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POLICY NOTE on Sector proposals to increase the impact of Microfinance in the EU



With financial support from the European Union



The social and economic crisis in Europe and the long term objectives for microenterprise development and for reducing poverty, make microfinance a key tool for the future. Microfinance refers to the provision of financial services to financially and socially excluded people. It includes microcredit defined as a loan of less than €25, 000 aimed at supporting self-employment, microenterprise development and job creation.

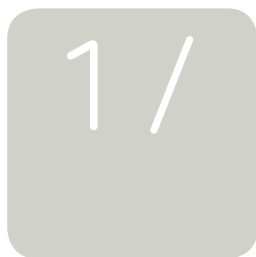
Microfinance in Europe is quickly becoming a relevant tool to reduce social & financial exclusion through the provision of both financial (microcredit, microinsurance, etc.) and non-financial services (trainings, mentoring, etc.). The European microfinance sector offers solutions to the under-served to help them become self-employed and to create jobs across the continent.

The demand for microcredit is high throughout the European Union. There are both external (rising unemployment, de-industrialisation, the growing interest in self-employment, the withdrawal of banks...) and internal factors (better structured offers, institutional recognition, professionalism...) in the sector. The needs of the sector will therefore increase. Nevertheless, the coverage of microfinance in Europe is still patchy and provided by very diverse and mostly very small institutions.

In order to further enhance the development of the sector and its impact, several questions need to be considered by stakeholders all over Europe:

- Is the current Microfinance definition appropriate for the sector?
- Are the EU programmes for Microfinance conveniently designed and implemented for the sector's needs?
- How could the different regulatory frameworks be better adapted to the development of the sector?
- Should the EU programmes reinforce specific support measures for the provision of all the non-financial services offered by the sector?

The European Union has understood the potential of microfinance in relation to the Social Investment Package for Growth and Cohesion and the implementation of the Europe 2020 agenda, and has started to translate this recognition into crucial financial and regulatory initiatives. Nevertheless, the sector wants to present different proposals to the European institutions that could be key to the future development of the sector's activities and its impact among the European population:



Revision of the microcredit definition



The current definition of microcredit was adopted in 2007¹. Though the main characteristics of microcredit are cited in this and further documents (target, object, amount and delivery system), the definition has been eroded during the past years and the implementation of the successive programmes has mainly paid attention to the maximum amount (€ 25,000) and only for the purposes of self-employment and entrepreneurship.

As a consequence, this is creating some perverse effects: banks apply for programmes by including small credits, which they offer to small businesses, without necessarily paying attention to the social aim of the operation nor providing accompanying services.

Moreover, only the transactions that aim to encourage self-employment are considered microcredits even though other microcredit products have emerged for instance personal microcredit and green microfinance, and other financial services such as microinsurance or microleasing.

A reference point other than the amount would make it easier to distinguish the programmes supported by DG Enterprise (COSME) from DG Employment Programmes (EaSI), and to not redirect the budget allocated for microfinance to the benefit of banks.

Indeed, the definition of **microcredit should be based on the type of client** targeted (underserved population by the financial institutions), on **the type of institution offering it** (social purpose organisations characterised by their transparency, client protection and ability to report on their social performance results), **and on the type of services offered**, especially considering that the provision of accompanying services (non-financial services) is a key component of microfinance. Further, the definition should not be restricted on the basis of a limited amount.

1. Communication from The Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions "A European initiative for the development of micro-credit in support of growth and employment".

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Involvement of industry stakeholders in the design and management of programmes

Firstly, the European Commission is currently appropriately sustaining the sector's representation through the support of the two European microfinance networks (EMN & MFC) and it should continue to do so.

Secondly, the development of EU programmes for the Microfinance sector is based on the mutual agreement between EIF/EIB and the European Commission. This system could be improved and better adapted to the needs of the microfinance sector with the **incorporation of new actors for the development of the sector's future programmes.**

The two European microfinance networks (EMN & MFC) would like to become real partners to work together with the Commission and the EIB group in order to design and evaluate the different EU programmes for microfinance. Their experience as representatives of the sector puts them in a privileged position to provide feedback and cooperate in the management of these actions in order to suit the needs of their members who account for 90% of the applicants of EU programmes.

With this purpose, formal co-operation agreements should be set up with the executive and management sides of these programmes (mainly the EIB group) as has already been done with the European Commission (DGEMPL). ■



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Strengthening microcredit promotion

Microcredit has very positive effects on different policies that are especially sensitive in our societies:

1. Social Cohesion, since it offers more opportunities for employment²,
2. Economic Development, via wealth creation and small business financing
3. Public Finances. Encouraging the unemployed to start a business can save money and it also generates additional revenue for the public authorities).

Microfinance institutions should be considered as partners by national institutions for enterprise creation/development or job creation/self-employment. This way, the sector's activities will be better known by the general public as effective tools to offer services to the unbankable/excluded groups.

Member States should be encouraged in particular to develop a regulatory framework conducive to the creation of non-bank MFIs (as is the case in France, Italy and Belgium). Non-bank MFIs face significant obstructions in several countries (e.g. Germany or Spain) and are financially constrained as non-deposit taking institutions. A peer review organised at EU level would be very helpful.

Moreover, the statutory provisions for a beneficiary to make a secure transition between unemployment and self-employment are key to avoiding the "inactivity trap" or the growth of undeclared work. For example, in France it is possible to combine unemployment benefits with an income from a small fledgling company.

The implementation of better regulatory frameworks for the promotion of Entrepreneurship and self-employment will decisively enhance the impact of the sector and will have positive effects on social cohesion and economic development. ■

2. See "MICROCREDIT IN FRANCE: What impact does it have on employment?" Social Finance Working Paper. ILO, 2014.
www.ilo.org/wcmsp5/groups/public/---ed_emp/documents/publication/wcms_247028.pdf

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Providing tools for the financing of support for beneficiaries

The European Progress Microfinance Facility has led to the consolidation and streamlining of funding and guarantees provided by the European Union to support microfinance in the EU. The Facility exhibited strong complementarity with related initiatives financed by the EU, including the Joint Action to Support Microfinance Institutions in Europe (JASMINE); European Parliament Preparatory Action on capacity building of microcredit providers (EPPA); the European Social Fund (ESF) and JEREMIE; as well as the Competitiveness and Innovation Framework Programme (CIP).

Currently, the new EaSI programme offers both technical assistance (in the form of ratings & assessments and horizontal services) and financial services (guarantees and funding) support to the MFIs in Europe. Nevertheless, both the previous EPMF and the new EaSI instruments lacked a measure dedicated to funding microfinance institutions in order to **support the accompanying activities** (non-financial services like training, coaching, mentoring, monitoring of beneficiaries during repayment, and financial education), closely linked to the loan and required for vulnerable clients of MFIs.

Non-financial support measures in addition to microcredit support are key to the success of microfinance; this kind of support substantially reduces the risk of default and is of highest benefit for the clients. Nevertheless, this support is costly in resources and time, requires a full range of dedicated volunteers and cannot be covered by the margin made on microcredit operations (except to raise interest rates to difficult-to-accept levels).

Though this measure partially exists in the EaSI Programme (in the form of funding for capacity building), it would be advisable that all European programmes supporting microfinance incorporate such measures. They could be financed through the use of a mix of guarantee and grant systems that support the guarantees to MFIs with an additional grant for the provision of the BDS to the final beneficiaries, as it has already been successfully done in the past.


A clear mandate for financial inclusion measures to be included in the guidelines, which should be followed by the national operative programmes under the Structural Funds, would also serve to facilitate the adoption of projects for the support of micro-entrepreneurs via ESF & ERDF funds.

Other missing support measures include, the access to subordinated funding or equity. This puts pressure on MFIs without commercial shareholders and sometimes can lead to a shift of the organisational mission. ■




Context



The European Microfinance Network (EMN)  envisions a society in which all those who are financially and socially excluded have access to the full range of financial and complementary support services empowering them to start new ventures, consolidate existing businesses and finance personal needs that improve their lives. EMN's mission is to provide advocacy and facilitate capacity building at European level by promoting transparency, best practices, good governance and research among social purpose organisations delivering or facilitating financial services to the underserved.



The Microfinance Centre's (MFC)  mission is to contribute to poverty reduction and the development of human potential by promoting a socially-oriented and sustainable microfinance sector that provides adequate financial and non-financial services to a large numbers of poor families and micro-entrepreneurs. MFC primarily focusses its activities in Central and Eastern Europe and in the Commonwealth of Independent States.



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