The German 'Mikrokreditwunder': Lessons learned – challenges encountered

23rd of June 2014

A paper by evers & jung on behalf of GLS Bank

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Imprint	
Editor	evers & jung GmbH Deichstr. 29 20459 Hamburg www.eversjung.de
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Status	June 2014

Preface

With a very high commitment GLS Bank has contributed significantly to the development of microfinance in Germany.

The commitment of GLS Bank started in 2000, when GLS Bank together with the project Enterprise established the first micro-credit funds and provided an amount of 100,000 DM for this purpose. Within the framework of this project some young founders were financed and supervised from a youth centre in Brandenburg / Havel from.

In 2004, the GLS microcredit fund has been established to pool local projects. 80 individuals and GLS Bank have then invested over 500,000 Euro. At this time the first five microfinance institutions (MFIs) started the pioneering work with great idealistic commitment. The German Microfinance Institute (DMI) was founded as an association for quality assurance in the German microfinance sector and to represent the interests of microfinance institutions.

In 2006, the KfW banking group, the Federal Ministry of Labour and Social Affairs and the Federal Ministry of Economics and Technology have invested a further 1.5 million Euros to this fund, which was renamed "Mikrofinanzfonds Deutschland". The GLS Bank was also involved at this time again and has provided the MFIs with 100,000 euros for their establishing costs as well as with a manual and an internet based tool.

At the beginning of 2010, the "Mikrokreditfonds Deutschland" was started with initially 10 MFIs. For this purpose, the Federal Ministry of Economics and Technology and the European Social Fund have provided funds in the amount of 100 million Euro. In the following years the number of loans and MFIs increased a lot more than expected. Since the beginning of the Mikrokreditfonds Deutschland more than 17,500 loans with a volume of over 100 million Euros were granted.

As a current challenge GLS Bank is facing an increasingly tougher regulation of the credit business, which makes it more and more difficult to grant micro-credits within the framework of the existing system.

The Mikrokreditfonds Deutschland expires at the end of 2014. A lot of experiences have been made and a lot of knowledge has been gained since the launch of the funds in 2010.

Therefore, in 2013, GLS Bank has asked evers & jung to carefully prepare a lessons to be learned study. GLS Bank would like to share its experiences of the past years with the stakeholders of microfinance business in order to further support and develop microfinance in Germany and Europe. GLS Bank is therefore very happy to present the following paper of evers & jung to the participants of the 2014 annual EMN conference

Heike Linnemannstöns

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Introduction[1]

The access to finance for enterprises and start-ups in Germany was until recently rated as favourable compared to its international peers, due to a strong saving banks sector and a well developed system of promotional funding schemes. However, today this situation is challenged by the **growth of new target groups with limited access to finance**, e.g. micro start-ups out of unemployment and self-employed with a migratory background. Together with the main actors of the German microcredit sector the federal ministry for labour and social affairs (BMAS) in 2010 decided to set up the **"*Mikrokreditfonds Deutschland*", pooling resources with a total volume of 100 Million €, including 60 Million € from the ESF**, to finance start-ups and microentrepreneurs previously without proper financial access. This marked a significant moment for microfinance in Germany and sparked considerable interest from microfinance practitioners and policy makers throughout Europe, due to:

- **The size of the investment** - It is the biggest single national public investment in European microfinance
- The successful establishment of **non bank microfinance organisations as front-end for loan provision** in a restrictive legal framework
- The specific setup of the system - Using **ESF resources for a national guarantee fund** in a multi-stakeholder system

With over 17000 loans distributed in less than four years of operation, the Mikrokreditfonds surpassed the initial expectations in terms of general outreach and proved that **even in welfare states it is possible to do microfinance at a large scale and in an economically viable manner.** But what are the main success factors of the system? What are the persisting challenges? And finally, what can be learned from this experience for the European microcredit sector? Based on an in-depth lessons learned analysis, commissioned by the GLS bank this paper sets out to answer these questions along these areas:

- **The market perspective:** identifying demand and supply for microfinance in Germany
- **The legal framework:** Using Non Bank MFIs as front-ends for a nationwide provision of microloans
- **Outreach:** Setting an incentive structure for nation-wide growth of loan portfolios
- **Risk:** Managing portfolio risk in a multi-stakeholder system
- **The funding structure of the system:** Covering operational costs in a sustainable way

[1] This paper is a summary of a more detailed study on the German microcredit system by evers & jung on behalf of GLS Bank that hasn´t been published yet. See: Bendig, M./Evers, J and Unterberg, M. (2013). On this basis Heike Linnemannstöns, Maria Nowak and Jan Evers discussed the German model at the international microfinance conference in Lisbon in June 2014 together with microfinance experts coming from more than 12 countries. The discussion focused on important learnings for Europe and chances to further improve the German model. Its results were used for an update of this version of the paper.

1. Market perspective: Identifying demand and supply for microfinance in Germany

The German market for microfinance was for a long time seen as of limited scope. This notion was based on several characteristics of the German financing and funding landscape:

- **SME-oriented financing offers of savings and cooperative banks:** The savings and cooperative banks traditionally have a very strong role in financing small enterprises in Germany[2].

- **Geographical coverage** of the German banking sector: In international comparison, Germany always had a high level of coverage of bank branches even in rural or less densely populated areas, including commercial, savings and cooperative banks.

- **Activity of public promotional banks,** both at federal level (the German Bank for Reconstruction and Development - KfW) and at the regional level ("Landesförderinstitute"): Since the Mid-Nineties these publicly backed financial institutions offer structured financing offers for SME and start-up finance which are distributed via the banking sector[3].

- Also, since the beginning of the 2000s Germany features a **welfare bridge for start-ups out of unemployment** that was taken up very well and contributed to a boom in this start-up segment in Germany between 2002 and 2005[4].

So what has changed, that microfinance became a very relevant issue for German employment and entrepreneurship promotional policy in the past years? There are some **recent trends** that indicate the limits of bank-based provision of small credit volumes to start-ups and microenterprises in Germany:

- The **risk aversion of commercial banks** in credit allocation generally increased due to the financial crisis and growing regulative burdens for risk taking of banks in credit provision to target groups with low levels of collateral, higher default risks and unfavourable cost-revenue ratios.

- The **number of bank branches decreased** by 44% from 1990 to 2011, with the biggest decrease in the savings and cooperative bank sector deteriorating the financial access of start-ups and microenterprises in rural areas or from marginalised groups[5].

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[2] They can be seen as one of the first MFIs, since they accepted to take in savings and distributed small credits to the less wealthy and established client groups. Still today, again in the presence of negative effects from market liberalization, these institutions are financing ¾ of all SME and 80% of all business start-ups in Germany and consult on international development projects (see IMF (2011)).

[3] The success of this system in supporting SMEs with restricted access to bank finance was highlighted in the recent crisis and spurned plans to set-up similar institutions in other European countries.

[4] See Siewertsen, H./Evers, J. et al (2004).

[5] See IMF (2011)

- **Public promotional banks** started to **offer dedicated microcredit schemes** during the past EU funding period[6]. The experiences of the past years showed that the outreach of these programmes is limited by the strategy to use banks as distribution channel, since they are not willing or able to invest in the costly and time-consuming processes to deal with excluded target groups.[7]

Additionally, the welfare bridge for start-ups out of unemployment was further reduced in the past years with regard to the time period it is granted for and to the volume of the benefit. Since 2011 it is not paid as a mandatory benefit to long-term unemployed anymore.

In order to gain deeper insights about the potential market for microcredit, a **study on the demand for microcredit in Germany was instructed by the Federal Ministry of Labour Affairs** (BMAS) in 2009. The results demonstrated that 1) there was an above average growth in self-employment of marginalised groups after the financial crisis and 2) it is difficult for these groups to receive adequate business financing below the 20.000€ threshold.

The study called for a government intervention to **offer microcredit at a national level**, with credit sizes of less than 20.000€ and maturities under 3 years, especially to marginalised groups. Furthermore, in the light of the experiences made by the promotional banks' schemes, a **non bank front-end for loan provision** was favoured by the study to be the most viable approach to reaching the underserved target group of excluded entrepreneurs.

Based on the outlook presented in this study and the pilot success of a previous microfinance guarantee fund at national level, BMAS together with the Federal Ministry for Economic Affairs (BMWi) decided to set up a **new national guarantee fund for microcredit, increasing its volume to 100 € Million**, using 60 € Million from the European Social Fund (ESF). It was the biggest single national investment in European microfinance to date and piloted the use of ESF resources for risk sharing in microfinance. The characteristics of the **loan products** offered via the fund were based on the recommendations of the study:

Loan characteristics of the Mikrokreditfonds

Purpose	Entrepreneurial activities (investments, working capital, etc)
Loan amounts	1st loan max. 10.000€, 2nd loan up to 20.000€
Interest Rate	Currently 8.9% (effective annual rate)
Extra-Fees	No
Loan period	Up to 3 years for annuity loans, 6 months for bullet loans
Collateral	Co-signing, collateral with high personal value

[6] KfW started even earlier (in 2000) with a nation-wide microfinance scheme (Startgeld) that included a counter-guarantee by EIF for the banks that distribute the loans.

[7] As a consequence, some of these public programmes already scaled up their approach beyond typical microcredit and towards more bankable target groups. The KfW program Startgeld now can hardly be seen as a dedicated microcredit scheme any more with loans sizes up to 100.000 EUR.

The demand for the loans grew quickly since the setup of the fund in 2010 and surpassed even the most optimistic predictions. An **average loan size of 6.452 €,** and an **average maturity of 24 months**[8], indicate that the majority of the loans indeed address the market segment identified in the demand study.

Lessons for Europe:

- There is a **substantial market for microcredit** with loan volumes below 20.000€ and short maturities even in countries with highly developed banking sectors and welfare bridges.
- National microfinance schemes need to offer **geographic proximity** to the potential lenders. This can be realised via a **network of non bank MFIs** that use a central structure for refinancing and/or risk sharing.

2. Legal framework: Using non bank MFIs as front-ends for loan provision

The German Banking Act does not differentiate between microcredit and providing standard loans. Thus the **professional or regular provision of microloans requires a banking license**. Unlike their counterparts in countries with a specific regulation on microloan provision, e.g. in France, German non bank institutions are therefore not allowed to provide loans to the target groups of microfinance on their own[9].

In the past this limited the outreach of microfinance via non bank channels to individual regional cooperation models of banks and non bank MFIs. **An innovative approach was needed to realise a national cooperative microcredit scheme** with sufficient outreach potential both in terms of geographical coverage as well as number of loans provided. To realise this, the fund was based on the lessons learned from a series of prior piloting projects, including the "Mikrofinanzfonds" that was based on the cooperation between GLS bank, an ethical-ecological cooperative bank, and the **German Microfinance Institute (DMI)** representing several regional initiatives of non bank MFIs. The Mikrofinanzfonds represented a first modest success for the delivery of non bank microcredit with a loan size of less than 10.000€[10].

This initial success convinced the BMAS to base the new Mikrokreditfonds on the **established cooperation model between GLS bank and MFIs that were organised in the framework of the DMI**. The model was modified to allow the addition of additional MFIs and to realise the risk-sharing element provided by the ESF-fuelled national guarantee fund.

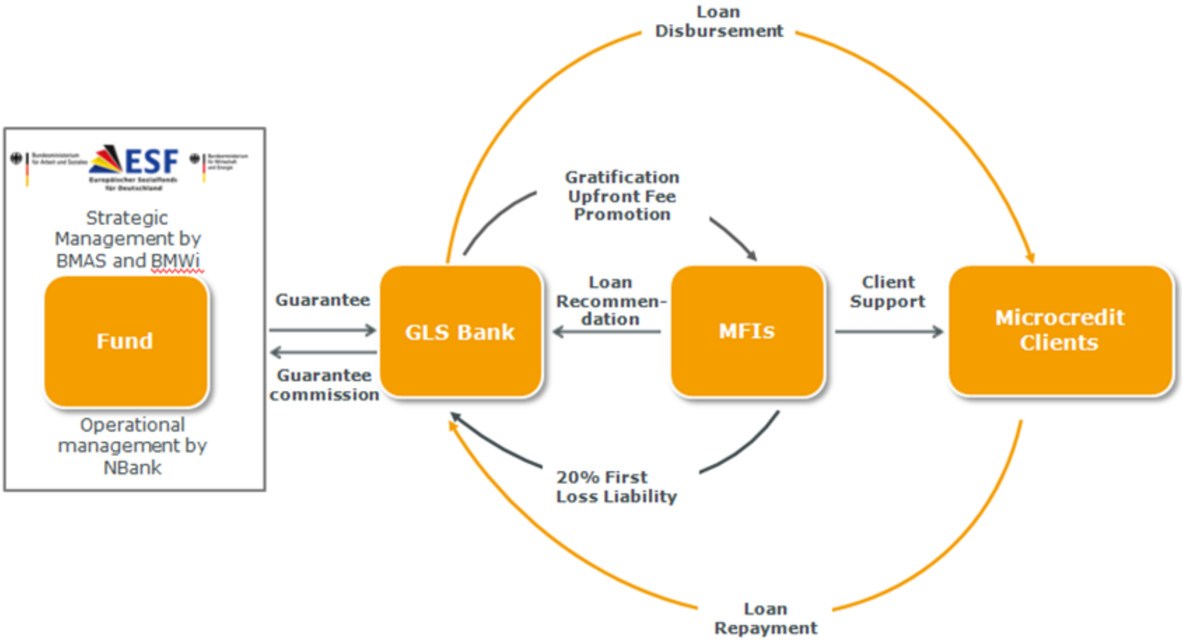
Although quite complex at first glance, the approach chosen for realising the fund was praised upon its start for its innovativeness in allowing nation-wide non bank microfinance in a restrictive regulative environment for loan provision. It involves **four**

[8] Status as of May 2014

[9] For a more detailed account of the legal situation in Germany see Thomas Reuters Foundation (2011).

[10] The fund had a size of 500.000€, shared through a network of 5 MFIs. 1,5 € Million national resources were added from BMAS and BMWi. 500 loans were distributed, with a total default rate of only 3%.

main actors, which contribute in different roles to the overall performance of the system (see graph).



1. **Representatives of BMAS and BMWi compose the management board** of the fund, setting the overall strategy of the fund's activities, including product framework, regulation of the remuneration system, etc. **(Strategic fund management)**

2. The fund itself is **managed by NBank**, a regional promotional bank which is not involved in the actual credit operations. It mainly covers treasury functions, and informs the management board of the overall performance of the fund. **(Operative fund management)**

3. **GLS Bank** is the only commercial bank partner contracted by the fund and functions as the **intermediary between the fund and the MFIs**, thus constituting the central actor in the system. Its main responsibilities are the refinancing and processing of the loans provided by the MFIs, the organisation of the flow of remuneration between the fund and the MFIs and the management of the network of MFIs **(Back-office function)**.

4. The **MFIs,** made up of start-up centres, economic support centres, business consultancies or NGOs, are **preselecting and screening potential clients**, and also serve as personal contact point for the client over the period of the credit reimbursement **(Front-office function).** The majority of them is organized in a national network managed by the **DMI (Deutsches Mikrofinanz Institut)**, that supports the MFIs in various capacity building and moderating functions (e.g. implementing the European Code of Conduct, offering training, organising an ombudsman).

Over the cause of the past four years the chosen setup showed some distinctive **strengths**, especially during the initial growth and experimentation phase:

- A good balance of top-down regulation by the fund and GLS Bank and bottom-up activity by the MFIs to scale up loan provision throughout the system
- Enough flexibility to establish different channels for loan provision via a heterogeneous set of MFIs, who at the same time worked on common standards for loan provision and risk management in the DMI network.
- The right mix of incentives and entry barriers to make the system attractive for MFIs as well as clients.

It also demonstrated some specific **weaknesses**, especially in the following phase of consolidation:

- The need of further centralisation to ensure the enforcement of standards in risk management and quality assurance throughout the system
- The tendency of the fund's management to intervene in the operative activities of bank and MFIs
- The 'sandwich position' of GLS bank between the fund and the MFIs, resulting in an overstretching of the banks' resources in managing the individual MFIs. This situation could only to some extend be mitigated by including the DMI as an intermediary.
- The high amount of internal communication needed to adjust the complex risk sharing and remuneration system

Lessons for Europe:

- In a context of restrictive regulation for non bank loan provision, **cooperation models of non bank MFIs with banks** allow scalable microcredit activities, even at a national level.
- Complex microfinance cooperation models for loan processing and risk-sharing need to **allow a higher level of centralisation in consolidation phases**.
- The **separation of back- and front office** allows for high growth in overall loan provision if the responsibilities in the system are clearly defined and processes are lean and standardised.
- The German model is a **top-down approach** (one publicly managed fund cooperates via one bank with multiple MFIs) to develop microcredit provision at national scale. This has the upside of featuring direct public support from the start and potential efficiency gains in centralised loan processing. The downside compared to a **bottom-up approach** as it was piloted by ADIE in France (one MFI cooperating with multiple banks) is that the system is overly dependent on the bank actor and the specific regulation framework of the fund and is less focussed on the development of target group oriented microfinance practices and the general regulation of microloan provision. As an effect, in France the national regulation for providing micro loans changed and efficiency increased continuously, in Germany the regulation level even increases and efficiency staled.

3. Outreach: Setting an incentive structure for nation-wide growth of loan portfolios

The system was successful in reaching the desired increase in the market outreach of microloan provision in Germany: Already in 2011, only one year after the fund became operational, more than 400 credits were given out monthly, putting Germany among the top five growing microcredit sectors in the European Union[11]. While the initial aim was to provide 15,000 loans by 31 December 2015, **already in May 2014 more than 17.500 loans had been distributed** (see table).

Year	2010	2011	2012	2013	Total (May 2014)
Number of loans distributed	1740	4852	5853	4284	17.506
Loan volume (in Mio EUR)	9,78	29,57	33,61	24,90	103,25

This success was based on several aspects contributing to the outreach of the system:

- By using a **nationwide network of non bank MFIs**, the system managed to reach a high degree of accessibility for start-ups and microenterprises.
- For the medial propagation of the program an **internet campaign** was launched via www.mein-mikrokredit.de, so that many different actors could become aware of the program[12].
- The **product features** proved to be attractive for both start-ups as well as established micro enterprises, allowing MFIs to widen their target groups and serve more clients.

Additional to these aspects the **remunerative system** for the MFIs played a crucial role in the outreach performance of the system. In contrast to traditional MFIs, that refinance themselves via the income from the interest rates of the loans, the MFIs in the German system receive **performance-based payments for cost coverage** from the fund (see chapter 6 for more details). In the growth phase of the fund these payments were set at a high level to generate incentives for high outreach.

In the first years the fund was also very successful in **increasing the network of participating MFIs** and therefore was able to offer a broad coverage of microcredit provision throughout all German federal states. Due to the heterogeneity of the MFIs involved, it was also possible to serve a big variety of different target groups, ranging from start-ups out of unemployment to existing microenterprises and freelancers in the creative sector. The fund started with 12 MFIs and reached a total of 60 MFIs in 2013, including local community based providers as well as national providers offering loans via a web-portal. Most of the credits distributed since 2010 were given out by three bigger MFIs that together held 40% of the total loan portfolio for the first three years. Ten MFIs alone distributed on average one loan per day.

[11] See EMN Overview survey 2010/2011

[12] The site includes a search engine for MFIs and videos of supported entrepreneurs. For small amounts of money, MFIs can use banners, posters, flyers for promoting their activities.

The outreach success of the fund showed that it was right to admit a high **degree of heterogeneity of MFIs** in the beginning, in order to see which MFIs would do well after 2-3 years and then to decide future cooperation with those that were most successful.

Lessons for Europe:

- In a cooperation model between banks and MFIs it is crucial to **set outreach incentives for the MFIs**.
- A **high degree of the MFIs' heterogeneity** regarding their organisational form and target group approach supports the outreach of the system.

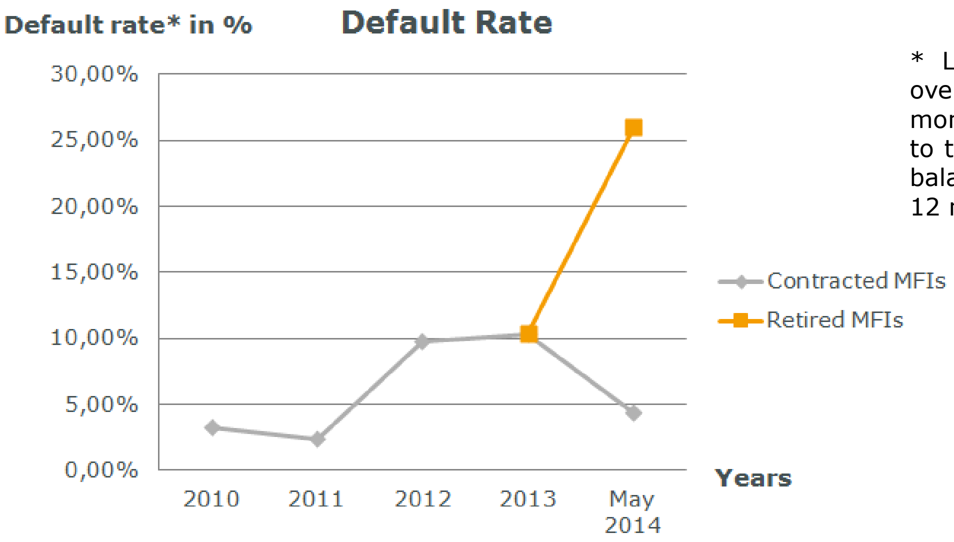
4. Risk: Managing portfolio risk in a multi-stakeholder system

The question of risk management is crucial for microfinance providers as they deal with low income target groups, whose entrepreneurial ventures are vulnerable, resulting in a more than average risk of default. In a system that separates front and back-office operations the main challenge in risk management measures is to set them at the right level to be effective. This aspect was reflected in the chosen **risk management measures**. They include the following aspects:

- A **thoroughly accreditation process** of new MFIs (facilitated cooperatively by GLS Bank and DMI) to ensure the quality of MFIs: Out of 211 applications in the first rounds of accreditation, 43 MFIs were accepted, yielding a rejection rate of almost 80%.
- **Monthly reports** sent by MFIs to GLS-Bank about the current level of risk in their portfolios.
- If the reported level of risk reaches a certain threshold, GLS-Bank is entitled to set up a **crisis intervention procedure** for the MFI that is organised in three escalation steps: 1) action plan of the MFI to lower the risk; 2) temporary stop of the loan delivery by GLS bank; 3) permanent stop of the loan delivery
- GLS-Mikro, the **management information system (MIS)** by GLS-Bank, allows continuous monitoring of the portfolio at risk after 15 days and provides information on social indicators (like gender, migrant background, education, trainee places)

Additionally the system was designed with an **elaborated risk sharing mechanism** to counterweight the fact that MFIs are merely acting as the front-end of the microloan provision. Its main feature is that the MFIs bear a 20% first loss liability. The 20% First Loss Liability is determined for each calendar year and limited to 20% of the highest annual balance of loans recommended by the MFI. The guarantee fund covers the rest of the potential default. Before recommending any loans the MFIs have to provide securities (cash or bank guarantee) which need to cover the MFIs liability at any time.

The **ratio of defaulting loans** (see graph) showed that the risk management measures worked well in the first years of the fund's activity.



* Loans write offs over the last 12 months in relation to the average loan balance of the last 12 months.

When growth slowed down somewhat in 2012, the ratio of defaulting credits in the last twelve months went up, even if the quality of the loan portfolio stayed the same. Consequently, **in 2012, the level of loss became more critical, close to 10% and thus well above the EU average of 7%.**

The underlying problem of the rising default rate was the high growth in overall loan provision, which created a huge additional workload for GLS Bank in ensuring a tight control in the appraisal of loan recommendations by MFIs resulting in high risk loan recommendations. Also the chosen accreditation process was not able to completely exclude MFIs that focused mainly on reaping the incentive upfront fees of the system..

However, the majority of the MFIs involved in the fund's activities demonstrate sufficient risk awareness in their recommendations of loans, mostly due to their liability for defaults. They have installed well functioning measures regarding the screening (focus on risk and demand for clients) and the monitoring of clients (ensuring ongoing mortgage payments, and pro-active risk management), yielding in well balanced portfolios of these MFIs. Some have also advanced measures in place to retrieve part of the outstanding loan volume in case of default.

In the face of the development of the default rate in 2012 GLS bank together with the fund's management nevertheless decided to push for stricter rules in the cooperation with MFIs in 2013, e.g. **tighter qualitative check-ups on MFI's loan portfolio and measures to ensure trustworthiness** on the side of the MFIs. As a result of this a selection process took place, **resulting in a current number of 32 MFIs** in the system (34 MFIs have been offered a contract for 2014). The **default rate developed accordingly, dropping to 9,33% in 2014**. In regards to the MFIs that were offered a contract for 2014 the default rate is in average lower than 5 %. On the other hand, the default rate of the retiring MFIs amounts to more than25 %, although these MFIs are still responsible for the client support and are paid a gratification based on repayment success of the outstanding loans. For the MFIs who had to drop out of the system this is a very challenging situation, for which they can get various support by the national network DMI.

Lessons for Europe:

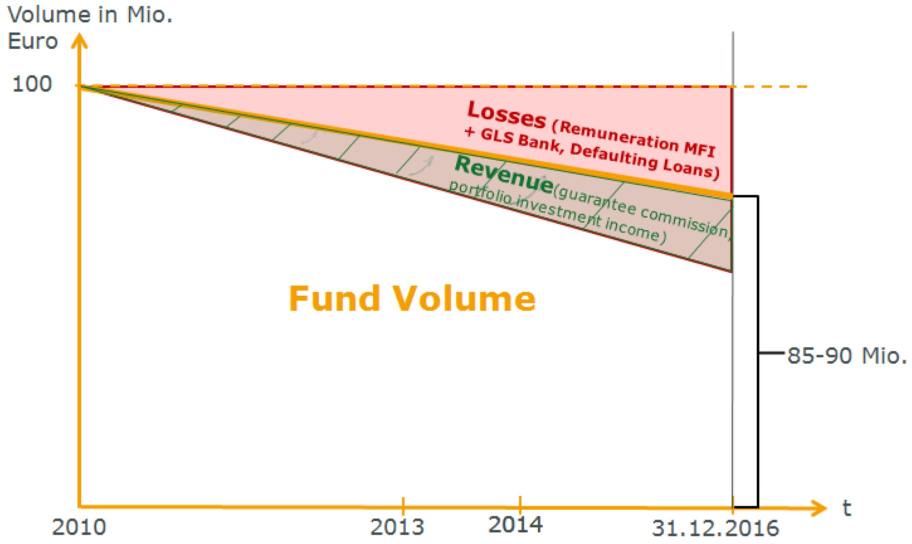
- In a cooperative system for microcredit provision **suitable risk management measures** need to be in place at both the level of individual MFIs and the overall level of the cooperating bank and the fund.
- Even in a model separating front- and back office, risks can be controlled sufficiently by **setting the right incentives and liability structure**.
- The incentives for growing outreach in such a multi-level system need to be **balanced with the capacity of the central bank actor for risk management and intervention**.

5. Funding: Covering operational costs and leading the way towards long term sustainability

The funding structure of the system was set up to ensure on the one hand the overall **economic sustainability of the guarantee fund** during the ESF funding period and on the other hand to allow MFIs and the GLS bank to **develop their institutional capacities for efficiently delivering a growing number of loans**. This was necessary as the interest rate of the loans was capped at market prices limiting the external revenues that the system could generate from loan provision.

To reach these objectives **a balanced system for redistributing risk and revenues between the involved actors** was installed. This **risk sharing mechanism** included the MFIs with a first loss liability of up to 20% of their portfolio (see chapter 5). This reduced the risk exposure of the guarantee fund and contributed to the overall economic viability of the system, as the fund on the other hand used part of its resources to compensate the MFIs and GLS Bank for their operational costs. For this the fund generated revenues via a guarantee commission that is paid by GLS bank for each loan and treasury revenues.

The following graph illustrates how the fund's resources were planned to be used over the originally planned activity period.



There are mainly **two remunerative elements** in place for the MFIs:

- An **upfront fee** to reward the loan provision services of the MFI. The initial amount of the fee (800€ per loan[13]) was set to ensure that the MFIs could build up institutional capacity, equity for covering losses and professionalise their business during the first years of operation of the fund. After that the fee was decreased continuously and finally abolished in January 2014.

- A **gratification reward** to cover the costs of monitoring and supporting the client in repaying the loan (of up to 10% of the annual loan amortisation). This reward is only paid if the defaulting loans of a MFI represent less than 10% of its total portfolio[14]. This element was designed to offer MFIs with low default rates a steady source of income for covering overall costs of their operations.

Originally it was calculated that based on the combination of these two remunerative elements a MFI could develop an economically viable business model with intermediating and monitoring 150-200 loans per year. Later on, when the upfront fee was reduced, this calculation was challenged by the MFIs. The average costs for a MFI in supporting a microcredit client was assessed in 2012 by a study of DMI at 961 €.[15]

As the central bank actor in the system, GLS Bank receives the interest from the clients to cover its refinancing and operational costs. Since it has to pay a guarantee commission[16] for each loan to the fund as a commission for covering the default risk, it receives an annual lump sum to cover additional operational and IT costs.

During the initial expansion phase the system worked well and was successful in balancing economic viability and cost coverage of the stakeholders. Beginning in 2012 the situation changed **as the incentives for growth in loan provision were reduced by the fund's management and default rates of many MFIs portfolios increased**. The remuneration available to these MFIs via the fund declined accordingly and put a lot of the MFIs under pressure to cover their costs. For GLS bank the expenses for risk management and controlling the performance of MFIs increased in this phase as well. It showed that the **standardisation and efficiency of the operations at the level of both MFIs and GLS bank had not developed fast enough** to counter these effects. In addition, due to the annual payment cycle of the gratification reward and ongoing problems by GLS bank in calculating the reward for each MFI on time[17] many MFIs had to deal with liquidity problems until the payment was cleared by GLS bank. Also the system did not manage to produce sufficient transparency in the allocation of costs, revenues and payments between MFIs, GLS Bank and the fund. As a result the system was lacking incentives and control mechanisms for MFIs and GLS bank to become more cost-efficient during the first years of its existence.

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[13] Only for the first loan to an individual client, the fees for subsequent loans were lower.

[14] Actually the reward is reduced by the default rate in the portfolio. So if a MFI has a default rate of 6% it receives 4% of the annual loan amortization.

[15] Including costs for providing collateral for defaulting loans, see DMI (2012)

[16] This is set at currently 3.9 %.

[17] This was mostly due to the complex nature of the arrangement and technological difficulties in the processing of loan data at the level of the MFIs portfolios.

Starting with 2014 some important changes were implemented in the system in order to increase the incentives for ongoing support of existing clients and to improve the liquidity situation of the MFIs:

- The remuneration system is now based on **rewarding loan repayment only**. The gratification on loan repayment by the microcredit clients has therefore been increased from 10% to 18%, the element of upfront fees is no longer in place.
- The gratification reward on loan repayment is **linked to the ongoing client support provided by the MFI** not the recommendation of the loan.
- **Monthly payment** of MFI remuneration to improve liquidity of MFIs

From a policy perspective the funding situation is nevertheless acceptable as the system was mainly designed for increasing outreach in loan provision and for funding the development of professional structures in the non bank MFI sector. The economic sustainability of the guarantee fund is ensured and to date the reduction of the overall volume of the fund lies within expectations.

<u>Lessons for Europe:</u>

- The funding structure of a multi-stakeholder system for microfinance needs to **balance incentives for growth with incentives for more efficiency and cost reduction**.
- The instrument of a **decreasing upfront fee** for loan recommendations works as incentive for outreach but not for economic viability
- A high volume and well managed **guarantee fund** can generate **additional revenues for covering operational costs** of the system's stakeholder.
- In a **MFI network approach** to microfinance, the **homo- and heterogeneity of its members**, e.g. in terms of target groups, needs to be balanced in order to ensure economic viability.

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