loans at zero interest, which allow the beneficiaries to access significant complementary bank credits. In 2008, *France Initiative* granted 13,200 "*prêts d'honneur",* which allowed 31,000 direct jobs to be generated or maintained. *Parcours Confiance*, created in 2006, brings together the associations set up by the savings banks ("caisses d'épargne") which also aim to fight against financial exclusion through the provision of microloans. These associations, which funded a little more than 3,000 projects in 2008, are non-profit bodies, even if they remain connected to the banks that created them. About half of all micro loans are disbursed to clients below the national poverty line, at ADIE more than 50% of the new clients is part of an Ethnic minority or immigrant. While this target groups are expected to remain at the core, subgroups might change (at ADIE: In 2007 young clients, in 2013 seniors).

[11] Source: *www.convergences2015.org,* Microfinance Barometer 2013 and 2014

Table 2 Basic data for Microfinance worldwide and in Europe

	Developing countries[12]	Europe (EU)[13]	Nederland[14]
Number of organisations specialising in microcredit/microfinance[15]	> 12,000 (est.)	> 430	15[16]
Number of clients	> 150 million	> 300,000	~>130,000
% female	60%	30 - 40%	~40%
Amount of outstanding loans	~€90 billion	~€1 billion	~€601 million
Range of loans (€)	~€100 – 425-1.000	€500 - 9,600 – 25.000	€9004, 100 – 15.000

Source: Processed data, Lectoraat Financial Inclusion and New Entrepreneurship Research group (2015)

Microfinance did not "just like that" appear out of the blue and was not just invented overnight. The system has a long history and is based on both practical insights and economic theories. And it has grown over the past decades. Small initiatives have evolved in a movement not to be overlooked anymore.

For centuries, large numbers of people experienced limited or no access to financial services. Many were and are still not considered prospective clients of any importance. The loans they ask for are regarded as too small, the handling as too costly and the financial and economic returns as insufficient and unattractive. What is more, their place of work is seen as too far from the bank (physically and psychologically), they are unable to provide the required collateral and, perhaps most importantly, they do not speak the language of the formal financial institutions.

In spite all those negative arguments why large segments of society cannot be served people have always found solutions to these issues. Small projects have been initiated, have turned into organisations and a growing number of people are now attended by an extensive , global network of microfinance institutions ranging from small community based organisations to large specialised micro banks. Experience and knowledge have been used over the last few decades to develop microfinance into what we know it as today, as big as it is, not micro at all. Organisations with their own management and boards of directors concerned about the risks those now larger organisations may incur. And subsequently taking decisions to reduce and even avoid such risks like all well-established financial institutions do. Protecting the interest of a wide range of stakeholders: donors, public and private financiers, larger depositors, staff and co-workers, management itself, and of course the clients. But that might as well create distance with the original target groups. Does that also mean that the poor people - for whom access to finance meant so much - are ignored once more?

[12] Source: Mix Market 2009,2013 based on around 3.000 MFIs reporting
[13] Source: EMN Surveys 2007, 2009 and 2013 (with only 145 MFI reporting)
[14] Centrum voor Microfinanciering Inholland 2009/2011 and the Financial Inclusion and New Entrepreneurship Research Group (FINE) of The Hague University of Applied Sciences (2014)
[15] Excluding the general banks, but including specialised microfinancing banks.
[16] Of which three larger ones operating nationwide; based on data from EMN 2014 and FINE Research Group – 2015 analysis

4.

WHY ARE WE OFFERING MICROFINANCE?

...look carefully, there is more to it...

There are some microfinance institutions that are only providing micro loans (referred to as microcredit), while other MFIs offer a broad range of services. The majority of MFIs claim that their microfinance services support people in developing and developing small businesses. Others see microcredit as a tool to empower people. In both approaches supporting people to set up economic activities to generate income plays a central role. And would it not be crucial that MFIs providing such services become sustainable?
In the past century, many programmes to support and develop small and medium-sized businesses were set up on the basis of an *integral approach*. The supporters of this approach believed that while financial services are important, other services needed to be provided too. These other business development services consisted for instance of entrepreneurship education, coaching, mentoring and management training. The idea was that clients need all these services in order to be able to start a viable economic activity that generates income and creates jobs.

At the end of the 80ies, the *minimalistic approach* gained in popularity by focusing exclusively on (micro) credit and less on additional services. This change took place following a number of evaluations of small and medium enterprise (SME) financing and development programmes in developing countries that had demonstrated that:

a. the effects of SME support programmes were not all that significant (in terms of numbers of SMEs reached and SMEs becoming viable;
b. the costs of training and business advisory services were too high in comparison to the investments made by small entrepreneurs and could not be paid by the latter;
c. the programmes failed to become self-sufficient and
d. private sector operators were in a better position to offer demand-driven services.

Those who want to help people to participate in the economy have many effective forms of support to choose from all with their own blend of financial and business development support services. But if one wishes to do so in an efficient and (financially) sustainable way it was argued better to choose that type of support service that has the greatest (positive) effect. The minimalistic approach focuses primarily on costs and effects of services on clients. That led to the conclusion that microloans solely (e.g. offered without any other additional services) were to be regarded most effective in support of poor people who wanted to set up modest economic activities to generate work and income. And since the mainstream financial system was neither interested nor capable to render that kind of services there was scope for new and alternative forms of financing. And it was understood that those services could best be provided by specialist organisations built around already existing community based (CBO) and other nongovernmental (NGO) development organization. Microcredit was born (again).

In the 90ies a mission shift took place. A neoliberal conviction prevailed that the provision of microcredit could only be guaranteed if the *microfinance institutions themselves were financially sustainable* and could operate on their own. Their continuity was regarded as a crucial prerequisite for a well-functioning microfinance system. That sustainability had to be ensured by generating income from the financial services rendered, in other words

income from interest on micro loans. Interest rates were consequently set at rates that suited the MFIs. And as long as clients were paying these rates, such an approach was seen as fair and correct and propagated intensively by larger international development organisations. Some development organisations were even that convinced that they presented it almost as a kind of development theory (see for instance the publications of Acción International *www.accion.org*).

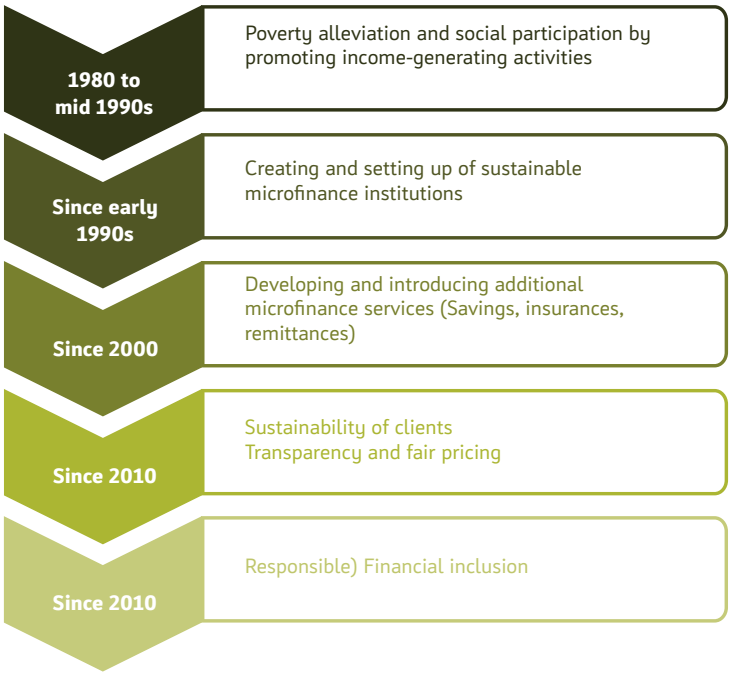
Over time it was understood that client not only needed credit, but also wanted to protect their savings and would benefit from insurance to cover death or illness. Microcredit was henceforth complemented with micro savings services, insurance, pensions and/or payment systems. In other words, microcredit became microfinance.

Microfinance was (and still is) considered an instrument to help people out of poverty as it enabled them to engage in income-earning activities. In addition, microfinance is expected to contribute to social and human development and to enhance empowerment, in particular of women. And next to these economic and social aims, the sector also thrives for sustainability. However, those two objectives are not easily brought together as – for instance - the evolution of the microfinance sector in Bangladesh demonstrates. In Bangladesh, the number of borrowers has increased from 2.7 million in 1998 to 25 million in 2007 attended by over 600 MFIs. The average loan size increased from 5,000 taka (US$746) to 300,000 taka (US$4,477) with a total loan portfolio of US$ 3,3 billion (MRA 2014) . But the income of the rural poor only slightly improved (Karim 2011). In the Bangladeshi market , NGOs offering microloans compete heavily for clients. Clients are stimulated to continuously borrow and renew their loans ("repeat loans") and even accept ever increasing loan amounts when this is not justified, on seemingly attractive terms. Consequently, borrowers, mostly women, juggle with money and risks to become over-indebted by participating in more than one microloan scheme to use the loan of one microfinance institution to repay a previous lending MFI. And if that fails, the private money lender is the last resort. But once fallen (again) in the hands of loans sharks they risk that business or personal assets are confiscated or even houses demolished in case of default. In short microcredit can then have a severe influence on different levels of the life of microfinance clients.

Over the past decades however, clients become more conscious and critical about the financial products available. In Nicaragua for example, microfinance clients started a "*no-payment movement"* as a reply to high interest rates. This movement affected severely the national microfinance industry in countries such as Bolivia, Pakistan, Bosnia and Nicaragua. Critical voices have stated as well that the microfinance sector should be stimulated to listen more carefully to their clients and develop products that fit their needs, that the impact of microfinance products on the social life of its clients is neglected and their livelihood strategies are ignored altogether; that strategies adopted by MFIs has resulted in badly developed products or services for the poorer sections of society. Over the last few years, the mission of the sector has shifted again. Also due to critical voices nowadays taken more seriously, it has gradually been understood the sustainability of the *clients' businesses* must not be subordinate to the interests of the financing organ-

isations. That requires transparency in costing (fair pricing) in the market and awareness among the MFI of their corporate social responsibility. And a pleas is made thus to focus on responsible financial inclusion: In other words to work towards a system that is open to all and that is willing to serve everyone by providing the right (mix of) services for an acceptable price, whereby the needs of the clients must be the central pillar for the strategy of the MFIs. (see also figure 1)

Figure 1 Evolution of microfinance



Source : Adapted from Molenaar (2011) Microfinance, evolutions and challenges....are we still in touch with the real client?....

A more detailed analysis of the aforementioned developments also reveals that approaches are scarcely based on theories (with the minimalistic approach as exception) but rather on assessment of developments in the market itself. Insights are primarily based on practical experiences and are casuistic in nature. Only the past decades successful programmes and projects are described more in detail (with studies covering lessons learned and best practices, impact evaluations and random control trials). The results are widely disseminated by organisations such as the Consultative Group to Assist the Poor (CGAP) and EMN. Further evaluations and studies are indeed desirable in order to be able to hold a debate on the advantages and disadvantages of microfinance and the way the instrument can be used. Will the mission shift again? When will the client finally remain in the picture? Are we now seriously concerned with his or her personal sustainability?

5.

ONLY FOR THE POOR IN DEVELOPING COUNTRIES?

...the percentage of people living in extreme poverty must be at least halved between 1990 and 2015 (Millennium Development Goals, UN)...[17]

Somewhere in Amsterdam...

What do you know about microcredit?
... It is for people who want to borrow small amounts, for a small shoe repair shop for example. So not for mortgages of five or six hundred thousand Euros or for cars of 80,000 Euros. The loans are primarily available in poor countries, I think.

Do you consider microcredit to be a solution to poverty?
... Whether it is the definitive solution, I couldn't say. It is certainly a type of lending for those who have no money to help them make their plans a reality. And if someone cannot pay back that 100 euro loan, well it's only 100 Euros. It won't cause a bank to go bankrupt, anyway.

Who do you think benefits the most from microfinance?
...That depends on the interest rate applied to it. If there is no interest to pay, it could well be the loan applicant.

Does microcredit reach the people who need it most?
... I cannot say; I do not know.

Have you ever received a microloan?
...Once when I borrowed money from someone, who ultimately let me off paying it back.

Source: RNW Dossier Microfinance (20120

Tortilla baker *Linda Flores* and her family have lived on the poverty line in Nicaragua[18]. The local organisation Pro Mujer[19] had confidence in Linda's dedication and commitment and gave her an initial loan of $ 90(~€70). Her family's living conditions have improved since that time. And production and sales have even increased so dramatically that husband and children had to lend a hand in meeting clients' demand. And the house is now partly built of brick. And all thanks to selling tortillas...

[17] In 1990, 1.8 billion people, or 41.7% of the world's population, were living in extreme poverty.
[18] See also the video about Linda on the RNW website, www.rnw.org Dossier " Microfinancing".
[19] Pro Mujer literally means: for the benefit of women. Pro Mujer is a flagship organisation of the microfinance sector in Bolivia.

At the Microcredit Summit[20] participants pledged to ensure that 175 million impoverished people, like Linda Flores, would have access to microcredit (and additional services) by the end of 2015. Many believe that target to be realistic. At the end of 2014, over US $80 billion was outstanding in microloans. Close to 150 million people have used microloans (with an average loan amount of US $522) provided by over 12,000 microfinance institutions. The majority of these clients were designated as 'poor'.[21]

But when is someone considered poor? The United Nations claim that someone is poor if (s) he has less than $2 to live on per day[22]. That will allow people to survive, e.g. to make it to the next day. And if all goes well, maybe with a better future for the children. It makes participating in the economy seem unrealistic at least from our Western perspective, let alone imagining a 'poor' person saving money or taking out a loan from a bank. But being able to save and access to borrowing are still the key to participating in society. In many cases, however, the poor are denied access to those general services. And in the absence of banks willing to extend loans, they soon end up at the doorsteps of private moneylenders who then will offer the 'solution'. And with no choices left, excessive interest rates as charged by those loans sharks[23] for short-term loans are all too quickly accepted. The poor thus 'inevitably' end up in a poverty spiral...

Arnold Hoek knew that setting up a Solex rental company would fill a gap in the market. Even so, not a single bank would give a loan to the 57 year-old, who lived social welfare (being disable to work). He earned a little extra now and then by giving drawing lessons, but it was not exactly a money-spinner. He cannot bear to ask anyone for money. He did not want to be dependent on anything or anyone. Hoek was able to make his dream come true, when he managed to obtain a micro loan of Euro 29.000 for which paid just 7 percent interest per annum to set up motor rental service.

Before Hoek obtained his micro loan, he did not know that such type of financing was also available in the Netherlands. Now, he believes it is logical that it is not only available for people in developing countries: *"The farmer who can buy a cow thanks to a new micro loan and is therefore able to become independent - I can fully identify myself with him, because I am actually in the same situation."*

Source: RNW Dossier Microfinance, 2011.

[20] The Microcredit Summit is an annual conference on microfinance, with participants from all over the world.
[21] Source: Mix Market and Convergenses (2014).
[22] This $2 per day has been adjusted for differences in buying power between different countries.
[23] Easily more than 200% per annum.

Bangladesh is one of the poorer countries with a Gross Domestic Product (per capita) of $3.200 per year (2014 est., CIA World Factbook 2014). Over 30% of its 168 million people live below the poverty line (2010, CIA World Factbook). In this country, the moneylenders have been partly replaced by specialised microfinance institutions over the last few decades. In late 2014, more than 600 MFIs in Bangladesh granted microloans to over 25 million people, with an average loan amount of Euro 168. (MixMarket 2014; MRA 2014). Microfinance proved to be a way out for the poor, as was demonstrated by the rapid growth of the sector.

Poverty is of course a relative term. Even in richer countries, there are people living below 'a' poverty line. In the Netherlands, one of the richest countries in the world with a GDP per capita of €33.3200 (CIA Word Factbook 2014), that poverty line for a family with two kids has set at around €21.200[24], while in Spain it is €17.040 (INE / EAPN 2014). Translated into income per day, this amounts to €59 for the Netherlands, more than 28 times the amount that the United Nations considers the poverty line. And despite this, microcredit is offered in the Netherlands as well, in a country where one can fall back on social security benefits in case of unemployment or disability to work. Yet, such benefits unfortunately do not guarantee (continued) participation in society: the loss of work may also go hand in hand with social exclusion, something that in Europe we regard as a severe form of (social) poverty. Offering microcredit can therefore be regarded as a tool for addressing that exclusion (see also the EU 2020 Strategy[25]).

Stimulating and supporting the unemployed to participate in society by setting up and running their own enterprise are regarded as important challenges facing Europe in the coming years. The European Commission's ambition is ensure that at least 20 million people who are currently not participating in society or are at risk of becoming unemployed, still play an active part in the community. Microfinance is seen as a tool that can be effective in achieving this and Member States are therefore called upon to support microfinance institutions. In 2010 the European Progress Microfinance Facility (Progress Microfinance) was launched to increases the availability of funding for private or public banks, non-bank microfinance institutions and not-for-profit microcredit providers to offer microcredit – loans below € 25 000 – for setting up or developing a small business. Since 2015 the EASI facility of the EU supports actions in two thematic sections: (i) microcredit and microloans for vulnerable groups and micro-enterprises and (ii) social entrepreneurship. EUR 96 million is already available for interested microcredit providers and social enterprises. And the European Investment Bank (EIB) extends larger loans to finance micro lending by specials micro finance institutions since 2016.[26]

[24] As defined by CBS (Statistics Netherlands) as €930 per month for a single person (2010).
[25] See also: http://ec.europa.eu/europe2020/index_en.htm
[26] January 2016 the IEB and Qredits signed a loan agreement for € 100 million

In the Netherlands, by early 2015 more than 660,000 people[27] were unemployed[28] of which 430.000 depend on the minimum social welfare benefit (CBS, 2015). Micro loans are offered to them as a tool to become self-employed and start income generating activities. In 2015, about 3,500 people made use of a microcredit (about 1,000 via Qredits and 2,000 under the BBZ facility), with an average microloan amount of around €19,000, almost 170 times the amount in Bangladesh.

In Bangladesh, the average microloan is €168 (Central Bank Bangladesh, 2014); and given to a single woman, she can try to earn enough money to clothe her children by selling some vegetables on the market. In Nicaragua, the microloan of just €70 ($ 90) gave the tortilla baker's family hope for a better future, while in the Netherlands, the man who is unfit for work could return to work by renting out mopeds with a microcredit of approx. €26,000 ($ 32,200). Despite the significant geographical, cultural and financial differences, these examples have something in common: all recipients are now participating in society thanks to a microloan...But are they really in the same situation? Are the poor in more developed economies not better off with access to social welfare and banking services readily available?

[27] In addition about 263.000 people are not looking for work, but could have been added to this number.
[28] Source: Statistics Netherlands (CBS 2012)

NOTES

6.

OR IS IT FINANCIAL INCLUSION?

...obvious, but still...

At the G20 summit held in Toronto in 2010, the Principles of Financial Inclusion were adopted, and in 2011 HRH Princess Máxima of the Netherlands (as she was then known) was appointed the UN Secretary-General's Special Advocate for Inclusive Finance for Development. But is financial inclusion not a new (buzz) word for microcredit and microfinance?

Microcredit, microfinance, financial inclusion? For the casual observer, it seems as though microfinance no longer exists; at least, the word is not being used so frequently anymore. Since 2012, a great deal more was spoken and written about the need to make financial inclusion possible. Fair, open and direct access for everyone to the right financial services at affordable costs is the theme of Financial Inclusion. That makes it possible for everyone to participate in society, particularly to become an economically active citizen. But that is what microfiance has always been about. The first microloans given 30 years ago in Bangladesh were intended to help the poorest of the poor to participate in society; to empower them and thereby gain belief in their own ability. The women borrowers became more active in society with increased self-confidence through their participation in the solidarity groups without which they could not obtain a loan initially. Similarly, the savings group set up and promoted by a local organisation, Grameen Development Society (GDS) in India gave women a chance to participate an break the barriers that creates their social exclusion (Molenaar 1998). In such groups, women encourage one another to save regularly, to lend to each other, but above all to help all members to participate in the village community: a form of financial and social (!) inclusion. Over the years, many people have gained that self-confidence and the urge to participate in economic and social life, thanks to microfinance...

> Full financial inclusion is a state in which all people who can use them have access to a full suite of quality financial services, provided at affordable prices, in a convenient manner, and with dignity for the clients. Financial services are delivered by a range of providers, most of them private, and reach everyone who can use them, including disabled, poor, and rural populations.
>
> *Accion Centre for financial inclusion*

It is therefore not surprising to see that in 2012, many female clients of the Grameen Bank in Bangladesh were demanding to remain co-owners of their bank in spite of attempts by the Bangladeshi government to oppose it.

Initially, NGOs only offered microloans and indeed very successfully. Worldwide, MFIs have lent microcredit to 150 million people (totalling over 81 billion Euros) by the end of 2014. That certainly resulted in people being able to participate in society once again.

Microloans enabled them to open a small shop or kiosk to generate extra income. They had real access to money and the provision of financial services was tailored to their needs. At least, that is what the MFIs claim. And at the outset, clients accepted the services provided and the methods used including mandatory formation of – solidarity - groups to become eligible borrowers, gradual increase of loan amounts based on repayment performance, participation in supplementary training and orientation programmes covering a wide range of (from explanation on the interest rates to hygiene and sanitation) . The population appeared willing to pay the interest rates charged without complaining, which was subsequently used as an argument by the MFIs that clients could afford to pay those rates....

But over the course of time it became evident that there were still weaknesses in the system such as:

- The loan amounts were either too high or too low. Loan amounts sometimes turned out not to be the right ones as a result of the credit methodology in use and loan limits set. Certainly if a graduated system was used, the loan amounts made available were too low, particularly in the early period of a cycle, and it could increase excessively over time, due to the automatism in the system with MFI offering increasingly higher loans after each repayment.
- The costs are relatively high or excessive for the clients. It emerged that clients were actually unable to pay the interest rates charged (i.e. loans were not offered at affordable costs). That is most likely the heart of the debate fuelled in for instance India, Pakistan, Bolivia and Nicaragua with clients deciding not to pay loans anymore.
- Providing/obtaining loans alone is not sufficient. Clients are also interested in other services, such as savings or micro insurances, mortgages and money transfers. A range of financial services that the MFIs were unable or unwilling to provide in the first instance.

The common understanding is that microcredit alone is not enough. People must have access to a broad range of the right financial services for a fair price". The first step towards financial inclusion may well be to provide access to microcredit, but opening a bank account, creating the possibility to save , to take out insurances and eligibility for pensions , or transferring money are part and parcel of this too. In many countries, all of these activities are a problem for a large proportion of the population, particularly for the poor. Banks and other formal financial institutions treat them as if they do not exist, procedures are not client-friendly, services are costly and the conditions for using services (documents and declarations to be submitted, for example) also significantly restrict access. Moreover, the products and services are not tailored to the needs of these parts of the population: In many countries, for example, there is no medical insurance for the poor and mortgages for smaller houses in the poorer urban neighbourhoods are often not available either. Even opening a bank account, which is still often a gateway to other services, is often impossible or difficult due to the minimum amounts that have to be deposited or maintained.

The consensus is that particular attention needs to be paid in developing countries to designing a financial services system that is accessible to all in other words to *Financial Inclusion*.

Sixty percent of self-employed people are not insured against incapacity for work

Almost two thirds of self-employed people in the Netherlands have not covered themselves against incapacity for work and are therefore at risk of financial hardship. The high costs associated with insuring against such incapacity are cited by 58% of self-employed people as a reason for not taking out insurance or only taking limited insurance.

A large group of self-employed people believe that they do not need incapacity insurance because they have a partner whom they can fall back on, while one quarter believe they have sufficient financial reserves in the event of incapacity for work. The study has also shown that almost half of self-employed people are putting no or insufficient money aside for a pension.

www.ikgastarten.nl, Rabobank, 2012

But would such also be needed in European countries? In the Netherlands everyone has the right to open a bank account and can therefore participate... But a closer look shows that the reality is different. Also there some financial services offered do not meet the actual needs: costs of some financial services like insurances for the solo self-employed are excessive, small and micro entrepreneurs are not attended by the banks, financial institutions do not have real contact with society and certainly not with a changing client groups like the upcoming hybrid entrepreneurs.

Financial institutions and banks have still not responded creatively to changes in society and are still focusing heavily on old paradigms: in their view people need to set up businesses for the rest of their life, are then engaged in their enterprise on a full time basis and such businesses are the only source of income. Products offered and evaluation systems applied by the financial institutions are based on such old paradigms and the organisational culture is focused on maximising profit. Money that was entrusted by depositors to banks has become a commodity with which bankers feel free to do what they think is best for the bank (and themselves) (Luyendijk 2015). As a result, they are finding it difficult to respond effectively to changes in their environment and provide the right services to existing and new clients.

Consequently the new, hybrid entrepreneur is not seen yet: the man or woman who, alongside a part-time job as an accountant (say three days a week) also wants to become a self-employed car mechanic or the student who wants to open an online shop alongside his or her studies. Banks fail to respond to such changing markets adequately. The new profiles are not recognized by the digitalised evaluation systems, the amount applied for are too low, and the combination of work and self-employment is not considered serious business...

The person receiving social welfare who wants to supplement her income by starting as a self-employed person for a few days a week faces similar problems. As soon as she contacts the Chamber of Commerce and registers as a self-employed, her social welfare payment is at risk. And the little earning as self –employed through her cookery school will be considered additional income and taxed accordingly (implying that it falls in a higher tax bracket). Apparently society is not yet prepared for new forms of enterprising where people combine work or social welfare with self-employment.

With the prevailing digitalised existing evaluation systems banks seek client with a profile that does not reflect reality: you pass the evaluation if your education level is reasonably high, you are not too old and your current salary is well above the average. It is of course a plus if the applicant owns a house and lives in the local area with a "good" postal code (i.e. not in poorer neighbourhoods or in areas earmarked as problem areas). Those systems have replaced the credit analyst's assessment and simply exclude people with differing profiles. Enterprising talent is being lost.

Likewise transferring money is still not possible for a reasonable, affordable and transparent price. Whether it concerns a payment from or to a foreign country for a SME or a transfer of a small amount of money by an migrant to his/her country of origin, the costs charged by money transfer agencies are still not transparent and have proved to be excessive. This is certainly so if we consider the fact that they are usually digital transactions in which banking staff are hardly involved. Websites such as *www.geldnaarhuis.nl* can offer a certain improvement, but this still raises the question of whether access and costs for use are indeed reasonable and affordable.

Obviously Financial Inclusion must also be an item on the agenda in countries like The Netherlands or Germany, certainly if we like to see that everybody participates. Experiences from other countries, particularly those gained by microfinance institutions in developing countries, might be relevant for Europe as well. Should that not be an issue to be taken up by the UN Special Advocate as well?

NOTES

7.

ARE YOU BETTER OFF IN A GROUP?

...together we are stronger...

Apparently microfinance organisations working at grass root level appreciate to work with groups of clients. People interested in a microloan are requested to form groups to guarantee each other, to receive jointly a group loan, or to jointly decide about the amounts to be passed on to members. Interesting condition if we see that what once started as a small savings and credit groups can become large financial institutions such as Caisse d'Epargne in France of Rabobank in The Netherlands. And also since those banks also took over the prime role of the group: checking whether an applicant could repay and most of all can be trusted.

But a bank is mostly interested to get an answer to a different question: what assurance can the borrower provide that the loan will indeed be repaid? Whether the loan is to be used for purchasing a refrigerator, new furniture or setting up a small business, the bank wants to be certain that it will get 'its' money back; even in adverse circumstances, for example when the borrower stops receiving a regular income, or when the business does not generate the profit shown by the business plan. Normally banks give loans using money deposited with them as savings. Hence they must always be in a position to pay back such savings to the people who entrusted their money to them. Banks will thus demand that borrowers pledge tangible assets as collateral-ideally assets that can be sold off easily and turned into cash immediately. So clients (big or small ones) without property have difficulties in accessing loans. And poor people have no assets, so access will be denied almost by definition. Poor people have no or irregular income. It is not certain whether they will earn anything tomorrow, let alone how much and for how long. And they do not have possessions that could serve as security either. But in groups that lack trust could be solved more directly and in a personal way as history shows us:

- In the Middle Ages, craftsmen were organised in guilds, in which people could start out as an apprentice and climb up the ranks and become a master. And an apprentice who wanted to start his own business could do so under the supervision of a master and with a small loan from that same. The guild was in fact also a small group of lenders.
- In the 15th century, churches organised support funds for those in need. Members of the church contributed to the fund, which was used to help those same members if they suddenly needed money in the event of illness or death, or example.

These informal savings and insurance schemes existed in Europe in different forms in pre-industrial Europe, many labourers and farms workers were members of such small and predominantly informal self-managing savings systems.

- During the industrial revolution, Friedrich Raiffeisen set up local cooperative (micro) savings and loan systems to help poor farmers to become more independent from suppliers and clients. These cooperatives ultimately grew into the Dutch Rabobank.
- The modern insurance company Achmea started as an initiative of a group of farmers who met in the Frisian town of Achlum and formed a mutual savings group to insure themselves against major disasters such as haystacks that burst into fire, accidents with costs that no one could bear alone.

Those systems could only function on the basis of mutual trust. People were willing to provide security for one another, were willing to organize themselves and therefore make progress; something that has been taking place for centuries in developing countries as well. Community based organisations have developed loan programmes around groups. Each member of the group - in essence a (potential) borrower - acts as a guarantor for the others. Individual guarantees are replaced by group guarantees for each member that borrows. The group becomes the guarantor.

This is how Muhammad Yunus began his Grameen loan programme together with students of the university where he worked. He had observed that the costs of borrowing for poorer citizens were excessive and he tested the idea of group-loans (Yunus, 1999). He experimented with a solidarity group lending programme by providing loans without security to poor women from the village of Jobra in Bangladesh. An initiative that he introduced later in other places as well. This was the start of what later would become the Grameen Bank, nowadays with over 8,5 million clients most of them women and all considered members of that bank (Grameen 2014).

Beekeepers in Morocco do not often work alone. If they form a group with three fellow workers, they can obtain a group loan. Beekeeper Abdelkebir Baddi receigves such micro loan. He believes this system has advantages and disadvantages: 'If someone within the group fails to pay, the others will have to pick up the bill'.

He and three other beekeepers entered into a 'solidarity contract' with one of Morocco's largest microfinance organisations, Al Amana. He was able to borrow 300 euros for five extra hives. The organisation charged around 30 percent interest. The beekeeper agreed to repay about twenty or thirty euros every fortnight. To make this repayment, he sometimes needs to borrow that amount from others. But he hopes that over time he will still be able to build up some capital for his family.

Source: RNW Dossier Microfinance.

Community Based Organisations (CBOs) and other locally operating development organisations have learned to appreciate the (added) value of groups, group-guarantees and group-lending over the past decades. Most of their credit methodologies and modes of operation reflect such understanding. In their evaluation and assessments of loan applications, the MFIs could then concentrate on the evaluation of the group. Analysing the income statements, delving into applicants' pasts and valuing property of individual borrowers were not needed anymore. The assessment of the group itself was considered sufficient and the lender could allow the members of the group to stand individually as guarantors for one another. Each member was then granted the same loan amount. Common practice was that

individual members will not be granted any new loans if one of the group members fails to repay his or her loan. The social control within the group and the pressure between the members themselves were expected to be the proverbial big stick... An important pre-condition is that a group consists of people who know one another. After all, every member can be called to account for individual loans of each group member separately.

The group-guarantee approach is applied in various ways: in the more commonly group-based systems the lender transfers a loan amount to the group and the members themselves decide how that loan amount is shared and distributed equally between the members. The group can then be the borrower or individual members are each considered borrowers (with the group being the guarantor). Both systems result in considerable savings in distribution and administration costs for the MFI.

Although group-based lending has been a successful and was used by many NGOs in launching their microcredit programmes, the number of individual micro loans has been rising steadily over the past years. The more striking important explanation is that many groups have fallen apart over time. Members did not want to bear responsibility for a loan of fellow members who were no longer able or willing to repay. Or groups (actually composed of members without any assets to be liquidated and turn into cash for repayment) had no means at all to repay.

Since the group was held responsible for the repayment of such defaulting loans, all members were denied access to (new) loans with only one of them defaulting. What is more, some members aspired to grow more quickly than others, were willing to repay faster but saw themselves inhibited when others seemed to be happy with a slower pace of development. Group solidarity and group guarantee schemes as well as group loan repayment systems proved thus to be counterproductive. Subsequently borrowers *and* providers alike increasingly preferred the individual loans.

Longer-established MFI seem to prefer individual loans, certainly if the loan amounts increase in size. Inflation is one of the reasons for such increase, but it can also be attributed to the fact that borrowers want their modest income generating activities to grow into micro-businesses. MixMarket Exchange reported that almost 85% of clients of microfinance institutions in 2009 had an individual loan. In the Netherlands as in many other European countries, portfolios of MFIs is composed of almost 100%[29] of microloans.

So group based systems are replaced by individual loan programmes. But how does that relate to recent developments where we see people again seeking control over their own finance in reaction to a growing discomfort with the way banks operate and function? Are the new forms of lending and savings schemes such as the Comunidades Autofinanciadas (CAF groups) in for instance Spain, Italy and the Netherlands (*http://www.comunidadescaf.org*), the revival of credit unions in Rumania and Bulgaria and even the launching of new cooperative banks like NewB in Belgium not demonstrating so?[30]

[29] Qredits the leading MFI in the Netherlands only provides individual loans.
[30] See also: Policy Note of EMN on Self Controlled Financial Systems 2015.

8.

JUST FOR WOMEN?

...ever since microfinance first began to capture public attention 25 years ago, the usual story line has been that it is a tool of extraordinary power to lift poor people - especially women - out of poverty, by funding their micro-enterprises and raising their incomes. (CGAP, no. 59, 2010)...

When people think of microcredit, they visualize groups of women who borrow very small amount: loans for purchasing a sewing machine or for setting up a small shop, for example. Loans that, it is claimed provide a great deal of help to women. And women are ultimately regarded as suitable candidates for a microcredit as it will empower them and at the same time their families and communities around them. After all, they are regarded the more reliable clients as well: Since they have to look after the entire family and the household, they are more careful in managing money, and will indeed ensure that loans are repaid. Take the women borrowers in the Kattike Project in Nepal, for example: As part of that project nine groups of ten women each were formed. The selection was made by an influential person in the community where the women live. And the living conditions were the determining factors for selection. When the group received a loan, the individual members are expected to be able to use that money to purchase livestock (goats, pigs) or modest vegetable plots. These are all seen as investments that can generate (additional) income - albeit after one year - via the sale of fattened pigs or vegetables not needed for own consumption. And with those proceeds repayment of microloans is ensured. And the women will certainly do so as they wish to support the family.

Women are regarded by MFIs as more reliable than men. They are more likely to repay loans and also remain loyal to the MFI. There is a plausible argument for this: women feel responsible for their family and will be more inclined to invest the loan provided to them in businesses that serve this purpose. In addition, they do not use the profits generated for their own use. Such profits are reinvested in education for the children, to buy (work) clothing, or are set aside as savings to pay for unforeseen expenses (such as medical expenses). The question is, however, whether the image of women held by MFIs is actually based on facts and reflects reality.

Many policy makers and professionals in the microfinance sector base their actions on data from the MixMarket Exchange. That organization collects global data on operations and evolution of MFIs. Reports from over 3.000 MFIs have shown that around 60% of clients are women. However, a more detailed analysis of these figures tells us that the situation may vary significantly from region to region, and that the average is significantly influenced by a small number of very large MFIs, including specialised banks, mainly operating in Asia and attending large numbers of female clients.
Table 3 highlights such regional differences.

Tabel 3 Women and microfinance in different continents

	Africa	Asia	Middle East and North Africa	Latin America	Eastern and Central Europe
Average loan	$308	$166	$373.31	$1,682	$4,117
Number of women	57%	93.80%	68.50%	46.70%	30.10%

Source: MixMarket and Centrum voor Microfinanciering Inholland 2009

Hotel Krasnapolsky, central Amsterdam. Ten course participants are hanging on to every word of Daphne Bunskoek and Elsemieke Havenga, who are presenting a workshop on behalf of the Women in Control Fund. The fact that the course participants have paid a considerable amount to hear tips from Daphne and Elsemieke does not bother them. "We are having a brilliant morning and the money is being well spent."

The workshop forms part of a major campaign set up by the Crystal Clear, a mineral water company, in partnership with the charity organisation Plan Nederland, to help women in developing countries to build their own life. The proceeds from this Women in Control Fund go to two specific projects in the Wa district in Ghana and the Makwanpur region in Nepal.

A commercial company backing microloans? That could raise some questions among cynics; but it is effective. Dutch celebrities are queuing up to affiliate themselves with Women in Control. Not just by providing workshops, but also to act for free at the events organized "And why not?" argues Elke Verhoeks, who manages the Women in Control Fund and organises the Because I'm a Girl Concert on behalf of Plan Nederland. After all, she believes it is obviously a win-win situation: "It has benefits for everyone. Even for the business community, because Crystal Clear is of course hoping to promote its brand through this initiative".

"It is good for Plan, it is fun for participants who can attend interesting workshops and a major concert event, and of course, it is above all beneficial for the women who receive micro loans via a number of projects, as 100 percent of the proceeds go to the projects."

Source: RNW, Dossier Microfinance, Women in Control: how microcredit can be 'sexy'

Grameen Bank and BRAC are two of the largest microfinance institutions in Bangladesh. The Grameen Bank holds a portfolio of well in excess of $817 million in microloans, while the Bangladesh Rural Advancement Committee (BRAC) has over $636 million outstanding in these loans (2010). Both organisations have substantially more female than male clients, namely around 95%! This is the result of their policy to expressly offer support to women.

But what happens when a programme is open to both men and women? Will women then also participate and be the major clients? To answer those questions, let us zoom in on the developments in three different countries (Bolivia, Kenya and Afghanistan) where the services are provided to both men and women.

- In Bolivia, 40% of all clients of MFIs are male. Even in one of Bolivia's largest MFIs, Bancosol, over fifty percent of its clients are men.
- The Equity Bank in Kenya had 715,969 clients in 2009, of which 343,521 were men, accounting for 48% of the total[31].
- In Afghanistan, microcredit has been offered on an increasingly larger scale by a growing number of microfinance institutions over the past decade (with wide-ranging support from the international community. These institutions have stated in their joint reports that 60% of their clients are women, very much in compliance with the policy of donors. However, an impact study in 2010 reported that only one third (33%) of these loans are actually being used by women[32]. The rest 'hand the loan over' to the spouse, i.e. a man.

And what happens when the loan amounts increase? During the period 2009- 2013, the average amount of microloans in Latin America increased from $640 to $1,682. At the same time, the percentage of female clients has fallen from 62% to 47%.

In Europe, 40% of clients of microfinance programmes and institutions are women[33]. The average loan is approximately €9,600 well in excess of the average of around €500 in developing countries, where the percentage of female clients is 60%. Do men only come into the picture when the amounts become bigger? And if a woman takes out a loan, will the man play a role in the background?

[31] Source: Website Equity Bank 2011
[32] Source: MISFA Internal reports 2010-2012
[33] Source: EMN Surveys 2007 and 2009

9.

JUST FOR BUSINESSES?

... dreams are lies...

Whoever has a dream, but no access to financial services, will have difficulty realising that dream. But with a helping hand, such as a small loan, the dream can still become true. The dream itself may be a modest one, like daily putting food on the table for the children or being able to send them to school, or the wish to just be part of society and stand on one's own feet. It is not just the wish to start up a small shop; it might be more, like becoming your own boss and earning a reasonable income; the desire to no longer depend on external support, to be regarded as a valuable person or to participate fully in society. And such can be in different forms like being a member of self-help group, of the village community or of a small business association. Maybe microfinance is not only about lending but about social inclusion as well?

Nineteen-year-old Abdul, a citizen of Laghman province in Afghanistan, has gradually expanded his business after receiving financial services from a local NGO. To support the 14 members in the household, he is working together with his father and brother. After graduation from school, he could not continue his higher education and instead, started his own small business. The first loan, amounting to 7,500 Afghanis, helped him to open a small shop in the village. That that was grew gradually into a bigger shop with the second loan of 15,000 Afghanis. A third loan of, 25,000 Afghanis made it possible to buy a motorized rickshaw and he handed his shop over to his father. By purchasing the rickshaw he could leave the business in the village and look for higher income in the city.

Abdul says: "My message to my people is to use the opportunity of accessing micro loans, and either start or expand their businesses. This way I am sure we will have a better livelihood in our province."

Source: AMA Newsletter, Afghan Microfinance Association 2010

In the last twenty to thirty years, millions of poor people in developing countries have seized the opportunity to participate. Microcredit made it possible for them to open a small shop and start selling groceries or purchase a sewing machine and start working as a tailor. All those men and women who received a microcredit were able to earn money, which in turn changed their lives. Participating in a group in which all members are willing to act as guarantor for one another makes people feel they are worth something. Participating in a savings group gives people a feeling of belonging. The money saved by the group can be used as small loans to be granted to members who need them. And those loans create self-confidence in people and improve the family's financial situation. The community also immediately recognises that their members, even the poorer ones, can do something and

be valuable. A carpenter can be working in a modest workplace and sell tables and chairs to people of similar background, but also to people with higher income. The poor are then seen by the middle class. Micro entrepreneurs become members of business associations and trade organisations. And be seen by other entrepreneurs as valuable links in a commercial chain. Social differences fade away and class systems are broken down.

NGOs that launched microcredit programmes had very clear objectives such as fighting poverty, allowing people to participate in society and prevent people from remaining side-lined. This has been recognized worldwide.

- It was formulated effectively in the Millennium Development Goals for 2015 (MDG is 'Fight against Poverty') of the United Nations which stated: ..."*by providing the poor with access to financial resources, they can achieve better living conditions. The focus lies on providing financial services (loans, savings, insurance and pensions) in very small amounts for the less fortunate in society, 'the Bottom of the Pyramid (BoP)' in order to make 'Financial Inclusion' possible for the 'Poorest of the Poor'*".
- In *Europe*, the European Commission called upon all Member States to place microfinance on the political agenda at national level in 2007, with the aim of *achieving.... 'social inclusion' by encouraging entrepreneurship and providing financial support and training to the 'socially excluded'* "(EC 2007). Attention is primarily being paid to encouraging active participation among the (long-term) unemployed, people who are at risk of losing their jobs due to the economic crisis and people who are dependent on the welfare state.
- In *the Netherlands*, microcredit and microfinance are seen by the Ministry of Social Affairs and Employment and the Ministry of Economic Affairs, Agriculture and Innovation as services to promote entrepreneurship among people not attended by the banks, such as people living in poorer neighbourhoods and deprived areas in cities, the unemployed, young graduates, school drop outs and the elderly. *"Money (microloans) and knowledge (coaching and advice) are regarded as the tools to encourage those groups"* (see also figure 2).

Figure 2 *Microfinance, offered worldwide to enable social participation*

In all cases, participation in society is a primary objective. It is anticipated that activities carried out independently (whether as self-employed, or as micro-entrepreneur) will offer an opportunity to break out of social exclusion.

But will all of those efforts by clients, supported and encouraged by microfinance institutions, actually result in greater social inclusion around the world?

Starting a business however small, demands constant attention. Starting a business means extra workload, certainly for women, as men will rarely take over her chores, even if she has started her own business. But the household is supposed to continue as always. Keeping a new business running may also imply that the entire family is occupied for more hours during the day. Labour can indeed be found quickly: the partner and children can also help with the business and it is cheaper than hiring an employee. The fact that the children miss school now and then is a price that people are then often willing to pay.

A micro loan enabled Linda Flores to start making tortillas, very much in demand locally. Her husband delivers the tortillas and her two children help with baking them. However, Linda's children did not go to school anymore; they had to help their mother. The situation is paradoxical: without help from the children, household and family income will remain marginal, but without education, the children will have no future.

The family now hopes to be able to obtain a new micro loan in order to start up a small shop selling bicycle parts. Linda will then remain responsible for the tortillas while her husband looks after that shop. And as for the children, they might be able to go to school (?).

Source: RNW Dossier Microfinance, 2009

In 2011, the Centre for Microfinance of the Inholland University of Applied Sciences carried out an exploratory research in a number of municipalities in the Netherlands that had provided support to social welfare recipients in setting up their own businesses to break away from unemployment (Verhagen & Heffelaar 2011). The service package offered comprised entrepreneurial selection, advice, training, business advisory support and provision of a small loan (with an average loan amount of Euro 20,000[34]), and the target group consisted of often long-term, marginalised unemployed individuals. The hypothesis was that the members of that target group were socially excluded and were unable to participate in society. The key research question was whether starting one's own business (supported with a microloan) would result in (more) social participation, i.e. more contact with family, friends and neighbours, active membership in clubs, participation in voluntary work and/or cultural activities. The striking finding of this research: Starting one's own business sometimes costs so much time that social participation is in fact reduced. The loan enabled people indeed to start a business, and they were very much engaged in making it a success. But they also lost social contact. So does microcredit really improve their participation in society?

[34] In Europe, a loan of < Euro 25,000 is considered a micro loan (EU/EC); in the Netherlands, the Ministry of Social Affairs and Employment and the Ministry of Economic Affairs, Agriculture and Innovation have set the threshold at < Euro 35,000.

NOTES

10.

DOES IT LEAD TO ENTREPRENEURSHIP?

....Start your own business!... Bottom of Form

If we were to believe the newspapers and the promotion campaigns of MFIs, microcredit is the ideal tool to create micro entrepreneurs. Whether a beekeeper in Ethiopia or a vendor of vegetables in Peru, they are all portrayed as (new) entrepreneurs who were given the opportunity to become so thanks to micro loans extended to them. Following that line of argument, extending microcredit creates microenterprises. But is that true?
In every society, there are people with ideas of setting up their own business. The motivation behind this has been found to vary quite widely and may entail arguments such as:

- It may arise from an urge to gain freedom (to become one's own boss);
- It may be the desire to acquire a(n) (better) income;
- It may be the conviction that one can realise their ideas independently, or
- It may arise from dissatisfaction with the state of affairs at work.

At first glance, the reasons are manifold, but what they all have in common is the desire to do something *yourself*. What is more, prospective entrepreneurs are convinced that their objectives cannot be achieved by carrying out (paid) work for third parties. Research has shown that the most important reason is the urge to become one's own boss (EIM, 1996). And the objective of gaining a higher income is cited far less often as a reason for starting one's own business. Findings very much in line with insights yet gained over the past decades in developing countries in various entrepreneurship development programmes.

Table 4 What motivates people to become an entrepreneur?

Reason for wanting to become an entrepreneur	%
Independence/being one's own boss	28%
Challenge	15%
Unemployment	13%
Dissatisfaction about a job in paid employment	8%
Combining family and work	7%
Income	6%
Using one's specialist knowledge	5%
Discovered a gap in the market	4%
Money is available	1%
Status	1%
Not defined	18%

Source: "Het starten van een bedrijf" [Starting a business], EIM, 1996; adapted by authors.

There are many types of entrepreneurs and enterprising people. People may start their own business out of pure necessity: they are sitting at home unemployed, have no income or just depend on social welfare benefits (if they happen to live in a country with such facility) and, they may have lost connection with society to a greater or lesser extent. Setting up their own economic activity, even on a very small scale, can provide them with an (often supplementary) income. They may initially start without help or advice from third parties. It is only when they need money from others that they notice that they are not taken seriously by the outside world, certainly not the banks. This is where microfinance institutions may come in. Microfinance often offers them a solution. However, whether or not an idea actually leads to a (micro) business not only depends on a cash injection and personal drive. There are many people who *want* to become entrepreneurs, but not so many who are *able* to, and even fewer who *do* it. And the number of ultimately successful ones is even lower. Apparently it does not have much to do with money or knowledge; it is primarily determined by entrepreneurial characteristics.

... Microcredit is a powerful and effective means of providing support to impoverished people, for whom a small loan of fifty or a hundred Euros is often already enough for them to start their own business or expand it. Microcredit has a very positive effect on the living standards of millions of impoverished people.

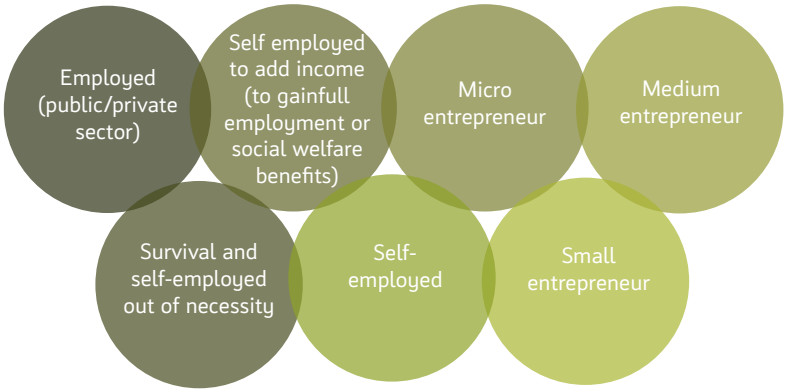
Micro entrepreneurs find it difficult to obtain a loan from banks because they have no security. They can get the funding they need from a microfinance institution though. Those entrepreneurs, usually women, form groups to help one another to repay the loan. Once the loan has been repaid in full, they have another opportunity to obtain a loan. This increases the social control within the group....

www.oikocredit.org

Do we know who we are referring to when we speak of users of microfinance? Are they actually only (micro) *entrepreneurs*? In practice, it turns out that members of the group vary widely and include all kinds of people who might benefit from proper access to financial services. But not all of them will become successful entrepreneurs.

The economic activity people can set up depends on entrepreneurial capabilities, their aspirations and of course on their asset base. That asset base can be divided in the three capitals: human, financial/material and social capital. And not all enterprising or entrepreneurial people will possess the same sets. Hence the types of businesses they intend to set up and are capable of creating, developing and managing, will differ. Those can range from survival activities out of necessity to generate some additional income, to self-employment, micro-enterprises and small or medium enterprises exploiting opportunities and aspiring growth. See figure 2. It covers all type of economic activities in which the entrepreneur / founder still plays a dominant role (or can play so). At both extremes such presence can be less indeed: in medium enterprises we often see the founder/ entrepreneur adopting gradually the role of investors/ co-shareholder but then without a clear role in daily/ operational decision making. And at the extreme left side community based organisations and NGOs sometime take over the role of the (destitute/ less privileged) person, who indeed works hard to survive, but has little say over the decision relate dote economic activity at stake.(figure 3)

Figure 2 Classification of income generating activities and types of businesses



Source: Based on classification by Farbman and Lessik (Gosses, 1989) and further adapted by the author (Molenaar, 2013)

Financial organisations are neither able nor willing to have just anyone as a client. They try to focus on specific target groups and adapt their products and services to them. This specialisation may result in effective and efficient service provision; specific target groups also feel more comfortable with organisations that give the impression that they want specifically those groups as clients. (See table 5)

Table 5 Businesses and entrepreneurs and their relationship with financial institutions

Size of business	Focus of the entrepreneur/ proprietor	Type of entrepreneur	Financial institutions
Medium-sized business 50-250 employees Officially registered Various proprietors[36]	Focused on profit and growth	Investor, manager and sometimes still fully engaged as owner/ entrepreneur	(General) banks
Small business 10-50 employees, Officially registered A single proprietor	Focused on work, growth and continuity	Independently operating owner/ entrepreneur	(SME) banks , Specialised (micro) banks
Microbusiness 1-10 employees, A single proprietor	Focused on continuity and reasonable income	Entrepreneurial person, accepting the level of operations	Specialised (micro) banks NBFIs, crowdfunding
Self-employed 1 employee = entrepreneur/ proprietor	Focused on income and (sometimes) independence	Self-employed worker without employees (ZZP)/ enterprising person, without desire to grow	Specialised microfinance programmes, IT based systems (mainly crowd funding)
Hybrid entrepreneur/part-time entrepreneur Generates supplementary income/survival activity[37] Often part-time practically self-employed and usually also seasonal	Focused on supplementary family income and survival	Enterprising persons (often not registered)	Specialised microfinance programmes, IT based systems (mainly crowd funding)
Special target groups that want to continue either as self-employed or as a (micro)entrepreneur	Focused on acquiring (supplementary) income	Artists, single parents, young people, long-term unemployed, disabled, recipients of benefits	NGOs with microcredit programmes Special programmes

Source: Authors, adapted from (Molenaar, They are not yet seen... but, Hybrid Entrepreneurship, emerging in a changing society, 2016)

In many parts of the world, various kinds of special credit and financing schemes have been set up to enable small and micro-enterprises to get started or to expand their operations. These services are offered by different kinds of institutions, depending on the different types of entrepreneurs. Poor people who undertake income-generating activities for their immediate survival usually rely on socially-driven government or non-government organisations (NGOs). They do not necessarily need a loan, even with grant they might be better off. Creditworthy micro-entrepreneurs usually deal with microfinance institutions. Small and medium-sized enterprises normally try to obtain loans from banks. (Table 6).

[35] Except in family businesses – property of a single family, often distributed among various family members.

[36] In modern economies this can expanded with lifestyle self –employed/ hybrid entrepreneurs.

Table 6 Types of financial service providers and their target groups

Type of funding	Grants	Development loans	Industry loans
Financial service provider	NGOs and socially-driven government organisations	Microfinance Institutions	Banks, venture capital companies
Target group	Grant worthy	Creditworthy	Bank worthy
Type of economic activity	Survival activities	Micro and small enterprises	Small and medium enterprise

Source : Author adapted from (Molenaar, Tomorrow holds another Future, Programme Evaluation on Income Generating Activities of Counterparts of Dutch MFOs, 1998)

People may have different aspirations and varying entrepreneurial characteristics. Those again determine their plans and hence their financial needs.

All these people will be looked at and evaluated in different way. But they all have in common: they have plans, entrepreneurial qualities and subsequently need finance. Just offering finance will not make them an entrepreneur.

The likelihood that a business will still survive the first years after its start strongly depends on the starter's entrepreneurial qualities. Not everybody will be successful and not everyone who starts out on a very small scale will ever manage a large business. There are, of course, stories of soft drink producers or IT professionals who turned their once small business into a multinational firm. But those individual success stories do not mean that every microcredit will generate a micro entrepreneur and that every micro entrepreneur will ever manage a large company.

Selection is therefore important at the outset, so that it is clear straight away whether someone actually has the aptitude for being an entrepreneur. This selection becomes more effective if combined with *self-selection*. In other words, it is important to stimulate people to question whether or not they are suited to becoming an entrepreneur. Such self-reflection may indeed result in a decision to aim for something else e.g. actively seeking employment and dropping the idea to become an entrepreneur.

Is that not a better approach than promising everybody that they can become a successful entrepreneur?

11.

LOOSING ITS CHARACTER?

...who comes first?...

The poor in society have limited access to loans, savings, guarantees, insurances or pensions. At local and community level, a wide range of small initiatives have been developed over time to tackle this injustice. Social and community development organisations have designed and developed special (micro) loan programmes tailored to the needs and means of these people. These programmes have proved successful. And it enabled the organisations to grow into specialised financial organisations, offering not only loans but also savings services, insurance and/or payment systems. In other words microcredit became microfinance and the specialised organisations providing the services are now known as microfinance institutions (MFIs). These specialised organisations form an essential part of the general financial system in many countries.

In fact, the term MFIs is an umbrella term that refers to any organisation that provides one or more microfinance service(s). A microfinance organisation may be an association or foundation, often designated by the term Non-Governmental Organisations (NGOs). They mostly operate without being subject to supervision by government bodies, usually at local or regional level and have direct contact with their target group(s). Their primary aim is social development, for example to resolve social exclusion as a result of discrimination, unemployment or physical disability. The provision of microcredit (micro loans) in support of small-scale economic and income generating activities - is used as a means of breaking through that social isolation. But an NGO may also be set up without being imbedded locally and operate on a nationwide scale to provide loans to micro and small entrepreneurs wishing to set up or develop a micro or small enterprise. Such is the case of Qredits in the Netherlands (see *www.microfinanciering.com*).

In 2011, the Netherlands became the first EU Member State to receive money from the European Commission to expand its micro lending operations. The European Investment Fund made available 2 million Euros to the Qredits foundation. Since then Qredits has received more substantive support from the EU affiliated organisations (Since 2015 over 100 million Euro)

Small and new business owners can apply for a micro loan from the Dutch microcredit institution Qredits. Qredits,a NGO, registered as a foundation and acting as a Non Banking Financial Institution (NBFI), has been in existence since 2009 and has since provided over 6,000 loans worth over Euro 100 million to micro and small entrepreneurs. Funding from the Netherlands government, major Dutch banks and the EU made this possible. Qredits has also arranged for over 2,200 coaching projects and sold also over 2,500 e-learning packages.

Microkrediet in Nederland Qredits

www.qredits.nl

Some NGOs that provide microcredit (sometimes in combination with other services such as insurance or guarantees) as their core activity have gradually developed into specialised financing organisations with a quasi-banking known as Non-Bank Financial Institutions (NBFIs). In different countries they are registered with different names such as EdPyMEs in Peru. Depending on the country in which they operate and their legal structure, they are sometimes subject to official supervision. Those NBFIs are then required by law to report to the central bank or other regulatory bodies as were they operating as general banks.

NBFIs again can continue to grow and turn into specialised banks that offer microfinance services. This occurs particularly if the NBFI intends to attract savings and deposits in the local market. There is then no other option then registering as banks. Examples include the K-Rep Bank (Kenya Rural Enterprise Programme) or Bangladesh Rural Advancement Committee (BRAC) Bank. In some situations, it is possible to establish special microfinance banks directly, such as in the case of the First Microfinance Bank in Afghanistan or Microbank in Spain[37]. These banks are focused more on lending to micro and small businesses (SMEs), not that much on financing of income generating activities set up by people who want to escape from social exclusion...

When NGOs go through all stages and become specialised bank, we call this transformation *'upscaling'*. In many cases, we see that the attention then also shifts: products and services are offered to micro entrepreneurs, and entrepreneurship becomes more important than social participation. The original target group is then lower on the agenda.
We also see that existing banks set up special programmes to 'enable funds to trickle down' so that they are also able to target smaller businesses and even micro businesses. This is referred to as *'downscaling'*. The question is whether they actually want to offer microfinance to promote social inclusion and fight poverty or just to get their share of what they regard as a lucrative market.

Banks may go about this downscaling process in several ways:

a. They may choose to expand their existing range of services to include microloans. The can do this by developing special products (possibly with the option of offering them without requiring security) that are handled by a special team of (usually) experienced staff members who are experts in assessing those clients;
b. A different option is to simply adapting (digitalised) evaluation systems, and start assessing clients as a 'human being' e.g, the entrepreneurial attitude and capabilities. Lending decisions are then based on trust in the client. Risk assessments need to be adjusted accordingly.

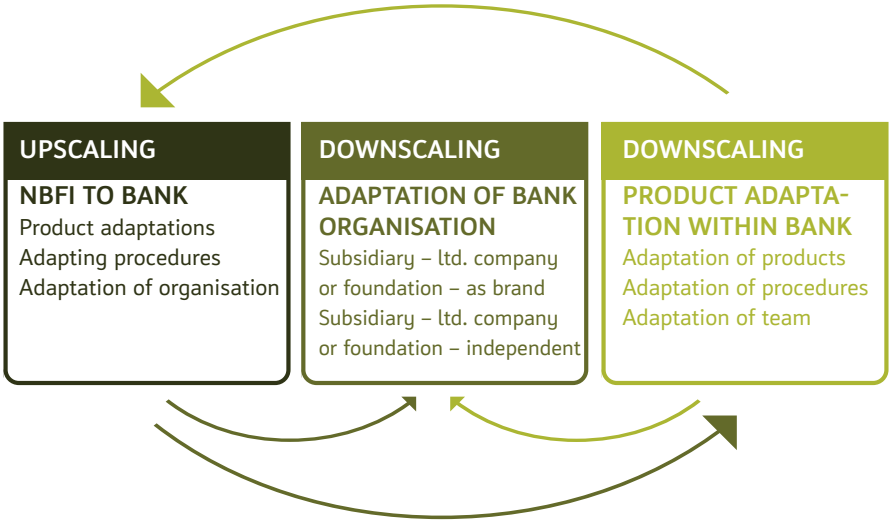
Downscaling is often rejected or not considered an attractive business by banks. Next to prevailing risk assessment procedures (small is considered a high risk almost by definition), the high transaction costs (costs per loan) are mentioned as a reason to abstain

[37] Microbank was set up by la Caixa, a leading bank in Spain.

from downscaling. That can be solved by allowing the new daughter company to make use of existing branch networks of the banks or offering the product as a separate brand name, like is the case with Millennium bcp Microcrédito of Millennium Bank in Portugal.

a. A third, more hybrid option (of quasi- downscaling) is for banks to structurally cooperate with a specialized (NBFO) microfinance institution and refer clients applying for a microcredit (or considered better off with a micro loan) to that MFI. The participating banks can claim that they are engaged in micro lending albeit it not directly. This is the case in the Netherlands where major banks such as Rabo Bank or ABN AMRO refer prospective micro borrowers to Qredits an organization governed partly by the same banks.

Figure 3 Downscaling and upscaling processes



The upscaling process is unambiguous: the NGO gradually becomes a (micro) bank with its own status, name and range of services. The bank will often go into the hands of several parties in addition to the NGO establishing it. In the first instance, these will often be organisations (donors, development agencies, development banks, and special microfinance funds) all with a development goal. However, ownership may also pass to commercial parties and individuals who primarily have commercial purposes. The jump to a normal bank is then an easy one. The overlap with the banks that work through a downscaling process is evident in that example.

Why would an NGO want to develop into a bank? The NGO is dependent on donors, such as family, friends, governments and/or good causes for its income. The capacity to provide micro loans is therefore dependent on the periodic donations and soft financing by these stakeholders. While the NGO is not permitted to offer savings accounts in order to acquire additional working capital, it is restricted to attending its clients with all the financial

services possible and needed. A bank is permitted to attract savings and can indeed offer all services. Banks can also attract funds relatively cheaply, which can then be lent again in the form of microloans. And it can attract funds on the capital market. What once started small to serve micro clients becomes big (business). Ownership is shared between several (private) shareholders. If the new shareholders only participate with a view to making profit, the pressure on the microfinance institution to make large profits will increase and the emphasis will shift from a 'social' to a 'commercial' goal. And as large profits are only possible if the portfolio (read: number of clients and average loan amounts) grows, we may observe two trends: the specialised banks try to sell as many small loans as possible which may lead to over-indebtedness or we may see that small and medium-sized businesses become the larger proportion of the client base. In the latter case, the bank's original target group gradually disappears from the radar, a phenomenon is also known as 'mission drift'. If the micro bank drifts, as it were, even further away from the purpose for which the organisation was set up in the first place will it then still be able to attend the poor?

The Mexican microfinancing bank Compartamos (Spanish for 'let us share') was established in 1990 by José Ignacio Hernandéz as an NGO that primarily provided group loans to women. It has grown into one of the largest national MFIs.

In order to be able to serve an ever-increasing group of clients, the organisation was transformed into a bank in 2006. Shortly afterwards, the shares were offered on the stock market through an IPO. The new owners bought the bank purely to net the anticipated profits...

http://www.compartamos.com

NOTES

12.

IS THE PRICE RIGHT AND FAIR?

...it costs just a little...

How much does a loan cost? And what does a microloan cost? If microcredit was specially developed for the poor and others at risk of being excluded from society, then a microloan will surely be cheaper than a 'normal' loan? But then how is it possible that we are increasingly hearing that microloans are expensive? There have even been reports of clients of MFIs in India said to have committed suicide because they were unable to repay the loans due to high interest rates. Are interest rates really that high? And what are the reasons to charge such high interest rates?

Interest rates on microcredit may vary considerably from country to country. But regardless of these differences, those interest rates are usually higher than the rates paid by companies and rich private individuals for their loans.

In the absence of formal financial institutions or specialised microcredit institutions attending the poor, small borrower, the only option is to turn to an individual moneylender. When money is suddenly needed for unforeseen expenses such as the costs associated with a funeral, illness or school fees, the individual moneylender can offer a solution. He (or she!) is willing to make money available, but also requires that it is repaid within a very short time. It can for example be on the basis of the 'six for five' principle; the borrower must then repay six Euros on Sunday for a loan of five Euros received that Monday... in other words: an interest rate of 20% over one week. A simple calculation shows that this is over 1,000% per year... and if the borrower fails to repay on time the loan plus interest, the lender will not be afraid to use brute force.

Ten years ago, an Indian woman called Bidi Mehidana went to a state bank for a microloan. For 4000 rupees (around 60 euros), she bought a cow. But one year later, before Bidi was even able to sell one litre of milk, the cow died. Since then, the micro loan has been a curse upon her.

Bidi, who lives in a village several hours away from city of Kolkata, went back to the bank two years later for a new loan. She wanted to buy another cow. But the bank refused to grant her a new microloan. Her debts had since increased to 12,000 rupees (175 euros), partly due to the increased interest on the first loan. The bank sends her monthly reminders, but she does not open them in the hope that this will prevent her debts from increasing further. Bank staff even come to her home to demand the loan. She cannot even pay the interest, despite the fact that bank 'only' charges 8% interest, which is significantly lower than the interest rates charged by commercial banks...

Bron RNW Dossier Microfinanciering, 2010

There is indeed a gap between banks and private money lenders, a gap that many NGOs have seized upon. Community development and locally operating social welfare organisations have been quite successful developing methods to lend money to the poor. But they attached a price to those methods too, of course: operational costs needed to be covered and interest rates were set accordingly. And those rates are still relatively high, higher than those for 'normal' loans to small enterprises, but far below those of the money lender. A loan of €100 has to be repaid over a month and 'only' €4 is charged as interest. However, that means that the effective interest rate would be more that 48%. And common practice would be that the interest is paid up-front. In that case, the borrower receives just €96 in 'cash', and that means they pay interest of €4 on a loan of €96, or more than 50% per annum ...

Borrowing from microfinance organizations gave rise to financial problems in Nicaragua, according to Stefan Platteau, adviser in microfinance for the consultancy company FACET. One of the causes is the aggressive actions of credit providers, who provide excessive loans and pay too little attention to the creditworthiness of the borrowers. "Quick and dirty" is how Stefan Platteau describes the trend among some providers of microcredit, who lend too much money too easily.
Nicaragua is one of the poorest countries in Latin America and has always been among the first in line as a recipient of developmental cooperation. Eighty percent of families have a microloan. With a total of 400 million dollars in outstanding loans, Nicaragua is ranked as one of the top recipients of microloans in Latin America, although it is one of the smallest economies. This popularity has resulted in a saturated market.

According to Platteau, it is not a global problem. "But it is also an issue in other countries where microcredit has been promoted to the extreme, such as Kyrgyzstan and Ecuador." Platteau is not aware of the effects of a loan on the people. "The problem has not yet been properly analysed. But I have observed that tens of thousands of clients are in payment arrears. Some of them are resorting to joining the "Movimiento No Pago," a movement of people who are refusing to repay loans."

Source: RNW, Dossier Microfinance, Microkredieten: te veel en te vaak, November 2011

Microfinance institutions argue that those rates are necessary and acceptable. Their argument is that their costs are very high and that they need time to allow the interest rates to go down by implementing efficiency measures. They also claim that their interest rates

are still significantly lower than those charged by individual moneylenders. And since client pay loans and interest there is no problem they argue. And eventually, one the programmes have been established rates will go down they claim.

Over the last years, the interest on microcredit in many countries may have fallen, but the rates are still higher than those set by banks for SME related lending. Websites of MFIs are not that informative about interest rates charged for microcredit. The average interest rates charged by over 800 MFIs reporting to the Mix Market and analysed over the period 2004- 2011 range from 12- 95%, with the median for Africa between 25-40% (overall range 10-82%) and for Latin America between 20-45% (and a range of 10 to 90% (Rosenberg, 2013).In Kenya, the interest charged by organisations such as K-REP was around 28% (in 2006/2007), while commercial banks asked for 6.5% interest for short-term loans. In Peru, Edyficar, required its clients in 2015 to pay between 38 to 70% for micro loans, while banks are offering businesses loans at 12% interest.

MFIs take the view that the costs of management, administration, assessment and supervision of small loans are extremely high, and in order to compensate for those costs, they ask for relatively high interest rates. We also see that the MFIs require clients to also pay administration fees and other surcharges. And often clients are required to keep save with the MFI, while low(er) interest rates are being paid on these savings. What is more, clients are sometimes expected to participate in all kinds of training programmes and information sessions; that time is a cost for the client as well, on top of the interest charged.

The differences in interest rates charged by specialised microfinance institutions and commercial banks have already existed for years. This raises the question of why the interest rates of MFIs are higher. Banks work with savings entrusted to them and NGOs/ MFIs use money they receive from donors. Much of that money is provided in the form of donations or as interest-free, long-term loans. That money is 'cheaper' compared with savings. The margins and yields realised by the NGOs/MFIs can thus be quite high. On that basis, it seems obvious that the interest charged by MFIs would be less than that that changed by commercial banks. And if those high margins are needed to cover the operational costs, the NGOs/MFIs should make that clear to their clients. And if they require those margins to cover the initial, start-up costs, the interest rate should fall over time. In both cases, it is important to make this clear to the market. Clients are then able to decide for themselves whether they consider the interest rates set as reasonable ones. And if not they should be able to question the MFIs' policies. Greater transparency is indeed needed. The Client Protection Principles launched by the Worldbank/ CGAP is a first step. In addition, MFTransparency, a global initiative supported by MFIs is the next one to promote fair and transparent pricing within the microfinance sector (*www.mftransparency.org*).

Clients have begun to change too. They are no longer the poor, submissive, excluded persons who accept everything. After many years, they have come to realise that an excessive interest rate is not in their interest at all. And in some countries they have even taken a stand and joined forces to denounce the interest rate policies of MFIs, such as in Bolivia, Nicaragua or Pakistan and started to mobilise other clients as well to refrain from repaying loans. What will happen to the system if they vote with their boots and leave the MFIs aside?

NOTES

13.

WILL IT IMPROVE PERSONAL CONTACT?

...we help you through the process...

The work of a personal moneylender has always been fairly easy: he or she lives near of the people who need money and knows their background, where they live and where they may work. The decision of whether or not to provide a loan is based on that personal knowledge. And when it comes to collecting the amounts owed, the moneylender knows where to find him or her. And when that borrower is failing to repay a meeting is arranged easily...

Personal contact is a cornerstone in microcredit programmes as well. The NGO operates at village level and the loan officers and promoters know the members of the community. That knowledge is essential in assessing a loan application, however small the loan may be. Even if the potential borrowers present as a group, local knowledge plays a primary role in assessing a loan application.

It was not all that long ago that the bank manager spoke to the client personally, later it became a senior staff member who eventually was replaced by a trainee in the loan office. A bank employee, whether in a rural or urban area, knew 'his' clients; when they came to see him, their background was known and the two parties would meet in person there and then to discuss plans. If necessary, the bank employee also visited the client personally to have a chat and familiarise himself with the business and the way household was faring.

It is precisely that contact that is disppearing nowadays in many European countries and increasingly in emerging economies. There are automated teller machines (ATMs) everywhere and internet banking is common practice. They have replaced the bank staff at the branch around the corner, and even such offices gradually disappear. But banks claim that the direct is reinstated thanks to that introduction of mobile and internet banking – and clients are assured that '*your bank is available 24/7*'.

But the personal conversation at the counter no longer exists. Internet and automated evaluation systems have replaced that personal contact. There is a webpage for every problem that directs the client to the right product. The prospective entrepreneur is now expected to fill in an entrepreneurship assessment form on the website of the bank, and if the profile fits, he/she can immediately download the application form for a starter's loan. The data submitted are process automatically, credit worthiness is henceforth assessed and loan decisions can be made almost immediately. A handful of variables suffice to determine quickly and efficiently whether the client is eligible for a loan:

- Age: young is better because if things go wrong, there is still a long time to repay the loan.
- Education: the higher the level of education, the greater the likelihood that the borrower will find a good job if the business does not succeed.
- The postal code: the better neighbourhoods, the better clients and they are certainly be interested as well in other banking products.

- The personal history: how long has the entrepreneur been a client with the bank? Are payments regularly made through the bank? Can new products can be sold? Are there any savings? Can they be blocked for as long as the loan is outstanding? It all reduce the risks for the bank.
- And last of all, a final check with Credit Reference Bureaus. They will provide supplementary information about the prospective client and the risk exposure for the bank.

So no personal contact is needed at all, it is all done automatically; neatly and fast...and the bank will subsequently offer the client a standard product, adapted to the systems of the bank itself, fast and cheap. What the client wants to do with the money is now not so important anymore.

Still a growing number of people are struggling to obtain a loan. Imagine being a young, budding entrepreneur, recently graduated, living in a regeneration area, without a banking history and a registration with a credit reference bureau for having failed to pay the mobile phone company once; where can he turn to? The Netherlands Council for Microfinance identified such bottlenecks as early as 2007: a growing number of people had problems obtaining loans from banks (particularly for smaller amounts). For that reason, they proposed micro lending to be introduced, a recommendation that resulted in the setting up a national microfinance institution, Qredits. And that organisation subsequently invested intensively in IT technology to improve contact with prospective clients, not just to reduce costs and risks only. It has now developed a blended system and shows that IT can indeed be instrumental in maintaining close contact with the clients, cutting costs and speeding up decision making processes.

In developing countries, personal contact forms the basis of many microcredit programmes. Poor, excluded people in semi-urban and rural areas were (and are being) completely overlooked by the banks, while NGOs did see them regularly during local community development projects and programmes. Daily contact revealed that people alongside education and better healthcare, also wanted to work to generate (additional) income and participate in society. Microcredit programmes supporting people to engage in income generating activities were subsequently set up. And since the people and their community were well-known judging their reliability as potential borrowers was straightforward. An application for a microcredit was swiftly arranged; the personal contact element guaranteed the fast processing of the applications and the close supervision (and repayments). The loan officer working with the NGO would visit the client in order to make a judgement about the client him/herself, his or her work, the household and to discuss the plans, and refine those where necessary. Once the market stall was set up or the micro enterprise started operations, personal follow up (supervision, advice) visits by staff of the NGO were standard practices. And such direct, personal contact was used as well to collect repayments. An approach not fundamentally different to the way in which individual moneylenders operated, but a costly one... The time the staff spent in conducting assessments, visiting clients and in direct collecting payments had to be paid for on top of other operational costs. High interest rates charged by these organisations were defended by

referring to such costs. Those interest rates were often lower than those of the money-lender, however, and in the early years, clients accepted them as they felt that those new types of (micro) loans ultimately improved their quality of life. But over the years clients (and the people around them) considered those interest rates excessive compared with a bank loan and made such knows to the MFIs. Costs had thus to be brought down, other credit methodologies had to be found. And the internet and mobile phone technology offered the providers such opportunities. Over the past decades most MFIs have invested heavily in IT and related applications which can lead to improved functioning at various levels:

- Promotion: over the internet a wider audience can be reached;
- Application systems can be simplified and evaluation systems can become faster ones;
- More effective administration and management information systems are developed and management costs are reduced significantly;
- Administrative systems can even be set up outside of the country using the internet (see Musoni for example – see text box);
- The working methods (assessments of applications, payments, repayments) can be simplified;
- IT can be used to assess loan applications more quickly and efficiently;
- The mobile phone is no longer just for calling; it can also be used for money transactions (see also M-Pesa in Kenya – see text box);
- New identification systems are being introduced (reduced fraud/better risk management);
- New saving and lending systems are being developed;
- Money transfers become simpler and cheaper.

All of those innovations result in significant cost reductions and loan officers can attend more clients, process larger numbers of applications payments run more smoothly and repayments can be made more quickly. And above all time consuming personal contact is no longer necessary. The time credit analyst or loan officer spends on clients can be reduced.

Innovations are the engine of development in all business sectors. In the financial sector, innovations are needed to adapt services and credit supply to the changing needs of the whole society or to the specific needs of a part of it. While in some cases innovations represent a top-down process, in others, the people and "the crowd", foster the innovation, and change the way in which financial services are provided.
Some of these innovations can be seen as a natural evolution of the increased connection among individuals, via Web 2.0 technologies, creating vast social networks like Facebook and LinkedIn. And we see IT based developments in financing (for SMEs) in two directions: one where profit making based on marginal income over larger numbers of clients is the determining factor and the other one where seeking direct control over one's own money is the leading principle.

M-PESA (M for 'mobile', pesa is Swahili for 'money') is a service of Safaricom, part of Vodacom, in which money is transferred using a mobile phone without the intervention of bank branches (also referred to as branchless banking). It was developed and introduced in Keny between 2003 and 2007. The basic idea was to allow the payment and repayment of microloans to take place entirely via the network of a mobile phine network of Safaricom and its sales outlets this way, MFIs could charge lower interest rates, since the money transactions become cheaper. The test runs showed that clients began to use the service for all manner of additional transactions, including money transfers to family members and direct payments for purchasing and or sales M-Pesa has become so successful that special legislation has been prepared in order to regulate it. Similar systems have been introduced in other countries such as Tanzania and Afghanistan.

www.safaricom.co.ke

Musoni goes one step further than M-Pesa. It is an MIS back-office service for MFIs (in Kenya, Tanzania and Uganda) that are struggling with their MIS. Musoni has set up an MIS system in the Netherlands using expertise that is not always available in countries where the MFIs themselves operate.

www.musoni.eu

All those new systems actually results in less direct, personal contacts with the clients; all can be done through internet and web based systems: fast, reliable, cheap... and with less time consuming visits and interviews. So more can be done by the MFIs.

When people have become more connected through the internet, mobile phones and social media, they also are more mobile and have more access to information and knowledge. They know more and often better than a few decades ago, at least have access to more information and they want to participate in the decisions about talent and assets. And this is also found in their desire to be part of processes related to the use of their money. The emergence of informal savings and lending groups, the decision to start new cooperative banks, the revival of community based lending and savings, or of mutual insurance schemes set up by self-employed or elder people, the increased number of platforms for crowd funding and peer2peer lending, those are not just reactions to the failure of the banking system. It also reflects the desire of people to regain control over their own money, to stay in close contact with their money as well as with the people who temporarily make use of it, and be part of the processes to decide whom to trust.

IT, the web and mobile phones have also resulted in changes amongst clients. Increased access to information informs client in many aspects: they know not only what is happening in the world, but are also well informed about prices in the market for their products or interest rates of other MFIs . The client therefore no longer lets him/herself be told what to do by the microfinance institutions; instead, they question the loan conditions, the interest charged or the obligation to follow special training. More information again brings the client in contact with the MFI...

Paradoxically, the intensive application of IT and internet caused as well less personal contact with clients MFIs. And personal contact is a cornerstone in microfinance. Will new organisations emerge to fill that gap? And are alternative financing systems based on IT - such as Crowd funding or Peer2Peer lending - the solution?

14.

WILL SAVINGS HELP?

...the more you save, the more you get

Over 150 million people have obtained a microcredit from microfinance institutions over the last few decades. Banks overlooked them, as they were of no interest to them: the loans were too small, they could not offer any collateral and above all there were no track records of those applicants. They did not yet save with the bank, had no loans outstanding, no payments were made through the bank and no other services such as insurance were bought. Fortunately, Non-Governmental Organisations (NGOs) and other development organisations were willing to look at the world differently. And they demonstrated that the poor do repay their loans, even without security. Millions of people have shown that it is well worth trusting and serving them. And they repay faith with interest. But was this the only service they needed?

Over the years, the number of people applying for a loan has grown exponentially. Loans are central to all discussions concerning microfinance. That is strange, considering that saving is most important to the poor. They know that they need to save in order to have money at hand for all kind of unforeseen events, such as sudden illness, death, marriage, school fees for children, a cow that dies, or a haystack that burns down. For all of those reasons and more, people have been saving money for centuries, however poor they were or still are. Saving forms people's first step towards tackling poverty... The local populations in many countries know only too well that there can be times when you suddenly are in need of money. Borrowing is not an option then; that is a lesson from the past: the local moneylender (loan shark) is too expensive and the money has to be paid back too quickly and banks do not see you as their customer. Only if you had saved you can meet unforeseen problems. People save, often individually, but also in groups. That has been going on for centuries, whether it is in ROSCAs in Africa or in local cooperative savings and lending programmes in Europe. Those savings and lending programmes have given birth to even larger financial institutions, such as the Rabobank in the Netherlands or Caisse d'Épargne in France.

In Europe, mainly micro lending has been promoted and only occasionally savings is considered, even though the microfinance sector has its roots in the saving and lending cooperatives. And recent research in the Netherlands (Kappers, Lehmann, 2011) has revealed that people in a more diverse society with a growing number of migrant groups are still taking actions to form their own informal savings groups. Also many NGOs in developing countries that set up a microcredit programme paid initially relatively less attention to the provision of savings products. They have primarily focused on expanding their lending programmes, and savings products were not considered important. And if they offered this service it was often a mandatory form of saving linked to (becoming eligible for) lending. Getting to know clients was one reason, another one to have control over clients in event of default. In the latter case the NGO could seize the mandatory savings unilaterally to offset possible losses. But saving was not offered as a service to the client.

Donors and development organisations are nowadays urging MFIs to also pay attention to savings as an indispensable service for their target groups. The poor indeed want to put away their money in a safe place without having to travel far so rendering such service seems warranted. But, thise external partners also asked the MFIs to consider mobilising and attracting savings *as a source of cheap funding for their loan portfolios*. And that was expected to lead eventually to reduction of the interest rates on microloans.
Normally, a micro lending programme was funded with a donation from a (inter)national donor organisation. The costs of attracting these donations were very low and mainly consisted of costs related to contacting the donor and meeting with its representatives, holding follow up negotiations (e.g. in Europe) and once funds were received the costs of devaluation. And the amounts made available were sufficient to meet the initial demands (and cover operational costs as often donations and grants would cover that as well).

But over time the actual situation revealed that new financing would be required:

a. The loan models used proved to be a trap: someone borrowed, but continued to borrow, with larger loan amounts made available upon repayment; repayment and continued borrowing were made attractive and businesses financed were in continued need of external financing as hardly any profit were made. So clients did not leave the system and with new ones entering the total loan portfolio and thus funding needs increased;
b. The loan amounts that the micro entrepreneur needed became ever greater, together with the evolution of his or her business; again loan portfolios would increase even without new clients entering.

The funds therefore had to be supplemented. That was made possible in various ways: First the donors and development agencies "lent" under favourable conditions to the NGOs which became increasingly specialized organisations. Those new funds were made under rather favourable conditions with low interest rate and extended repayment periods. The margins on the microloans were still high enough to cover the relatively high operational costs, making it a win-win situation for everyone: the poor had access to microcredit, the NGO was able to cover its operational costs, and the donor could gradually withdraw. Mission completed...

Over time it became evident that donors are prepared to help setting up a microcredit facility at the outset (and even pay for a large proportion of the start-up costs and the initial growth), but continuously financing the loan fund is less likely to happen. The solution is to apply for even more loan from other external parties and to be prepared to do so under (more) commercial conditions: first from the donors themselves and international development organisations, later from private investors. Such change of policy and funding give rise to higher costs of capital and subsequently higher costs or the borrowers for various reasons.

- Both the international development organisations and the private investors asked for relatively high interest for their loans, which potentially rose to 10% in foreign currency, first and foremost because the institutions wanted to cover their own costs. An

organisation such as Triodos Bank charged for instance 3.5% for the management and administration costs of one its microfinance funds (for instance for the Triodos Doen Fonds).

- The price for this type of funding rose even further with establishment of special regional and national funds in support of nationally and locally operating MFIs. Every partner in the chain naturally wants to receive some payment for its service. That all added points to the interest rates that could rise up to 10% in Euro or US$ considerably well above the, the (present) interest rates in the capital market for US$ or Euro; with a simple guarantee from those same development funds, the MFIs could have borrowed money more cheaply.
- , MFIs were in some cases also required to repay the loan in foreign currency. The MFIs passed that on to the client who had to repay a micro loan at the equivalent value of the foreign currency; with devaluating exchange rates that was indeed not to the benefit of the ultimate borrowers.

There is thus a need for cheaper money and an alternative is to attract savings in the local market. When interest rates on savings are not that high, the interest rate on microloans may fall (in the short term) and it may still be possible for the MFI to ensure a reasonable return on the lending of microloans.

Donors stress the importance for the microfinance institutions to mobilise savings and many MFIs have also taken this advice, though they encountered three interesting challenges:

- Their IT systems were not suitable to administer savings products. A feature of savings is that the saver must always able to access and withdraw its deposits, anywhere and at any time. It should be possible for a person to withdraw his or her savings at any branch of the organisation. That is only possible if deposits are recorded on real time basis. The IT/MIS systems must thus be adapted, which is a costly exercise;
- Not only borrowers were indeed interested in saving products, others as well... In some situations, those interested in savings outnumbered the borrowers significantly; for every borrower, there could be three people interested to save with a local institution (and not necessarily to be eligible for loans at a later date. But the sums of money to be deposited were modest. The transactions in branches therefore increased significantly and thus the costs. And the total volume of the money saved was not that much so the return on those funds appeared to be marginal as well;
- NGOs/MFIs were able to offer a higher interest rate for their savings than the general banks, which in turn attracted the wealthier citizens as savers. This indeed reduced the number of transactions and resulted in larger deposits, but with a side effect. Larger amounts were indeed mobilized but at a relatively high interest rates. And it is not in the interests of those larger depositors is that the interest rate would drop... This puts pressure on the MFIs to keep the interest on their micro loans high for clients who would not even get the same savings rates if they would deposit their money with the same MFI...

Table 7 *MFIs, interest rates for savings, deposits and microloans*

Name of MFI	Country	Interest on savings	Interest on deposits	Interest on microloans	Remarks
Grameen Bank	Bangladesh	8.50%	> 12%	22% to 27%	Interest rate on loans max. 27% in Bangladesh (since 2012);rates difficult to trace on website
MI Banco (Merged/ taken over by Edyficar)	Peru	1.80%	up to 4.9%	35% to 75%	The lower the loan amount, the higher the interest
K Rep	Kenya	2%	8 – 10%	> 24%	No direct access on website to rates
Banco Sol	Bolivia	0.30%	up to 3.8%	16% and7 % for SMEs	In US$ equivalent currency
Basix / KBS bank	India	3.50%	5.5% to 11%	20,5%	Not easy to trace data on rates
Compartamos	Mexico	2%	>2%	74% to 78%	Data not directly to be found
ASA	Bangladesh	6%	9% to 12%	> 27%	Up to 12% for deposits for up to 10 years; MFI contest the rates for lending
AMRET	Cambodia	4%	> 10%	36% to 42%	Rates hard to find on website

Source: Data from websites of relevant organisations, edited by the FINE Research Group, The Hague University of Applied Sciences (2012 and 2015)

Table 7 gives an impression of the different rates offered by a number of MFIs for micro-savings, deposits for larger loans and for micro loans. The first that strikes is that in general it is very hard to obtain clear information on lending rates or on rates for savings and deposits. This in spite of the fact, that MFIs subscribe to the guideline of organisations that promote transparency in costing and pricing such as transparency[38]. Secondly one may note that he margins on the interest rates for savings and microloans are considerable in most countries. Thirdly the data also show that small savers (who may need the money at any time) receive less on their deposits than those who can deposit larger sums for a long period.

It should then be no surprise that the smaller depositors may decide to transfer their savings to a different institution at a given time. Or maybe decide to set up their own savings group? Circles closed?

[38] See also: www.mftransparency.org

NOTES

15.

AND WHY ARE PRIVATE INVESTORS INTERESTED?

...pecunia non olet (Roman Emperor Vespasian, 9-79 A.D.)...

Most local initiatives to create access to finance were based on informal savings and loan groups. Small borrowers who noticed that banks took great pains to ignore them, took matters into their own hands. They formed informal saving and lending groups or set up mutual insurance schemes. Together, they felt strong, and many of those initiatives have grown into successful organisations and companies, such as Crédit Coopératif in France, or the Rabobank in the Netherlands. And now private investors appear and seem to take the lead in some countries. Are they also taking over ownership?

It's just like Wall Street

"Some private investors expect a 25 to 30 percent return annually from their dealings with MFIs", says an official from the international development organisation, Cordaid. "That is a very high return in the financial world; we think it is exorbitant. It can only be realized at the expense of impoverished people."

"You hardly ever hear the word 'client' amongst new investors. Sometime they use it, but not in the spirit of social responsibility." Like the rest of the financial world, you might start to raise questions about any MFI that predicts a return greater than 10 percent in the long term.

"Two years ago, we left an Indian MFI. The promoters of that company did everything they could to push the share value as high as possible. They then received a fat bonus of 2 million US Dollars. It was just like Wall Street. That is not what the microfinancing sector is intended to do, in our view."

Cordaid: "Luckily, 9 of the top 10 MFIs are completely dedicated to the interests of their clients. But commercialisation is a trend that we must be highly alert to."

Source: RNW Dossier on Microfinancing, 2011

The experiences and working methods of these informal savings and loan groups have been adopted by a large number of non-governmental organisations (NGOs) running microcredit programmes. Some of those organisations became impressive ones in number of employees or size of their portfolio) providing micro loans or other financial services , such as BRAC in Bangladesh, Al Amana in Morocco, K-Rep in Kenya and BancoSol in Bolivia. What characterises these organisations is that they are well embedded locally. Besides over time they are run by local staff and managers. What is more, the organisations are funded with local capital and savings from local people.

Governments, international and national donors have provided a great deal of support to local microcredit programmes and organisations. Their money was made available under very favourable conditions to the NGOs booth for capacity building and for the funding of the loan operations. These conditions included low interest rates, long repayment period often in combination with donations to fund start-up costs and initial investments. Knowledge was also provided (in the form of expert advisor training) in order to build the organisations. That support has proved to be successful. Many local organisations have expanded into flourishing and profitable financial institutions. Some of them have also broadened their operations; they offer a wider range of services and operate in an increasing number of locations. To finance that growth they increasingly require more money. Capital is necessary, particularly to fund the loans for the growing number of clients. Ideally, this is obtained by attracting savings, which is relatively cheap. Besides, many people also need quality savings products. Attracting local savings signifies that the MFIs start offering the service of safekeeping the (meagre) savings to the poor populations. That service implicitly strengthens the relationship with that population.

But introducing new services such as savings in combination with a fast growing loan portfolio requires adaptations in the organization as well. More staff and more buildings are needed, and the administration and IT must be adapted. Due to the fast growth many organisations were faced with a weak financial structure, with limited equity and too little net profit to retain to finance that growth. The original financiers (governments and international donors) appeared also less willing over time to continuously provide financing. They actually expect the organisations to arrange funding themselves. Next to mobilizing savings attracting long-term loans and increasing capital by issuing shares are options. Ideally that should happen locally. But when international (private) financiers make money available under apparently attractive conditions, it becomes (too?) tempting not to take them up.

Indeed an increasing number of internationally operating investment funds have been set up that attract capital to invest in microfinance institutions (Table 8). A relatively high financial return can be achieved with investments in activities that also show a high social return. A very attractive form of responsible investments indeed...

Table 8 *Selection of larger (private) investment funds investing in MFIs*

Name	Type of fund	Country of establishment/ origin40	Investments ($ million) in MFIs in 201441
Oikocredit	Private – affiliated with churches	The Netherlands	680
European Fund for South-East Europe (EFSE)	Multilateral fund primarily for Eastern and Central Europe	Luxembourg	938
Dexia Microcredit Fund	Private – affiliated with general bank; invests primarily in the more successful MFIs	Belgium	433
responsAbility	Owned mainly by a number of Swiss banks and financial institutions and a social venture capital company.	Switzerland	928
Microfinance Enhancement Facility	Invests in better MFIs thorugh various funds	Germany	537
SNS Institutional Microfinance Funds (I, II)	Set up by the German KfW Development Bank and multilateral investment company (IFC) – participation of various development banks and funds – invests in growing MFIs	The Netherlands	485
ASN-Novib Fund	Private – affiliated with a state owned bank (SNS) – primarily investments in more successful MFIs	The Netherlands	210

Source: The State of Microfinance Investment 2011, MicroRate's 6th Annual Survey & Analysis of MIVs, websites of the various institutes , adapted by FINE Research Group of The Hague University of Applied Sciences (2015)[40]

Private investors are thus attracted by the success of microfinance and the return that can evidently be made from it. Subsequently an increasing amount of money has become available for the microfinance institutions. This money will most of all go to the more promising markets, e.g. those with a stable an high return. Till date this has been the Latin American market where MIVs concentrated around 36% of their funds followed by Europe and Central Asia (with 33%) and only 12% in eastern Asia (where well know MFIs such as Grameen and BRAC operate)[41]

But such foreign and private investments have a flip side. Of course private investors do not provide their money 'for free' although it may in appropriate forms such as large – subordinated - loans or direct participation in the capital both leading to an improved financial structure. But the secondary conditions might by strict ones like a demand for a seat on the supervisory board or even in the board of (executive) directors. Attracting those funds means thus a loss of local ownership. Actually the new party (the private

[39] Not always the country where the fund is legally based; usually in countries with a favourable tax climate such as Luxembourg, for example.

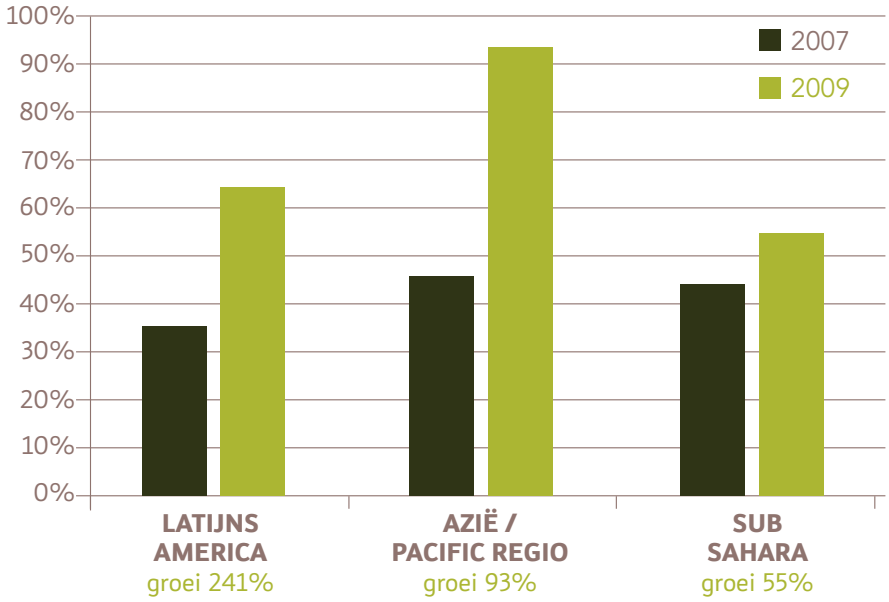
[40] If 2014 data were not at hand ; the latest data have been use

[41] See also Microrate 2013, *The state of microfinance investment 2013*

investor or the investment fund) gains some control and power over the microfinance institution, and the influence of local investors and the role of local depositors are marginalised.

In Latin America, participation by foreign investors in local ownership of MFIs increased by 241% in the period 2007 to 2009, while for Sub-Saharan Africa, that figure was still a modest 55% (see ADA 2010).

Figure 4 Growth of foreign ownership in MFIs



Source ADA 2009 and Centrum voor Microfinanciering Inholland (2010); updated by authors

External financing by private investors is seemingly a sign of solidarity, but it can have a direct impact on in the organisation. The new co-owners may exert pressure on management to ensure returns remain attractive (read: high). That can happen in two ways, namely by demanding (or continuing to ask) high interest rates for the microloans (combined with low interest rates for savings) and by continued growth of the portfolio often achieved by aggressively selling microcredit, insurance policies or micro lease contracts, such as happened in Nicaragua or India, for example (*www.rnw.nl/microfinanciering*). Investment funds represent often more than one private party each with their own policies and strategies... It is important for the MFIs to know the investors they are dealing with and what they expect in return for their investments. In order to increase transparency in the market, the '*Principles of Responsible Investing in Microfinance*' (PRI) were launched in 2011.

Of course, the new investors are not the only ones responsible for the situation that has arisen. In many cases, it is also the result of the actions of the local NGOs and, moreover, the people managing and leading those organisations NGOs. The legal structures of NGOs permit board and managers to act on their own without being accountable to third parties. They may decide to sell the organisations that they first have established with financial support from donors and the local community; donors that previously entrusted the ownership of loan funds and local citizens whom the NGO promised it would represent. This is what happened in Mexico with the sales via IPOs of Compartamos[42], for example, but also in Peru, with the sale of Edyficar once set up and owned by Care to a large private bank (Banco de Crédito del Perú)[43].

It is therefore very much open to question whether it is desirable that private investors whether based abroad or residing in the country be given greater power and control over what were originally local, community based organisations with social objective. Should they really become the new owner of what once was community based imitative? And it is not also the question that without knowing the intentions of the investors their engagement can become a threat for the continuity of the MFI?

[42] In 2004
[43] In 2010

16.

ARE THEY NOT LENDING TOO MUCH?

...we are responsible...

Millions of men and women now have a microcredit, a savings account or a micro insurance with local microfinance institutions. In some countries, institutions are reporting to attend several millions of clients per year. And numerous clients, who have repaid their loans in full to the NGOs, cooperatives or specialised banks clients, have subsequently applied for new loans. As their small businesses grew, their financial needs also became larger. So everybody is happy? And everybody is better off?

Microfinance has increasingly attracted controversy in recent times.
At the Responsible Finance Forum in The Hague (2011), Princess Máxima admitted that the supervision of the provision of microcredit is sometimes insufficient. "Microloans are too often geared towards lending money on saturated markets. That has led to a battle between competitors and aggressive marketing. We are now seeing the effects that this is having on clients, investors and markets", stated Princess Máxima.

Principles of Responsible Investing In Microfinance

- Actively support retail providers to innovate and expand the range of financial people in order to help them reduce their vulnerability, build assets, manage cash-flow, and increase incomes. Integrate client protection in our investment policies and practices.
- Treat investees fairly with appropriate financing that meets demand, clear and balanced contracts, and fair processes for resolving disputes.
- Include environmental, social and corporate governance (ESG) issues in investment policies and reporting.
- Actively promote transparency in all aspects.
- Strive for a balanced long-term social and financial risk-adjusted return that recognizes the interests of clients, retail providers, and our investors.
- Collaborate to set harmonised investor standards that support the further development of inclusive finance.

PRI Principles for Responsible Investment

The short repayment periods or high interest rates associated with the first loans did not seem to give rise to any problems. The MFIs charged those high interest rates claiming they had to cover high operational costs. But despite those high costs, many MFIs are making considerable profits enabling them to grow significantly. That can be partly attributed to good management and intelligent internal (risk) management. Continuous increase in the number of loans extended is clearly in the interest of the microfinance institution and its owners. The more loans with a relatively high interest rate are sold,

The suicides of more than thirty farmers in south-eastern India shocked the microfinance sector. The men and women were reportedly deeply in debt to the organisations from which they had borrowed money.

The news of the suicides in the Indian state of Andhra Pradesh prompted the Prime Minister there to make some strongly-worded statements. "Microcredit providers charge exorbitant interest rates. The poor are driven to take their own lives because of their debt and the brutal methods used to call in the loans", he told Indian reporters. Oddly enough, the Indian microfinance sector kept silent.

It took many phone calls before a manager of Sa-Dhan, an association of financial service providers, agreed to comment on the matter. "We want to investigate these specific incidents further", K. Balasubranmanyam told Radio Netherlands Worldwide. "Many moneylenders have recently begun to call themselves MFIs (microcredit providers) while they are not registered with our organisation or with the Reserve Bank of India (RBI)". Sa-Dhan has about 250 members and three-quarters of them provide microcredit.

The organisation has pledged to revitalise a voluntary code of conduct and enforce it more stringently. The code was already adopted by most members in 2006 in order to tackle brutal debt collection practices. In the same year, microcredit providers in Andhra Pradesh were also linked to suicides among farmers.

"The people calling in the loans are often not aware of the code of conduct", said Balasubranmanyam. "The membership of the MFI in question can be revoked following complaints, but the agreement was not always adhered to in the past."

Source: RNW Dossier on Microfinancing, 2011

the greater the return. That also attracts investors who can make additional money available to cover the increasing need for capital. Those investors will certainly remain interested if the microfinance institutions continue report to make attractive profits. And that implies continuously attracting new clients.

The institutions are thus constantly looking for ways to expand their portfolio. In the early stages of their existences that was not difficult at all. The poor are numerous and the NGOs and other institutions have indeed been successful in reaching that target group in large numbers. New providers are still entering the market, attracted by the success of the microfinance sector proper. But the market also has its limitations, and the more promising, better paying clients may have been attended to already. Then there is nothing left to do but offering existing clients even more and increasingly larger loans. That often goes unnoticed, particularly if the client is accustomed to systems in which repaying a loan automatically implies illegibility for a new one. On the other hand, if more providers enter the market, clients have more choices. It then becomes appealing to pay off the loan with one provider using the money made available by another one...

In both cases, this may cause major difficulties for the client eventually. They are offered the opportunity to take out loans that they do not actually need, and are unable to repay (in full). This may give rise to debts that clients are unable to repay. This is can easily occur when providers deal with clients who are not aware of the long-term effects of taking out too many loans or excessive loan amounts. Next to that, the bonus schemes for the staff of these institutions are such that the staff is only focused on expanding the loan portfolios further. We can now observe that loans are being sold to people who (have) already become over-indebted and are unlikely to ever be able to repay their loans.

These developments take place increasingly in a growing number of countries. Well-known is the case of Andhra Pradesh in India
At the Responsible Finance Forum held in The Hague in 2011, the then Princess Máxima reminded investors of their responsibility. An increasing number of institutions are heavily geared towards lending money in saturated markets. This led to a battle between competitors and aggressive marketing between MFIs that only want o grown without looking into the effect their actions might have on their clients.

Over-indebtedness is not only a consequence of the trading conduct of microfinance institutions. Clients themselves are sometimes to blame too. If a client is permitted to borrow a smaller amount from a microfinance institution than he or she needs, they may try their luck with other microfinance institutions. And when the latter have no information at all about the microcredits the client has already taken out elsewhere, over-indebtedness is bound to happen.

Over-indebtedness may occur among individual clients, but also in group lending. In the case of group lending every group member is liable for the total debt burden. The lender often neglects to compare the total group debt burden against the expected income of each individual member, which must be used to pay the loan and the interest.

So what is the solution? To lend less, or make clients more aware of their own actions?

In order to reduce risks of over-indebtedness, microfinance institutions in India have set maximum limits on microloans of 12.5% of GDP). This means that with a Gross Domestic Product (GDP) per capita of US $3,500, the maximum amount that can be lent is US $420 (12% of US $3,500). However, the result of this is that staff of microfinance institutions relaxes on analysing loan applications. They approve loans automatically, certainly if the credit analyst receives a reward (a salary increase, for example) that is related to his or her 'sales performance' (e.g. numbers of loans sold).

In Latin America, the governments and central banks have opted for investing in and embarking on financial education of the clients. National programmes have been set up to raise awareness among students in primary and secondary education of the advantages and disadvantages of borrowing (see for example Financial Education in Mexico, Peru and Columbia[44]). Something that also takes place in developed countries. The IceSave fiasco[45] demonstrated that there is still a great deal of work to be done in Europe. In the Netherlands, this is being promoted by the Ministry of Finance as part of the Centiq programme[46], as well as other campaigns. Handling money is about more than just having access to loans and other services. Access to knowledge is in fact far more important. But what will happen with the MFIs if better informed clients decide to borrow less? Will then the sustainability of MFIs not be at stake? And will their services then disappear? And will that then again not affect the sustainability of the businesses of the clients?

[44] See also: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1094224

[45] Iceland Banks offered relatively high rates for savings deposits and many private and public parties in the Netherlands stimulated each other to save there; eventually that system (which was partly a pyramid construction) collapsed and many depositors saw their savings dwindle.....

[46] See also: http://www.consuwijzer.nl/Over_ons/Samenwerking/Centiq_Wijzer_in_Geldzaken

NOTES

17.

ARE OTHER SERVICES NEEDED?

...do you need a business adviser?...

Up to the 80ies starting and existing small entrepreneurs were offered a package of services comprising training, advice, information and financing. Adopting the minimalistic approach meant that business development and support services could be abolished. CBOs, NGOs and donor community gladly said far well to those expensive activities. Just offering micro loans was enough. And some general information on the loan conditions would be sufficient to ensure that clients would know how and when to repay. But were those services effective? Are they needed?

Business development services include a broad array of business services aimed at individual enterprises. These services may range from market information to training and counseling of entrepreneurs. They can be operational, addressing an enterprise's day-to-day operations, or strategic, addressing medium and long-term issues related to the market access or competitiveness of a business. They may be provided directly or indirectly, as stand-alone or as so-called embedded services, and free of charge or at a price.

While in developing countries, microfinance services are fairly well developed, access to nonfinancial services for small entrepreneurs in this part of the world is not available on a large scale. By contrast, in Europe, microfinance services are still young, but microfinance providers generally provide BDS alongside their financial services and there is a broad array of BDS providers. Nevertheless, microfinance providers in Europe face several challenges regarding the provision of Business Development Services.

Each type of support services has its own relevance for a particular client group. Small entrepreneurs benefit from comprehensive business advisory services (ranging from management training to support in business plan formulation) while individuals struggling to survive and engaged in (additional) income generating activities might just need some simple information or orientations. Acknowledging this peculiar "Service/Client group Mix (SCM)" is the basis for the design, development, financing and implementation of effective service delivery mechanisms. And financial institutions can then better decide which services they could offer themselves and which are better offered by third parties with which they can then enter into strategic alliances. See table 9.

Table 9 Support services categorised

	Client development Services (CDS)	Entrepreneurship Development Services (EDS)	Business Development Services
Characteristics	Raising awareness among clients on basic personal (financial) situation. Generally aimed at preventing harmful situations (e.g. over-indebtedness, unhealthy environments). Clients are often in survival mode and not in position to pay for these services. When focus on financial literacy also applicable for other segments and (moral) responsibility of Financial Institutions (FIs).	Helping individuals to raise awareness on entrepreneurship as a career choice and to prepare for start of their own business. Also basic business skills training. Focus on clients aspiring to set up a business from a positive choice, not so much out of necessity.	Supporting existing small business owners to improve their operations, ranging from business advice, technical skills training and linking entrepreneurs to markets.
Small enterprises		Enterprise Education (at vocational training and polytechnic level); Business Creation programmes	Management training; Business Advice Information Technical Skills Training (formal) Supply Chain / Market access Innovation / R&D Sector/ market studies Infrastructure Business associations/ networking Safety, health and environment CSR advice
Micro enterprises	Financial Literacy programmes; Health, safety and environmental awareness programmes	Enterprise Education (at vocational training level)	General business advice; Coaching mentoring
Self employed	Financial Literacy programmes		Adjusted advice; informal (skills) training; Mentoring; web based information
Income Generating for Survival	Financial Literacy programmes		General counselling

Source : Molenaar, N. (2014) Business Development Services – some reflections

An increasing number of microfinance institutions nowadays again offer additional services to support their clients. Those services are claimed to meet the needs of the clients and are manifold.

Examples of this include the following:

- The Ethiopian Business Development Services Network (EBDSN) is the centre of a network of business development service providers supporting micro and small business owners in Ethiopia.
- ADEMCOL (Asociación para el Desarrollo Microempresarial Colombiano) in Columbia. ADEMCOL started providing management training already in 1995. Today, all kind of training is provided on a weekly basis to new client who started their businesses with microfinance;
- Established in 2007, the CF Lanka Microfinance (CFLM) Company aims to be the most dynamic and best performing provider of microcredit, training and consultancy services in Sri Lanka, by providing high quality services and improving economic and social status of families and children in need;
- And in the Netherlands, the Ministry of Economic Affairs, Agriculture and Innovation states that it regards microfinance as a combination of lending and coaching. And as from 2012 Qredits has begun offering coaching services to clients, to those who intends to apply for a loan as well as to those who actually received such financial services. And its e-learning packages are now also offered in other EU countries such as Italy.

Evidently, this is nothing new: integrated business development and advisory programmes were already set up in the 60iess and 70ies to enable small and medium-sized businesses in developing countries to operate and grow. Loans were offered in combination with business advice and training. And such approaches were evaluated, of course. One of the most striking findings of such evaluations was that the small the businesses receiving comprehensive support the less effective the non-financial services (such as training, advice and support). In particular to support cost-effectively very small, micro entrepreneurs just providing (micro) loans - without additional business development services - would suffice... Such financial services had best be offered by private parties (such as NGOs/ CBOs) who could become self-sustainable with the interest to be earned on such micro lending. The effect of providing additional business development services was reported to be marginal and not warranted in view of the costs in relation to size of the investments made but even subsidizing such services was discouraged.

Supported by the international donor community, local Non-Governmental Organisations (NGOs) took up the challenge and started to offer only very small micro loans. Those loans were primarily intended for the poorer strata in society who had no access to mainstream financial services. NGOs became increasingly specialised and grew into microfinance institutions (MFIs). And in turn, those organisations expanded operations and grew in size as their clients grew. Clients initially started with small-scale economic activities that generated a modest income. It could be in the form of a market stall, by street-vending or by maintaining or repairing cars. In addition to microcredit the organization only pro-

vided general information regarding the use of the loan and the required form and rhythm of repayment. Occasionally the locally operating organisations also launched extended training programmes informing clients more intensively about the use of financial services in general (also known as Financial Education).

Some clients succeeded in making their once tiny income generating activity grow into a micro business and even small business. That also meant that they were in need of more (external) money. The average loan amounts therefore increased[47]. Between 2003 and 2009, the average loan amounts per client in Bolivia went up from $1,397 to $2,215. And in Uganda, the amount increased from $195 to $502. And with the increased loan sizes the need to offer business development and support services was felt again.

A growing number of microfinance institutions regard micro and small business as their target markets. As part of that process, they also assume that training and business advice could result in the more effective functioning of their clients' businesses, with the expected positive side effect that payment of loans would improve as well. Such services could be both at the pre -loan stage such as training an advise in the formulation of a business plan and drawing up of loan applications, and at the post loan stage in the form of coaching and consultancy services during and after the start

In order to be eligible for a micro loan, it is often no longer sufficient to step forward with a group. Even the provision of a simple action plan stating the expenses that you want to pay for using the small loan is no longer sufficient. The microcredit provider now expects a business plan that shows the feasibility of the business to be newly established. Furthermore, the financier expects the potential entrepreneur to have the knowledge to draw up a business plan and later to possess the management skills to enable to the business to grow further. The evaluation of the cash flow projection of the business prevails over the assessment of the character of the clients. They are expected to be entrepreneurs not necessarily seen as excluded people who need support to participate. And businesses need to be supported with training and advice. Hence clients are supposed to know how to handle such advises. Is that what excluded people need to prepare for? Can they only obtain financing if they present a variable business plan and show that they are full-fledged entrepreneurs?

[47] Research Center Financial Inclusion and New Entreneurship 2015.

Staff of banks and microfinance institutions need to be aware of the impact that financial services have on their lives, and the same applies to people who use microfinance programmes. That has recently proved to be the case in Nicaragua and Honduras.

The Promifin programme pays special attention to financial education. Poorer people in particular must be aware of the effects of taking out a microloan, or to use a more appropriate term, a microdebt.

Radio programmes, training programmes, guides and booklets are being used to explain how important it is to have finances in order. It is even being instilled into people that it is more important to save than to take out a loan.

Understanding the effects of financing also makes people questioning the high costs of borrowing. This in turn forces staff of MFIs and banks to look into the appropriateness of the credit methodologies and loan conditions in place. Financial education this for all concerned.

Source: Facet/ Promifin (2012)

18.

MICROFINANCE AND POLITICS?

...it is all politics...

Local initiatives lead to the launching of many microcredit programmes and creation of microfinance institutions. Neglected by politics, overlooked by the banks and exploited by the local moneylenders, people - sometimes assisted by and local development organisations - took steps to make money accessible for instance by setting up their own savings and loan groups or other forms of cooperative actions. Started on a small scale and operating in the margins of society, it went unnoticed and, was tolerated. And when they are seen, they will be appreciated?

Becoming self-employed; is it worth doing?

There are about 1.1 million self-employed in the Netherlands; more than 8000,000 of them classificed as solo-self-employed e.g. they work fully on their own without staff/ co-workers. (2015, CBS)

Becoming self-employed seems fun and that is the case too. Determining for yourself what you will do and when, no longer being dependent, are the most important driving factors for the -employed workers in the Netherlands. A self-employed person is either youn and applies mainly IT / web based techniques or often slightly older and has ample experience in the business sector.

The urge to achieve freedom is the most important factor for many people. It may also be quite lucrative, but the motivation becomes questionable if it is only to fill your purse. In order to become independent, you need to consider a few things beforehand. It will be difficult without specialist knowledge, experience and contacts. It also requires considerable self-confidence and perseverance. If you can fulfil those requirements, then there are opportunities and options for you. Remember that without any orders, you will not earn any money.

Source: Stichting ZZP (Dutch association for the self-employed)

Many programmes functioned reasonably well without any formal supervision and regulation. The microfinance institutions themselves were the ones that sought contact with the political sphere, when they noticed that existing legislation and regulations could hinder them in how they operated. The possibility of being permitted to set their own interest rates was one of the first topics that the MFIs brought to the attention of the legislators and politicians. The considerable operational costs made it indispensable in their eyes to be able to charge high interest rates. It was believed that the poor could only be helped systematically and sustainably if the microfinance institution could become financially sustainable. Inspired by organisations such as Acción International, it was assumed in the early years of microfinance that that financial sustainability could only

be achieved if clients paid interest that covered all costs of the MFIs. And if a cap would be set on interest rates, as was the case in France, there was no other option but to lobby in order to abolish it (as ADIE did in France). No other solutions were thought of.

Initially, a microcredit was used for a small income generating activity that was either run at home or in the open air on markets and streets and normally run outside of the formal economy. Over the years, the MFIs also served entrepreneurs who wanted to set up a micro business or enter the market as a more permanent, full time self-employed. New forms of registering businesses were necessary for those groups a second area in which the sector and national and local politics had to work together. In developing countries, the micro entrepreneur and the self- employed were 'discovered' earlier than in Europe. It is only during the last decade that special regulations, policies or programmes have been tabled and introduced in Europe for these new categories. Examples are the introduction of microfinance programmes like those of Per Micro – Italy or MicroStart – Belgium offering loans for micro enterprises or new legislation governing the registration and formalization of the self-employed like that in The Netherlands ZZP - Self-employed without personnel or in Spain 'Estatuto del trabajo autónomo

But the MFI sector also lobbied to limit the uncontrolled growth in the sector and to prevent undesirable parties gaining access to the market. The success of the early years attracted the attention of many at local, national and international level. A growing number of private organisations and private individuals (!) decided to launch microcredit programmes. And often it was not made very clear what the intentions are: to provide services to the less fortunate in society or to set up a profitable business for the initiators themselves. To control the evolution of the sector, a number of countries have begun to regulate MFIs. Governments first attempted to do this by setting up umbrella organisations –APEX organisations – in order to manage the financing flows, later followed by obligations to register formally and by direct supervision, such as in Pakistan and Uganda...

The growth and development of the microfinance institutions also compelled central banks and financial regulators to take steps to regulate the financial functioning of MFIs. Microfinance institutions had become serious players in the financial sector: they increasingly received significant sums of money from (external) private investors, and also wanted to attract local savings. Aspects that called for regulation and legislation. Existing banking legislation needed to be adapted or even fully developed in order to govern the functioning of MFIs (whether operating as NGOs NBFI or specialized microfinance bank). The introduction of regulatory bodies has indeed resulted in more improvements in the sector. In countries such as Bolivia and Uganda, we the sector has developed significantly, as a result of the reporting and audit systems. This is reflected in greater diversification of loan portfolios, the introduction of risk management and the laying down of minimum standards for equity and liquidity. Attention is also being paid to setting up Credit Registration Bureaus, which enable the MFIs to gain greater insight into the market and the payment behaviour of their (potential) clients. This is all intended to professionalise the sector.

Muhammad Yunus, one of the people who laid the foundations of microfinance for the poor, was sacked as Managing Director of the Grameen Bank in Bangladesh in 2011 by the Central Bank of Bangadesh. The Central Bank dismissed the 70-year-old bank managing director on 2nd of March of that year on the grounds that he was too old. According to the central bank, he had acted illegally when his term was renewed in 2000. Normally, managing directors if banks in Bangladesh retire at the age of 60. The Supreme Court in Bangladesh ruled in favour of the bank.

In the view of Yunus' supporters, it is not just about his age; he is the victim of a political game. Yunus himself says that the government wants to take over power in Grameen Bank and would rather see him gone. "This bank belongs to the poor women of my country. That is at risk of change as the government tries to take control of the bank."

The significant growth of the sector has also in turn attracted the attention of politicians, for reasons that are many and varied:

- The boards of directors of an increasing number of microfinance institutions are taking steps to sell their organisations to private investors. Significant profits are being made by public offerings on the stock market or by issuing shares directly to private parties. The IPO of Compartamos in Mexico is a good example, as is the sale of the successful microfinance organisation Edyficar to Banco de Crédito del Perú (which later also bought MiBanco and merged those two MFIs into one giant microfinance institution) by the development organisation Care;

The profits made by public offering and the weak regulation of what used to be idealistic organisations are the subject of fierce criticism from donors, international financiers and national governments. The question is whether or not further regulation is desirable;

- Governments become increasingly aware that the microfinance institutions reach out to millions of clients. This gives microfinance institutions great political power, too great in the view of some regional and national governments.

The developments at the end of 2010 and early 2011 in India (Andhra Pradesh) and Bangladesh respectively are very clear in that regards. In India, federal state authorities restricted the MFI sector and impose strict regulation (read: control) on the operations under the pretext that the interest rates charged were excessively high. In Bangladesh, the government had even taken steps to remove Muhammad Yunus as managing director of the Grameen Bank, claiming that he was too old to be permitted to manage a bank. Yunus, who won the Nobel Peace Prize in 2006 for his efforts to give millions of poor Bangladeshi women access to microcredit, was becoming too high-profile, too powerful and therefore had to be taken out of the picture.

The poor, like the clients of Grameen and those of other microfinance institutions may now be visible, but have also been singled out as a potential political power factor. And their wish was to be seen. Or is it simpler than that? Is the microfinance sector no longer special? Has it become a normal part of society, and therefore also of politics? Was that not the dream of Jonathan Swift, Friedrich Raiffeisen and all of those people who have helped to build the microfinance system? And moreover the dream of all its clients?

NOTES

Glossary

Microcredit
Small (micro) loans, ranging from €50 to €2,000 (in developing countries) for those without access to the formal banking system. Microcredit is primarily regarded as money to finance small-scale economic and income generating activities that would solve social exclusion.
In Europe the threshold is set at €25,000 (EU).

Microfinance
All kind of financial services, including microloans, micro savings, micro insurance, micro pensions and micro guarantees offered to those who are otherwise denied access to such services.

Microfinance institutions – MFIs
A collective term for organisations that provide microfinance, which may be associations or foundations (also known as Non-Governmental Organisations -NGOs) , specialised organisations with a quasi-regulated status, such as Non-Banking Financial Institutions (NBFIs) and (micro) banks that are specifically established for the purpose of providing microfinance.

Microfinance sector (or industry)
The complex of public, private and multi-lateral institutions and development (finance) providing microfinance and related services for people with no or limited access to mainstream financial services.

Microfinance investment funds
Private and (semi-) public funds that invest money in microfinance institutions (in various forms such as direct participations, subordinated loans, long-term and shorter-term loans and guarantees) in the expectation that these investments will provide a return.

Financial inclusion
Everyone has access to the right financial services at the right time and at an affordable price.

Social exclusion
The segregation of a person or a group of people from others, as a result of which they are neither participating actively nor freely in society.

Access to financial services
The opportunity to be regarded by a financial institution as a prospective client.

Loan sharks
Locally operating money lenders who make money available at extorting terms to people with no choice.

Abbreviations

Abbreviation	Meaning
ACAF	Asociación de Comunidades Autofinanciadas
ADA	Appui au développement autonome
ADEMCOL	Asociacón para el desarrollo Microempresarial Colombiano
ADIE	Association pour le Droit à l'Initiative Économique
BCP	Banco Commerial Português
BFI	Bancaire Financiële Instelling
BV	Besloten Vennootschap / Private Limited
BKR	Bureau Krediet Registratie / Credit Reference Bureau
BRAC	Bangladesh Rural Advancement Committee
CFLM	Child Fund Lanka Microfinance
CGAP	Consultative Group to Assist the Poor
EBDSN	Ethiopean Business Development Services Network
EMN	European Microfinance Organisation
FINE	Financial Inclusion and New Entrepreneurship-research groep van De Haagse Hogeschool
GNP	Gross National Product
ISVLA	Informele Spaar-,Verzekering en Leenarrangementen / Informal Savings and Loans arrangement
K-REP	Kenya Rural Enterprise Programme
LETS	Local Exchange Trading System
MF	Microfinance
MFI	Microfinance institution
MIV	Micofinance Investment Vehicle
MMT	Mobile Money Transfer
MSME	Micro, Small and Medium Enterprises
NBFI	Niet Bancaire Financiële Instelling / Non Banking Financial Institution
NGO	Non Governmental Organisation
PRI	Principles of Responsible Investing in Microfinance
RNW	Radio Nederland Wereldomroep / Radio Netherlands Worldwide
UN	United Nations
ZZPer	Zelfstandige Zonder Personeel / Solo Selfemployed

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For web surfers

Organisation	Web address	Explanation
CGAP	*www.cgap.org*	Research/policy centre: CGAP is an independent policy and research centre dedicated to advancing financial access for the world's poor. It is supported by over 30 development agencies and private foundations who share a common mission to alleviate poverty.
EMN	*www.european-microfinance.org*	European Network: The European Microfinance Network is a Non-Governmental Organisation. It has proved to be essential for the promotion of microfinance in the European Union, assisting the fight against unemployment and social exclusion through the development of microenterprises.
Microfinance Gateway	*www.microfinancegateway.org*	Online library: Microfinance Gateway is the most comprehensive online resource for the global microfinance community.
Microrate	*http://www.microrate.com*	Research/survey: Surveys of microfinance investment vehicles highlighting the trends and outlook for the industry.
MicroSave	*www.microsave.org*	Research/policy centre: MicroSave is an industry leader in the area of market-led microfinance, contributing significantly to the global debate on the importance of broadening the boundaries of financial service provision to the poor by including microsaving products.
MIX market	*www.mixmarket.org*	International database: MIX collects and validates financial, operational, product, client, and social performance data from MFIs in all regions of the developing world, standardising the data for comparability. This information is available on a web-based, microfinance information platform, which features financial and social performance information for approximately 2000 MFIs as well as information about funders, networks, and service providers.

NOTES

Drop in for a chat?

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http://www.dehaagsehogeschool.nl/lectoraten-en-onderzoek/overzicht-lectoraten/financial-inclusion-and-new-entrepreneurship/over-het-lectoraat

Conducts practice-based research with the aim of using knowledge to achieve sustainable, fair and culturally diverse socio-economic development. It bases its work on the principle that "*a great deal of knowledge from the south is useful in the north*". The results contribute towards deepening knowledge of microfinance in the Netherlands.

CIDIN – Centre for International Development Issues Nijmegen
Thomas van Aquinostraat 4, 6525 GD, Nijmegen
+ 31 24 361 30 58
cidin@maw.ru.nl
www.ru.nl/cidin

CIDIN is an interdisciplinary academic institute that researches issues of inequality, poverty, development and empowerment. It conducts special studies of microfinance and supervises students who are graduating or writing doctoral theses in this field.

NPM - The Netherlands Platform for Inclusive Finance
www.microfinanceplatform.nl
info@microfinance.nl

Platform of 16 private and commercial organisations that actively support and promote microfinance worldwide. Aims to coordinate programmes with one another and develop joint initiatives where possible.

Qredits/Stichting Microfinanciering Nederland
Wierdensestraat 27, 7607 GE Almelo
Postbus 302, 7600 AH Almelo
www.qredits.nl

The leading provider of microloans in the Netherlands. When setting up the organisation, a great deal of attention is being paid to reducing operational costs by means of a high level of use of IT.

About the authors

Klaas Molenaar (1949), (MA Management Science - Rotterdam University) is a hybrid entrepreneur, consultant and academic crossing borders in search for new insights in entrepreneurship and financing. Professor on *Financial Inclusion and New Entrepreneurship* at The Hague University of Applied Sciences. In that capacity leading various research programmes in the field of microfinance/ financial inclusion Continuously seeking linkages between policy, practice and the academic world. Among other functions, visiting researcher on Transnational Diaspora Entrepreneurship at DSV Stockholm University. Favourite subjects: Entrepreneurship Development and Training, Economic Livelihood, Financial Inclusion and MSME financing (especially microfinance and SME guarantee funds) and Migration, Entrepreneurship and Development.

An entrepreneur who does not mind rolling up his sleeves and delving into the question of why we Europeans so often think that we know how microfinance works and how it should develop from here... "*Research conducted by the Financial Inclusion and New Entrepreneurship research group is based on our belief that much can be learned from experiences in developing countries. Knowledge that can be used in our industrialised world, whether or not adapted to local circumstances. This way of thinking and working may give rise to a reversed transfer of knowledge, and this in turn forms the basis of a more detailed insight and knowledge that can be used to organise microfinance services in Europe in a more effective and efficient way.*"

Julie-Marthe Lehmann is a researcher and PhD-student at the Research Group Financial Inclusion & New Entrepreneurship of The Hague University of Applied Sciences and VU University Amsterdam. She focuses on different research projects related to informal lending, saving and insurance mechanisms in The Netherlands and the linkages with financial inclusion. Julie-Marthe Lehmann studied in Germany, France and The Netherlands, where she attained a master's degree in International and Development Administration at Leiden University. She participated in different development-related projects in Cameroun, Malawi, Senegal and Tanzania.

Financial Inclusion and New Entrepreneurship Research Group - FINE

The research group aims to achieve the following:

- To systematize and disseminate knowledge on Financial Inclusion and New Entrepreneurship, both nationally and internationally.
- To undertake practice-based research with a close link to teaching.
- To contribute to the professionalization of lecturers and researchers of The Hague University of Applied Sciences by their active participation in innovation in education and research.
- To contribute to policy debates on Financial Inclusion and New Entrepreneurship.

Leading is our conviction that European countries have much to learn from the evolution of microfinance in developing countries. Feeding back lessons learned (reversed transfer of knowledge South - North) into education and research, can contribute towards more client-focused financial services for entrepreneurs, irrespective of their nationality or socio-economic status. Research activities undertaken are:

- Informal savings and loan groups in the Netherlands
- New forms of financing in the Netherlands
- Hybrid entrepreneurship
- Incubators and entrepreneurship
- Graduation in MSMEs
- Self-controlled financing systems (in Europe)

Innovation in education is undertaken to support students to learn and understand more about value creation in the next economy and the related new forms of entrepreneurship and new type of IT based and self-controlled financing.

Microfinance - what is it all about?

Microfinance has been given the attention it deserved, and its successes were rightly acclaimed yet microfinance is now facing criticism. To join in the debate one needs to know what microcredit or microfinance actually is and involves. What do we understand by these terms? What are the issues to be taken into account? Opinions and facts seem to become intertwined with one another and what is being postulated with apparent theoretical certainty is not always based on facts or is different in practice.

This book is intended for anyone who wants to join in the debate about microcredit, microfinance and financial inclusion. It makes the 'world of microfinance' (more) accessible to the reader, whether student, professional, practitioner or just someone interested in the topic. It may lead to surprising insights or doubts. Above all, it is intended to encourage the reader to raise questions, not to give answers.

The many people relying on and making use of microfinance now and in the future deserve the best services. Continuously questioning may certainly lead to offering more effective microfinance.