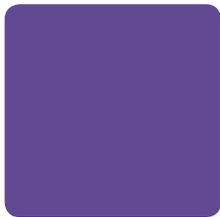




# Microfinance Institutions and Banks in Europe: The story to date



2015

Anastasia Cozarenco

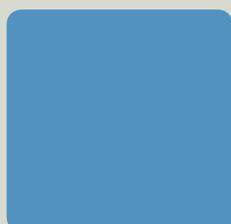


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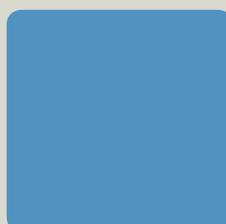


EUROPEAN  
MICROFINANCE  
NETWORK

# Table of content

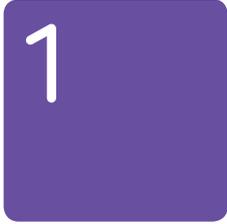


<b>Executive Summary</b>	<b>3</b>
<b>1 Introduction</b>	<b>4</b>
<b>2 Methodology</b>	<b>6</b>
<b>3 Brief description of the Partnerships and Strategies</b>	<b>7</b>
<b>4 Main Results</b>	<b>10</b>
<b>5 Alternative Partnerships</b>	<b>14</b>
➔ 5.1 Insurance providers	
➔ 5.2 Crowdfunding and peer to peer platforms	
➔ 5.3 Transfer companies	
➔ 5.4 Mobile banking	
<b>6 The Road Ahead</b>	<b>19</b>
<b>7 Case Studies</b>	<b>22</b>
➔ Action Finance Initiative	
➔ Adie	
➔ AgroInvest	
➔ Bank of Valletta	
➔ Community Developing Finance Association	
➔ Créa-Sol	
➔ DMI	
➔ National Federation of French Savings Banks	
➔ Micro Development	
➔ Microfinance Ireland	
➔ microStart	
➔ Opportunity Bank Serbia	
➔ PerMicro	
➔ Qredits	
➔ Réseau France Active	
<b>References</b>	<b>46</b>
<b>Appendix</b>	<b>47</b>
<b>Acknowledgements</b>	<b>48</b>



# Executive Summary

- There is a large variety of MFI-bank partnerships in Europe. They are shaped by legislative and economical national contexts. MFIs generally have more than one partnership, in some cases with a consortium of banks.
- In most European countries, MFIs and banks are not in direct competition. They serve different segments of the market and provide complementary services.
- Collaboration benefits all parties. For MFIs, partnerships ease access to funding and cost reducing technologies. They contribute to the expansion of MFI lending activities and improve their financial performance.
- Banks benefit from a better image through corporate social responsibility. Microfinance facilitates the construction of a pool of prospective, profitable clients. Additionally, collaboration creates cross-selling opportunities for banks. Entering the microfinance market is in some cases risk free for banks.
- Clients have the advantage of proximity when the provision of microfinance takes place through bank branches. Borrowing from/through an MFI in cooperation with a mainstream bank represents the first step toward financial inclusion. Additionally, the services provided by MFIs are tailored to better address the needs of micro-borrowers.
- Regulatory constraints are not necessarily perceived as impediments by MFIs. Nevertheless, MFIs need to benefit from more autonomy to successfully comply with their social mission.
- The main challenge for MFIs involved in partnerships with banks is to make sure that the objectives of banks and MFIs are aligned to avoid the risk of the mission drift.
- Cooperation can be improved through long term commitments, the creation of multi-bank partnerships models, larger decision power given to MFIs, decreased complexity of the partnerships, increased awareness of banks about microfinance and standardisation of methods and criteria employed.
- MFIs in Europe diversify their funding sources using funding opportunities available from the European Union or using innovative alternative partnerships with crowdfunding and peer to peer platforms. They moreover collaborate with microinsurance companies, and to a smaller extent, mobile banking and transfer companies.



# Introduction



Banks represent a dense network in Europe. According to the European Central Bank, as of March 2015, the European Union (EU) counted 7,233 credit institutions<sup>1</sup>. They play a crucial role in business financing (80% of European business activities are funded by banks; European Banking Federation, 2014), especially for Small and Medium Enterprises (SMEs). However, access to finance is not easy for the SMEs, particularly when they lack formal collateral or credit history.

In comparison, Microfinance Institutions (MFIs) mainly focus on the financing of very small and small businesses (business microcredit) and low income or poor individuals (personal microcredit). The driving force of the microcredit market is financial and social inclusion. Targeted micro-borrowers belong to segments of the population such as (long-term) unemployed, women, migrants, young, rural and/or disabled people. Business loans generally target very small (new) businesses that lack any form of collateral or credit history. However, no single definition of microfinance exists in Europe (European Banking Federation, 2010). The relative number of European MFIs is relatively low, estimated to range between 500 and 700 institutions (Bendig et al. 2014).

Another issue faced by MFIs in Europe are

regulatory constraints. In countries like Germany and Serbia, MFIs are not allowed to disburse microcredits on their own (see Table 1) and are therefore constrained to collaborate with banks to develop their activities. In other countries, such as Greece, there is no bank monopoly, but financial institutions require excessively high minimum capital requirements to legally perform credit activities. Such regulations make the development of the microfinance sector particularly cumbersome. In addition, MFIs that can disburse credits directly are generally not allowed to collect savings from their clients. Being denied access to this relatively cheap source of funding, MFIs had to find alternative ways to refinance themselves.

Given this context, interactions between MFIs and banks occur naturally in Europe. However, these interactions are not always voluntary; the national legislative frameworks, illustrated in Table 1, shape the partnerships and strategies observed in different countries. Obviously, both banks and MFIs are impacted by these interactions. On one hand, MFIs integrate mainstream banks into their business models. On the other hand, banks revise their operating strategies in response to the growing role of MFIs on the financial market in Europe.

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1 <https://www.ecb.europa.eu/stats/money/mfi/general/html/archive.en.html>

**Table 1**

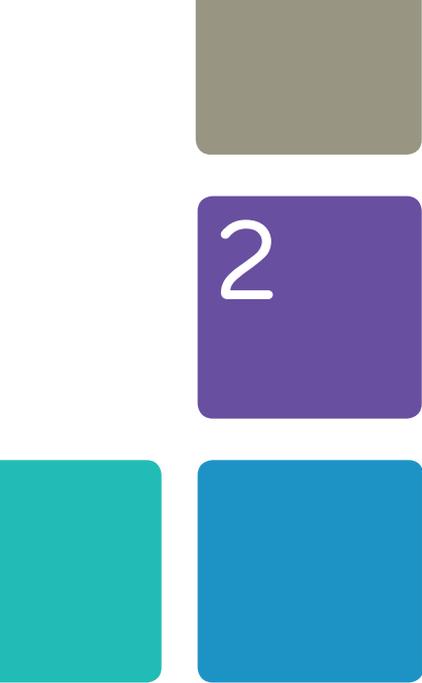
Source: Bendig et al. (2014), European Microfinance Network (2014), Adie (2011)

Country	Specific Microfinance legislation	Bank monopoly for lending activities
Belgium	No specific legislation	No
France	Specific microfinance legislation: microfinance associations are regulated by the French Monetary and Financial Code Art. R518-57 to R518-62	No
Germany	No specific legislation	Yes
Greece	No specific legislation	No
Ireland	Specific microfinance legislation: Microenterprise Loan Fund Act 2012	No
Italy	Specific microfinance legislation: Legislative Decree n. 141/2010	No
Malta	No specific legislation	No
Netherlands, The	No specific legislation	No
Serbia	No specific legislation	Yes
United Kingdom	No specific legislation	No

The aim of this study is to draw a relevant picture of MFI-bank partnerships in Europe. We analyse why MFIs and banks mutually collaborate, the challenges they encounter and discuss possible paths for improvement of their cooperation. To do so, we focus on the patterns emerging from fifteen case studies of purposely selected MFIs and banks in ten European countries. The list of the countries and participating MFIs is provided in Table 1.

The rest of this study is structured as follows. In the next section, we present the methodology used in this study. In the third section, we briefly describe the identified partnerships between

banks and MFIs in Europe, including both downscaling and upscaling strategies. The fourth section will present our main results through the lens of the emerging trends illustrated by the case studies. We frame our results in contrast to patterns observed in developing countries. In the fifth section we focus on alternative models of collaboration initiated by MFIs with crowdfunding and peer-to-peer platforms, microinsurance and transfer companies, etc. Finally, we present the road ahead for MFI-bank cooperation and develop the agenda for further research.



# 2

# Methodology

To illustrate the existing partnerships between MFIs and banks in Europe, we have applied the **purposive sampling methodology**. We have made this choice in order to focus on a particular characteristic of the microfinance sector in Europe, consisting of partnerships between banks and MFIs. The purposive sampling technique allows us to pertinently address our research question as we aim to study a particular group of MFIs, those interacting with mainstream financial institutions, rather than European MFIs in general.

More precisely, we have opted for the **maximum variation sampling**, or **heterogeneous sampling**, to capture the broadest possible range of existing partnerships between banks and MFIs. This technique allowed us to reach greater insights about collaborations between banks and MFIs by looking at them from several perspectives (including upscaling and downscaling strategies, and competition between banks and MFIs). This strategy allowed us to identify the common trends and the divergences among the institutions participating in our sample.

This research strategy allows us to draw a relevant picture of the partnerships between MFIs and banks in Europe through the process of **institutional isomorphism** (DiMaggio and Powell, 1983). Institutional isomorphism implies that when an institution becomes a recognized entity within an industry, other entities in the sector will apply similar practices. In other words, due to the institutional isomorphism, MFIs which are not in our sample are assumed to have similar behaviours as the MFIs participating in the survey due to their

recognised role as leading entities.

Our initial design included 27 institutions to cover various types of partnerships and strategies. Six of them operate as commercial banks and 21 are MFIs. Of these, 15 institutions participated in the study (3 banks and 12 MFIs). The case studies are based on the following survey information collected from MFIs:

- ➔ Identification of the type of the (existing or past) partnership(s) with a bank. Alternatively, identification of a downscaling or upscaling strategy.
- ➔ Partnership characteristics: start date, reasons of involvement, initiator, leading partner, level of operation (national, regional, etc.), impact on outreach and financial performance, constrained or voluntary partnership<sup>2</sup>.
- ➔ Advantages and drawbacks of the partnership for the MFI, bank and clients.
- ➔ Potential ways to improve the partnership.
- ➔ Competition aspect between MFIs and banks.
- ➔ Identification of alternative partnerships.

The trends identified through the case studies allow us to understand the rationale behind the involvement in partnerships, the challenges encountered by various institutions and the road ahead for MFI-bank cooperation. Before analysing the emerging patterns, we briefly discuss the main types of partnerships and strategies in the following section.

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<sup>2</sup> In practice it is difficult to differentiate between constrained and voluntary partnerships. For instance, some partnerships are voluntarily set to deal with constraints generated by the market.

# Brief description of the Partnerships and Strategies

Cooperation and dialogue between microfinance providers is essential (European Banking Federation, 2010). The European Microfinance Network (2010) and Isern and Porteous (2005) have previously identified and discussed a large variety of existing MFI-bank collaborations for developed and developing countries respectively. Our study is close to the Isern and Porteous (2005) analysis as we also focus on selected examples of banks and MFIs that provide microcredits and other services to the low-income individuals. However, their case studies are focused on developing countries which are crucially different from European economies.

In line with previous studies, we find a large diversity of MFI-Banks collaborations (see Figure 1). The most common type of collaboration entails **MFIs borrowing from banks** in order to finance their microcredit or operating activities. Eight MFIs participating in the survey have identified themselves in this type of partnership. This is one of the most common models of cooperation between MFIs and banks worldwide. According to Isern and Porteous (2005) MFIs that have access to commercial funding tend to have, among others, sound governance, high-quality loan portfolios, appropriate provisioning and write-off policies, reliable information systems, and good growth opportunities. The main rationale for this type of collaboration rests on MFIs' inability to access individuals' savings, generally due to regulatory constraints. Similarly, in developing countries, Vanroose and D'Espallier (2013) and Hermes et al. (2009) confirm MFI reliance on domestic bank funding.

Three MFIs additionally benefit from **bank ownership of their equity**. This kind of partnership translates into a sound relationship where the

funding bank can additionally provide operational, commercial, and financial support (see PerMicro case study). This type of cooperation gives more decision power to the bank. At the same time, the MFI can benefit from a solid image of the mainstream finance partner.

Three MFIs additionally **receive subsidies from banks**. Importantly, subsidization arises both directly (e.g. subsidies to cover MFI operating expenses, see Créa-Sol) and indirectly (staff allocation by the bank in the case of Créa-Sol, shoring up MFI losses in the case of Adie). These subsidies allow MFIs to charge lower interest rates to their clients since a share of their costs is supported by banks and, thus, is not incorporated into the interest rates charged to clients.

To decrease their operating costs, several MFIs **share infrastructure with mainstream banks** (front-office, back office, offices, ATM and IT). This is the case of PerMicro in our study. This type of cooperation eases the access to financial services to customers as bank branches have a high penetration level in Europe. The bank can exploit further cross-selling opportunities to micro-borrowers through the opening of current bank accounts, offering of saving, insurance products, etc.

To take advantage of the experience of banking sector professionals, six MFIs have **bank representatives participating in their board of directors**. Banks may use this type of cooperation as a means of control of the microfinance sector. As a result, MFI management should constantly make sure that bank representatives comply with its social mission.

On the other hand, banks can also benefit from MFI experiences in financing this particular segment of the population through **MFI screening and monitoring technologies**. Indeed, MFIs and banks use different screening technologies (Evers, 2000). Banks condition their decision mainly on hard information (financial information, collateral availability, experience of the applicant etc.), whereas MFIs focus relatively more on soft information (personality of the borrower, household characteristics, etc.), adopting a holistic approach. Moreover, MFIs often use onsite evaluations (visiting clients at their work places or home). However, the two approaches are not mutually exclusive. In practice, both types of information are analysed, but their relative weight in the decision process varies from MFIs to mainstream banks.

Another way for banks to reduce the risks of financing micro-businesses consists of collaborations where **MFIs provide business development services or mentoring** to bank borrowers. Advised beneficiaries might have greater chances to succeed and be more loyal to the financing institution. This will result in better repayment and retention rates to the bank.

In order to reach new customer segments, several **banks and MFIs co-finance projects**. This type of collaboration is the third most common among survey respondents (five MFIs). At first glance this might appear surprising. Indeed, MFIs aim to correct a market failure through the provision of credit to financially excluded individuals. However, co-financing arrangements make sense and are still compatible with MFI missions. Typically, clients benefiting from co-financing are marginally excluded. Generally, co-financed projects are new businesses rather than personal loans or established enterprises. These businesses have financially viable business plans, but are considered to be too risky by banks to finance the totality of the project. Microcredit is a reliable way for banks to share the risk of financing of such projects. Indeed, MFIs usually undertake the financing of needs that are unacceptable by banks such as cash requirements,

working capital, etc. Moreover, the bank is likely to retain the client after a successfully repaid co-funded loan. On the contrary, for the MFI, the risk is attributable to uneven lending terms, potentially putting the MFI in a subordinated position.

In addition to partnerships, banks and MFIs implement strategies that allow them to access alternative financial markets. Some banks are involved directly in microfinance through **downscaling**<sup>3</sup>. We identified two ways for banks to downscale. The first consists of banks directly granting microcredits. Bank of Valletta, in Malta, is one such example. The second consists of banks creating MFIs (internal units or external entities) to channel their microcredit activity.

On the other hand, some MFIs implement **upscaling** strategies and grant larger loans. Typically, upscaling arises when MFIs start granting loans exceeding the € 25,000 threshold proposed by the European Commission. MFI transforming into commercial banks is another example of upscaling. In Figure 1, we present the decision tree for banks and MFIs to enter into a partnership. In the "Selected Examples" column, we present the MFIs in our sample.

Finally, regarding the issue of **competition between banks and MFIs**, we should revisit the EMN 2008 conference in Nice that provided insightful details on the Romanian case<sup>4</sup>. According to the outcomes of this conference, in Romania, banks are more likely to be microfinance suppliers and MFI competitors in both the SME and the consumer loan market. In contrast to many Western European countries, the Romanian model appears to be operating on a profitable and sustainable basis. Nevertheless, collaboration is essential even among competitors. The Serbian MFI Micro Development also highlights the role of competition with mainstream banks. We can attribute the presence of the competition element to the economic development of a country. It seems that in emerging European economies, MFIs and banks are more likely to compete with each other.

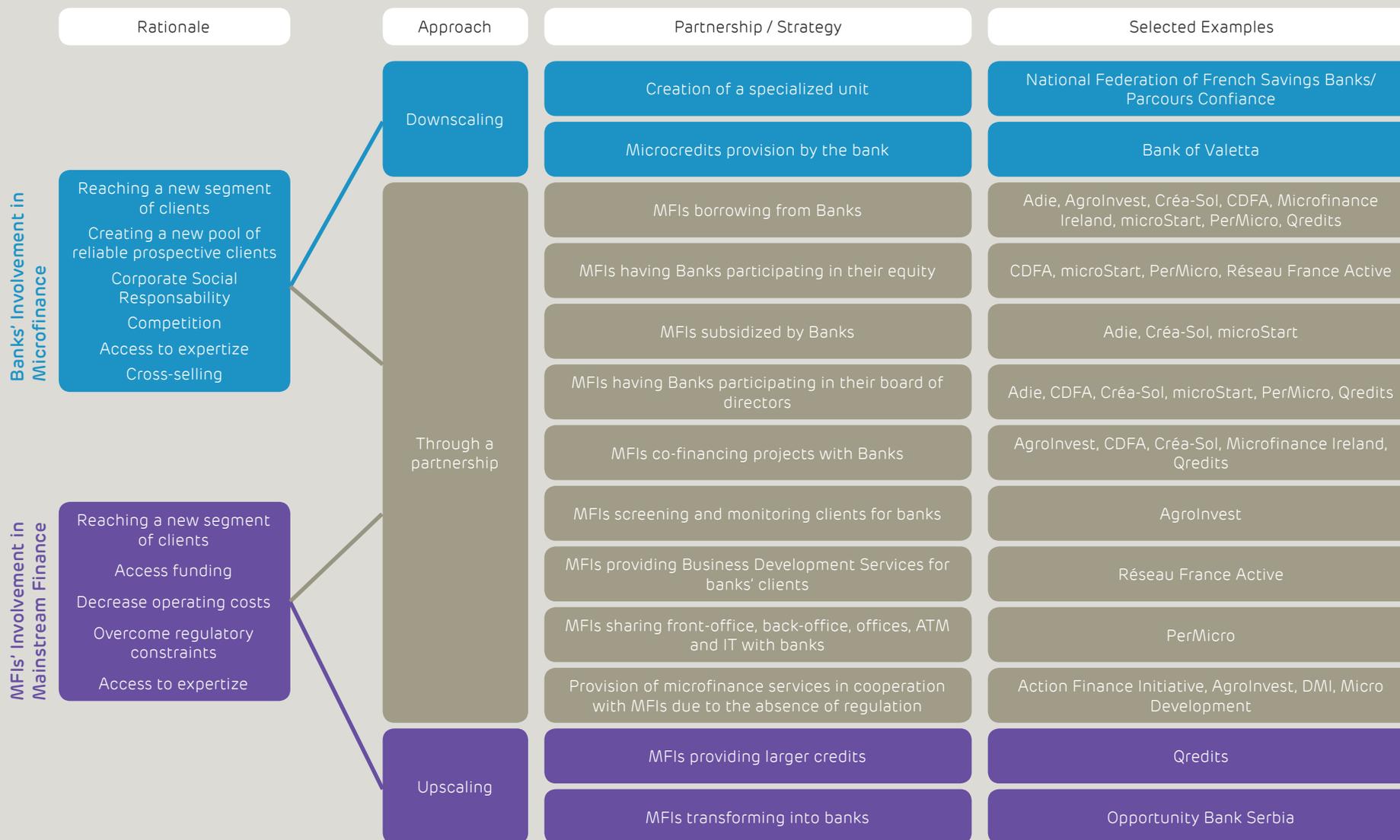
“The most common type of collaboration entails MFIs borrowing from banks in order to finance their microcredit or operating activities. This is one of the most common models of cooperation between MFIs and banks worldwide.”

3 Private banks are among the main providers of microfinance within the European Union (European Banking Federation, 2010).

4 Unfortunately none of the contacted Romanian institutions accepted to share their experience.

Figure 1<sup>5</sup>

➔ MFIs-Banks Decision Tree



<sup>5</sup> This figure is based on the decision tree for commercial banks in microfinance by Isern and Porteous (2005). The decision tree reflects the partnership category identified by the institutions participating in the study. Some of the partnerships are not described in details in the case studies.

## 4

# Main Results

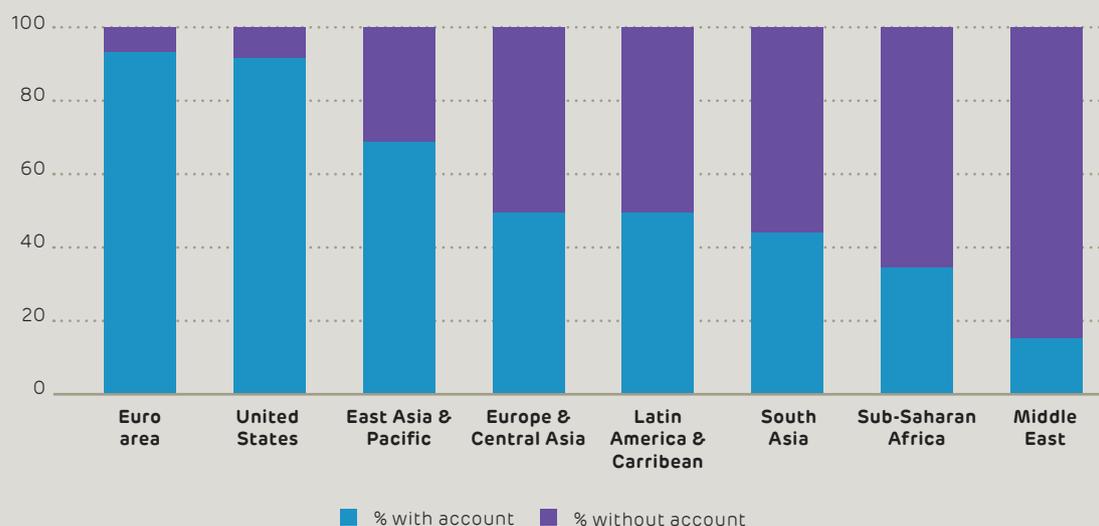
In this section, we analyse the principal trends emerging from the case studies and put them into perspective with existing evidence from developing countries. Discussing these differences is particularly insightful as many MFIs in developed countries were initially inspired by the microfinance model in developing countries<sup>6</sup>.

Obviously, the challenges are different in

developing and developed countries. While in the developing countries the main issue is still reaching the financially un-served individuals, in the developed countries the focus is rather on under-served clients (see Figure 2). Indeed, most of the individuals living in developed countries have a bank account. Financial exclusion should rather be understood as (partial) credit denial in Europe.

Figure 2

→ Percentage of respondents having an account in 2014<sup>7</sup>  
Source: Global Findex (Global Financial Inclusion Database), World Bank



From the fifteen case studies, we observe that MFIs in our sample generally have more than one partnership with banks. In a few situations, the relationship is exclusive to a single bank, but the general tendency is diversification. Collaborations between MFIs and banks are facilitated in developed countries by high bank penetration.

This point is illustrated in Figure 3. Nevertheless, high bank penetration can also represent an impediment to the microfinance sector. Cull et al. (2014) reveal that MFIs are less profitable in areas with higher bank penetration. This might explain why European MFIs are less profitable compared to their developing countries counterparts.

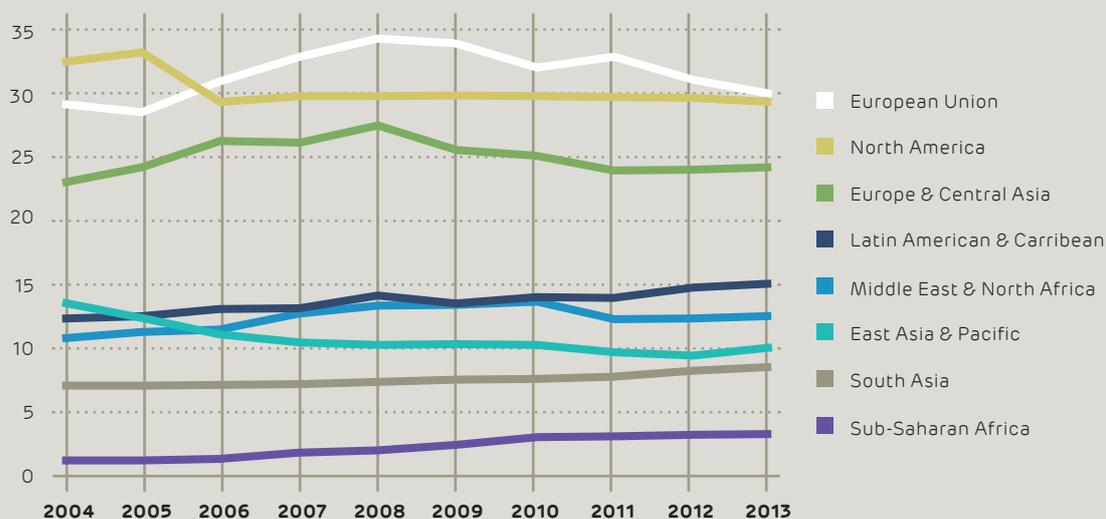
<sup>6</sup> For instance, Adie, the leading national French MFI has started its activity by granting group loans following the model of the Grameen Bank in Bangladesh, in 1980s.

<sup>7</sup> The figures denote the percentage of respondents, being at least 15 years old, who report having an account. This can be an account at a bank or another type of financial institution, or a mobile account.

Figure 3

→ Commercial bank branches (per 100.000 adults)

Source: World Bank



Notably, our case studies suggest that banks and MFIs operate through complementarity rather than competition (exceptions being Serbia and Romania<sup>8</sup> that exhibit some trends of direct competition). Interestingly, evidence about complementarity also exists in developing countries. Vanroose (2014) finds that commercial banks in Peru serve richer people and bigger firms, leaving a wide range of unbanked people and a large potential market to serve even within areas where they are active. MFIs therefore complement the mainstream financial sector and serve the unbanked and financially excluded part of the population.

Crucially, the case studies suggest multiple reasons for both banks and MFIs to enter partnerships. Figure 1 lists these reasons, which are briefly discussed in the previous section. In this section, we expand on the rationales for bank and MFI involvement cooperation. We observe that these collaborations benefit all the parties involved: banks, MFIs and clients.

A large number of commercial banks have successfully entered the market for retail financial services to low-income clients. Today, they play an increasingly important role in this market. In 1998, the Consultative Group to Assist the Poor (CGAP) described commercial banks as "new actors in the microfinance world." There are a lot of incentives for banks to enter the microfinance market. On one hand, banks can improve cost efficiency

and learn from cooperation (Evers, 2000). On the other hand, involvement in the microfinance sector improves banks' corporate image through social responsibility which is essential for their competitiveness. However, improved corporate social responsibility is only one aspect of bank incentives.

In many cases, entering the microfinance market represents a low risk (or even risk-free in some cases) investment for banks as microcredits are generally backed by guarantees provided by European or national public entities and MFIs. In case of DMI (Germany) and Micro Development (Serbia), microcredit activity generated risk free incomes for the bank (leaving aside the risk of MFI's incapacity to repay if the client defaults). In the case of French Savings Banks, the risk on microcredits has been minimized as a result of guarantees on losses and business development services provided by Réseau France Active. Indeed, business development services are supposed to decrease the risk of default by the borrower.

Respondent MFIs additionally underline that the bank profitability from microfinance clients can be enhanced through cross-selling opportunities, such as the opening of current accounts within the bank, establishment of saving accounts, insurance, payment services, funds transfer etc. The cross-selling strategy is a step toward enhancing the profitability of micro-borrowers.

<sup>8</sup> Unfortunately, we don't have case studies for MFIs in Romania. However, we observed the presence of competition from previous experiences and particularly the EMN conference in Nice in 2008.

We have three banks involved in microfinance participating in our survey: Bank of Valletta, Opportunity Bank of Serbia and the French National Savings Banks' Federation. None of the respondent banks declared that penetrating this new market increased their financial performance. This contrasts with evidence for developing countries where the main rationale for bank involvement in the microfinance sector relies on commercial opportunities such as sustainable profit and growth (Isern and Porteous, 2005). Indeed, for mainstream banks in poor countries, micro-borrowers represent a new segment of profitable clients. In Europe, however, the situation is trickier. Micro-borrowers are not viewed as profitable targets, at least not at the beginning of their borrowing cycle. On the contrary, engagement in microfinance represents a long term investment. Indeed, surviving micro-businesses are expected to develop, grow and eventually become profitable clients years down the road. Therefore, banks are very likely to benefit from successful micro-borrowers becoming their clients<sup>9</sup>.

For MFIs, cooperation with banks is often a necessary condition for development. It eases access to funding and cost reducing technologies. European Union (2010) acknowledges that bank involvement is essential for the accelerated development of the microfinance sector. All of the MFIs in our sample have declared that cooperation with banks has resulted in a larger number of financed clients. Therefore, the main consequence of these partnerships is extended breadth of outreach. Nevertheless, this is not the only consequence of the partnerships. Additionally, partnerships positively impact the financial performance of MFIs in all observed cases (with two exceptions). Despite the lack of data required to measure the size of impact of such collaborations, our qualitative assessment shows that partnerships have a positive impact both on the number of clients and the financial sustainability of MFIs.

In contrast, the depth of outreach (the level of poverty of new clients) appears to be less strong. In most cases, collaboration allows MFIs to increase the number of financially excluded, unemployed and female clients. To some extent, partnerships also ease access to microcredits for the poor and very poor, young and immigrant customers. Disabled applicants and those living in rural areas are very marginally reached as a result of a bank-MFI partnership (see the case studies for more details on the depth of outreach).

However, lower depth of outreach is not a negative outcome per se. Admittedly, MFIs use profits generated on clients financed through partnerships (for instance through co-financing) to cover their losses on poorer clients reached beyond

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For MFIs, cooperation with banks is often a necessary condition for development. It eases access to funding and cost reducing technologies.

”

cooperation. In other words, collaboration with banks creates cross-subsidization opportunities. As a result, more research is needed to assess the real consequences on the social performance of the partnerships.

In sum, MFI collaboration with banks is necessary to expand their lending activities and to improve financial performance. Indeed, MFIs in developed economies struggle to scale-up growth and reach financial sustainability. This is in line with Vanroose and D'Espallier (2013) who find that MFIs reach more clients and are more profitable in countries where the formal banking sector is less developed. Additionally, Hermes et al. (2009) argue that MFIs are more efficient where mainstream banks are more developed.

In addition, cooperation has significant, positive consequences for micro-borrowers. Notably, microfinance customers in developed and developing countries are very different, particularly in terms of alternative options (e.g. existing welfare programs in richer economies) and fiscal regimes. On one hand, this difference justifies public intervention in the microfinance sector in Europe. On the other hand, it might be the reason

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<sup>9</sup> One of the purposes of microfinance in Europe is to fight financial exclusion. Customers usually borrow only once from the MFI and integrate classical banks after successful repayment. Therefore dynamic incentives are less common in developed countries where MFIs and banks co-exist. In contrast, in developing countries MFIs often penetrate regions where banks are totally absent.

why charging high interest rates (covering the cost of microcredit provision) would discourage a large number of individuals from creating a business.

When the provision of microfinance takes place through bank branches, the greatest advantage for clients is proximity. Moreover, start-ups can access credit from a bank from the very beginning of their entrepreneurial activity. Clients benefit from market credit conditions and start building a trustful relationship with the bank. Generally, the costs of the partnerships are passed on to the clients (charges for the repayments made to the bank in the case of Micro Development and/or increased interest rates due to the pricing of loans made by banks to MFIs in the case of Adie and Créa-Sol, etc.). In contrast, borrowing from/through an MFI which cooperates with a mainstream bank often represents the first step toward inclusion in the financial market. Indeed, MFI-Bank partnerships allow start-ups to build credit history and latter use it to apply for a classical credit. In addition, the services provided by MFIs are tailored to the needs of micro-borrowers. For instance, loan disbursement is faster and repayment can benefit from increased flexibility. Finally, clients benefit from trainings and mentoring offered by MFIs.

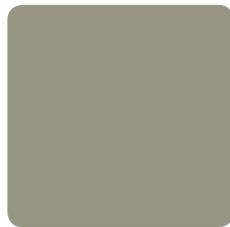
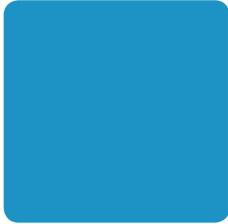
Nevertheless, MFI-bank cooperation is not always easy. The European Union (2010) admits that successful cooperation requires competence and high quality services from MFIs. Another essential aspect consists of objective alignment. If the objectives of the MFIs and the partner bank are not harmonized, the risk of mission drift arises (Armendariz and Szafarz, 2011). Cozarenco and Szafarz (2013) show that co-financing of projects with mainstream banks may result in MFIs financing larger projects. The importance of objective alignment is also stressed by Créa-Sol within its partnership where banks participate in its Board. Making sure that bank representatives integrate the MFI's social mission is crucial to

ensure that microfinance services are directed toward people who are most in need. In addition, long-term commitment of donors/investors is recognized as a success factor for microfinance outreach both in theory (Armendariz et al., 2013) and practice (see the case study of CDFA).

In addition, our case studies suggest that regulatory constraints are not necessarily perceived as impediments by MFIs. Indeed, in the German collaboration model, specialization of each partner is seen as a way to decrease the operating costs of microcredit disbursement. However, increased autonomy of MFIs is recognized as one of the immediate improvements to be made in Serbia and Germany, where banks have the lending monopolies.

In terms of public pressure, Isern and Porteous (2005) underline that governments in developed countries can mandate banks to become involved in microfinance. Albeit less frequent in Europe, we still observe that public bodies are in some cases at the origin of bank-MFIs collaborations. For instance Qredits, CDFA and Microfinance Ireland state that they started borrowing from banks at the initiative of a public body (Dutch ministry of economic affairs, Department of Business Innovation and Skills, and Department of Jobs, Enterprise and Innovation respectively).

Finally, we observe that MFIs in Europe diversify their funding sources through opportunities available from the European Union or by using innovative, alternative partnerships. Alternative types of partnerships are common among MFIs. MFIs in our study tend to link with partners who provide access to alternative types of funding (crowdfunding and peer-to-peer platforms) and products other than microcredit (microinsurance in particular). We discuss these alternative partnerships in the next section.



# Alternative Partnerships

## Alternative Partnerships

Alternative collaborations are to be further explored by MFIs. In this section, we focus on partnerships with other mainstream financial sector actors such as insurance providers, transfer companies and partners operating through information technologies such as mobile banking, crowdfunding, peer-to-peer platforms and credit scoring companies.

Cooperating with alternative partners can be an efficient way to provide a broader range of financial services to low-income individuals. Provision of such services through partnerships, rather than through direct chains, can contribute to sidestepping regulatory constraints and high

costs of implementation. This is essential since MFIs have large operating costs compared to mainstream banks (operating expense ratios for MFIs were 18% in 2013 according to Bendig et al., 2014).

Table 2 illustrates the alternative partnerships of the MFIs in our analysis. First, we notice that not all MFIs have alternative collaborations. Second, collaborations with insurance providers, crowdfunding and peer-to-peer platforms dominate the other partnership types. This pattern confirms the necessity of access to alternative sources of funding such as individual savings for MFIs.

Table 2

Alternative partnerships	MFIs
Insurance providers	Adie, OBS, PerMicro, Qredits
Transfer companies	OBS
Mobile banking	Micro Development
Crowdfunding platforms	Adie, Créa-Sol, Réseau France Active
Peer to peer platforms	CDFA, PerMicro
Private Investors	Action Finance Initiative

## 5.1

# Insurance providers

Microinsurance is defined by the International Labour Organization (ILO) as a “mechanism to protect poor people against risk (accident, illness, death in the family, natural disasters, etc.) in exchange for insurance premium payments tailored to their needs, income and level of risk” (Churchill and Matul, 2012).

However, microinsurance in Europe goes beyond covering individual risk. For instance, Adie has partnerships with classical insurance companies (AXA and MACIF) to provide microinsurance. Adie offers four different micro-insurance products. They cover the risk of theft, sinister, and support the micro-entrepreneurs in case of the incapacity to work. Cost of these products range between € 120-300 per year.

On the other hand, PerMicro offers two very

different microinsurance products to improve the risk management capacity of low-income individuals in partnership with the insurance company NOBIS (Safe Income and Ride Home). These products complement standard credit protection insurance (generally, MFIs and banks in Europe require such insurance by default).

The “Safe Income” microinsurance product is built specifically for people working in the personal services sector (such as domestic workers and caregivers). In case of job loss, the insurance provides income protection. In contrast, “Ride Home” is targeted to foreign citizens who, for religious or social reasons, in case of death, desire to have their body repatriated to their home country.

## 5.2

# Crowdfunding and peer to peer platforms

The recent renaissance of the sharing economy in Europe (and particularly in France) has been essentially driven by Internet developments. The sharing economy is built on trust, which is the necessary condition to facilitate exchanges between people. Enhanced by the financial crisis that has dramatically diminished access to credit, crowdfunding and peer-to-peer platforms emerged. Crowdfunding platforms allow project holders (individuals, organisations, start-ups, micro-enterprises) from various sectors (social businesses, cultural, charity, technology, innovation sectors etc.) and with different financing needs (cash needs, stock, etc.) to raise funds and implement their projects. These funds are raised by pulling together small amounts of money from individual contributors through an internet platform, without a financial intermediary.

There are different ways of financing through the crowdfunding platforms. Three primary forms of financing are donations, loans and share subscriptions. They are particularly relevant for the financing of young businesses, which are the most risky as viewed by mainstream banks.

Interestingly, all French MFIs (Adie, Réseau France Active<sup>10</sup> and Créa-Sol) participating in our case studies collaborate with crowdfunding platforms. This might be explained by the rapid growth of the sector since emerging in 2007 and recent regulatory changes. To enhance security in this sector, French public authorities have adapted regulation through the ordinance n°2014-559 which became active in October 2014<sup>11</sup>. In contrast, the crowdfunding market has been regulated in the United States since 2012 (Jumpstart Our Business Startups Act, signed in April 2012).

10 Réseau France Active has a partnership with Ulule, a French crowdfunding platform, since 2014.

11 <http://acpr.banque-france.fr/agreements-et-autorisations/le-financement-participatif-crowdfunding.html>

The French crowdfunding market is booming and expected to double funding for projects over 2014. In the first quarter of 2014, French, crowdfunding platforms have financed € 63 million (15% in equity investment, 25% in donations, and 60% in loans). The average contribution is € 2,036 for equity investments, between € 52 and € 61 for donations, and € 6,581 for loans with an interest rate (Percepta, 2014).

Several French mainstream banks have also jumped on the bandwagon of crowdfunding platforms. For instance, BNP Paribas has partnerships with Ulule and Wiseed to ease the financing of the projects

that are rejected from the classical banking market. The Crédit Coopératif has partnerships with Babyloan, Spear, Afexios and Arizuka and has launched its own tool, Agir&Co, for crowdfunding financing through donations with My Major Company.

Finally, PerMicro<sup>12</sup> and CDFA members state partnerships with peer-to-peer platforms. Financing through peer-to-peer platforms is similar. The main difference is that peer-to-peer lending takes place between individuals rather than a group of individuals and a business.

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All French MFIs participating in our case studies collaborate with crowdfunding platforms. This might be explained by the rapid growth of the sector since emerging in 2007 and recent regulatory changes.

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## 5.3 Transfer companies

Remittance flows are extremely important throughout the world. They generally represent the sum of money sent back by the immigrant workers to their families in their home countries. Figure 4 illustrates the size of the received flows (in billion USD) by geographical region. Interestingly, Europeans and Central Asians are the largest beneficiaries of money transfers.

These statistics are in line with the International Labor Organisation (ILO)<sup>13</sup> findings stating that, as a percentage of GDP, the top recipients of remittances, in 2012, were Tajikistan (52%), Kyrgyz Republic (31%), and Moldova (25%). These countries

are characterised by a large flow of emigrants. In addition, ILO estimates that the world average cost for money transfers is around 9%.

Remittances have a positive impact on recipients by increasing household living standards, improving health and education levels, contributing to poverty alleviation and acting as insurance against economic and natural shocks. On the macroeconomic level, the provision of formal remittance services fights against money laundering and terrorist financing (Matthäus-Maier and Von Pischke, 2008).

12 PerMicro's two peer to peer platform partners are Smartika and Prestiamoci.

13 <http://www.ilo.org/global/topics/labour-migration/policy-areas/remittances/lang--en/index.htm#bookmarks>

However, remittances can also have negative consequences by creating dependency, inflation and/or increasing inequality.

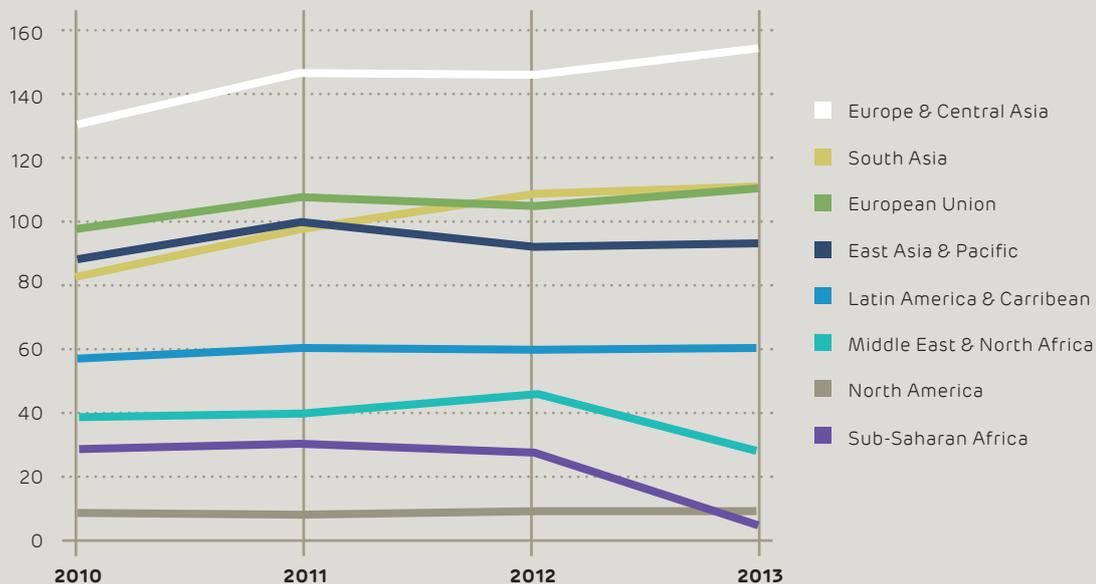
Using formal transfer services can benefit both MFIs and customers. Formal money transfers encourage savings and protect cash from various hazards (theft, fire, etc.). Banks and MFIs that collect savings can increase the size of the deposits if the transferred money is directly deposited into client bank accounts. Remittances can also increase cross-selling opportunities and customer loyalty. These services make the most sense for MFIs with a large number of immigrant

clients or for those MFIs with clients who have family members working abroad.

In our sample, only Opportunity Bank of Serbia has mentioned a partnership with a transfer company. Remittances are sent from abroad via Western Union and can be collected, a few minutes later in OBS branches. This can be done without opening an account. The major advantage of this service is its simplicity and speed. The received funds are paid in euro and the transfer fee is paid by the sender. One way to improve remittances products relies on the use of the mobile banking technology.

Figure 4

→ Personal remittances, received (in billions US\$)  
Source: World Bank



## 5.4 Mobile banking

Mobile technology has an important impact on the entire banking ecosystem. Despite high mobile penetration (more than 100% in some European countries), mobile banking (m-banking) usage was low in 2012 (Gupta, 2013). M-banking consists of the "delivery of financial services outside conventional bank branches using mobile phones and nonbank retail agents" (Kumar et al., 2010)

M-banking is believed to benefit both financial institutions, through a decrease of the operating costs, and clients, by decreasing the time and money spent going to bank branches.

M-banking primarily facilitates transfers and payments. According to CGAP (2010) and (Gupta, 2013), mobile banking in developing countries is mainly used for the following purposes. On the

supply side, m-banking allows MFIs to

- ➔ overcome limited infrastructure problems to reach more customers, especially in rural areas;
- ➔ send reminders for loan repayment or savings through SMS messages; and,
- ➔ facilitate loan disbursement, repayments or deposits.

On the demand side, m-banking allows for

- ➔ migrant workers to send money to their families;
- ➔ more convenient payment options (in shops or bill payment) for customers; and,
- ➔ a decrease in credit transaction costs: shorter group meetings, less time and money spent to visit the bank.

However, these reasons do not appear relevant for developed countries. Indeed, Figures 2 and 3 provide evidence of high commercial banking penetration and high bank account use within Europe. Therefore, payments, loan disbursements and savings are done using financial institution accounts rather than mobile banking accounts. In addition, the absence of infrastructure does not seem to be a significant issue in developed countries. Further, as we highlighted in the case studies, the MFI outreach doesn't necessarily focus

on rural clients. Finally, loan repayment and saving reminders do not seem relevant as these processes are usually automatically performed using bank accounts.

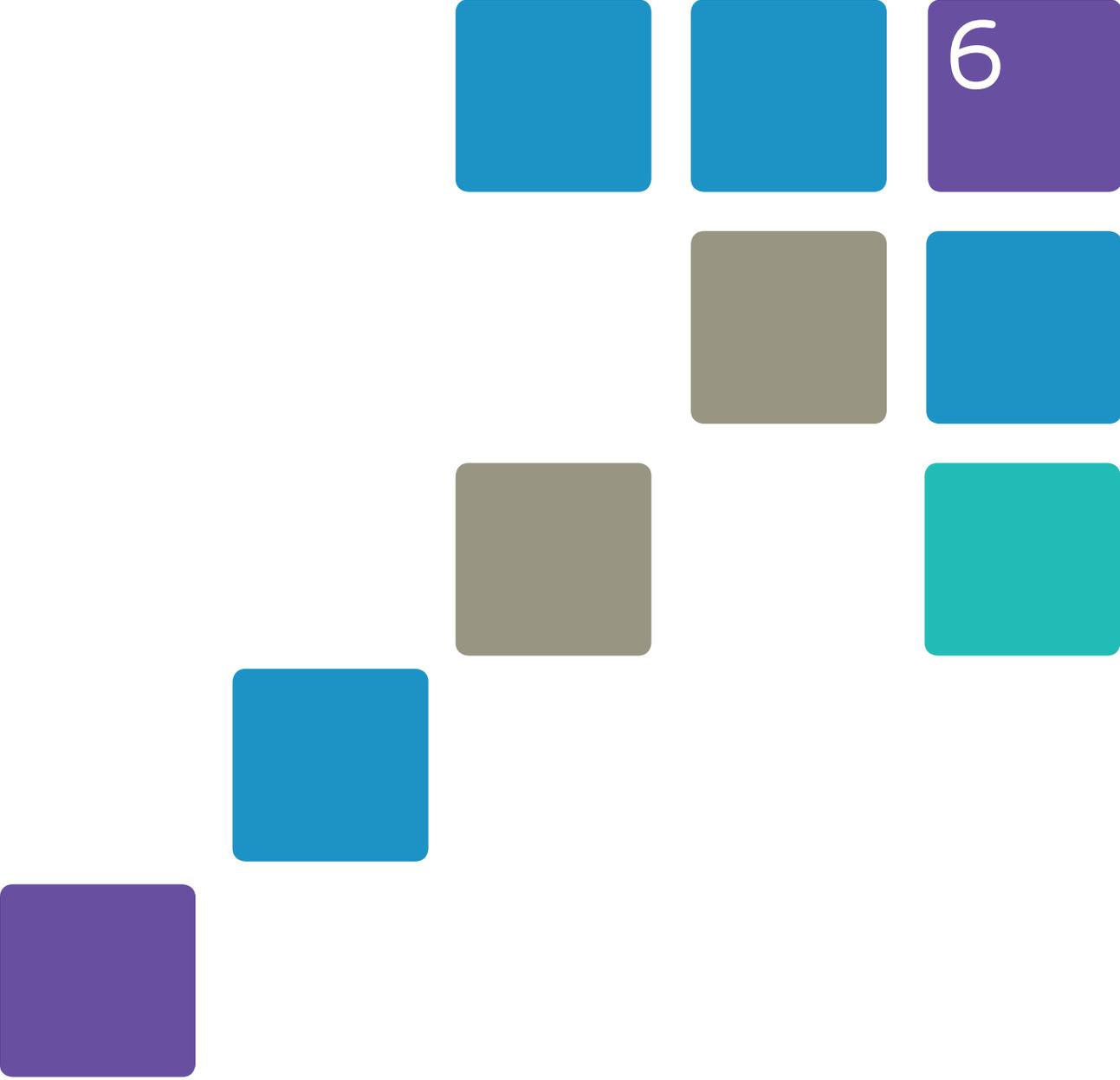
However, we acknowledge that m-banking might be appropriate to those MFIs considering expansion into remote areas where bank penetration is low and where m-banking can be successfully combined with transfer services.

In our sample of MFIs, only Serbian Micro Development has started negotiations for a partnership with a mobile banking company. To better understand this finding, we look at the particularities of Serbia's country level characteristics in more detail. Interestingly, Serbia has the smallest proportion of individuals over 15 years old with an account at a financial institution (83%, followed by Italy and Greece with 87% and 88% respectively in 2014<sup>14</sup>). For comparison, More than 98% of individuals have a bank account in Netherlands, United Kingdom, Germany and Belgium.

Finally, it is worth mentioning that the Action Finance Initiative has alternative partnerships with private investors to decrease dependency on a single bank partner.

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14 Source : Global Financial Inclusion Database.



6

# The Road Ahead

Partnerships with banks have been proven to be successful for many European MFIs in terms of the growth and improved financial performance. According to European Banking Federation (2010), the success of microfinance can be significantly enhanced through cooperation as well as information and good practice exchange by sector actors (bank, non-bank, public and private).

More generally, partnerships are perceived by MFIs as opportunities rather than impediments to development. However, as argued in section 4, these partnerships encounter various challenges. In this section, we provide the road ahead for bank-MFI cooperation that will further enhance outcomes in terms of social and financial performance.

## Creation of multi-bank partnership models

This improvement would have several positive consequences. First, it would decrease the cost of funding and services charged to MFIs by banks or decrease the margins pledged by banks through increased competition. Consequently, this model will translate to lower interest rates for clients.

Multi-bank partnerships will also decrease the dependency of MFIs on a single institution. This would decrease counter-party risk, more particularly decrease the consequences of a bank bankruptcy (see the case study for Micro Development in Serbia).

### More decision power should be given to MFIs

More decisional power to MFIs would create a more flexible process and allow for better impact. As argued in the introduction of this study, banks and MFIs have different approaches in conducting their businesses. Therefore, organisational specialization would be desirable. The banks' role should be reduced to what they do best: financing MFIs and disbursing loans to clients (in countries where MFIs are not allowed to do so). MFIs should be more independent in client selection to insure better social outreach.

### Decrease uncertainty in partner commitments

It has been shown that subsidy uncertainty can undermine MFIs' social missions (Armendariz et al., 2013). MFIs in our case study acknowledge that commitment from the funding partners should be extended to enhance the impact of the microfinance programs.

### Decrease partnership complexity

Administrative paper work, reporting standards, double interviews (for clients in case of co-financing) are a substantial burden, both for MFIs and clients. Reducing the complexity of the partnership schemes would lower costs and result in smaller interest rates charged to clients. Moreover, a simplified procedure can be more easily

explained to customers. This might be achieved through legislation for the microfinance sector.

Finally, members of multi-actor partnerships should use standardised methodologies. This could be achieved through training sessions where all parties of the partnership participate.

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Partnerships are perceived by MFIs as opportunities rather than impediments to development. However these partnerships encounter various challenges.

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## Make sure partnership actors have a strong social commitment

Many academic papers in microfinance have focused on the risk of mission drift. Banks and MFIs have different objectives by definition. The risk of mission drift is especially strong when two partners have divergent objectives. Therefore, making sure that the banks involved in microfinance have a strong social commitment is crucial for the

social bottom line. This is especially true when banks participate in the approval process (e.g. co-financing or provision of microfinance services through banks) or when banks are part of the MFI's Board. The risk of the mission drift decreases where MFIs are given more decision power.

## Increase bank awareness of microfinance

Increased awareness could result in automatic referrals by bank loan-officers to MFIs to those customers who are denied classical loans. These practices would significantly improve the flow of

customers to the MFIs. This type of initiative has already been implemented by Créa-Sol and the French Savings Bank and is in its development phase for Microfinance Ireland.



What about the public support in the collaboration model? Due to existing welfare programs in richer economies, public intervention in microfinance markets is justified. Indeed, microfinance can be viewed as a tool to encourage (self-) employment and therefore benefits public finances (Evers et al., 2007). However, public intervention should not be done at the expense of the fair competition between MFIs and banks (European Union, 2010). Due to the risks and uncertainties associated with micro-lending, the influential role of the public sector is also acknowledged by European Banking Federation (2010).

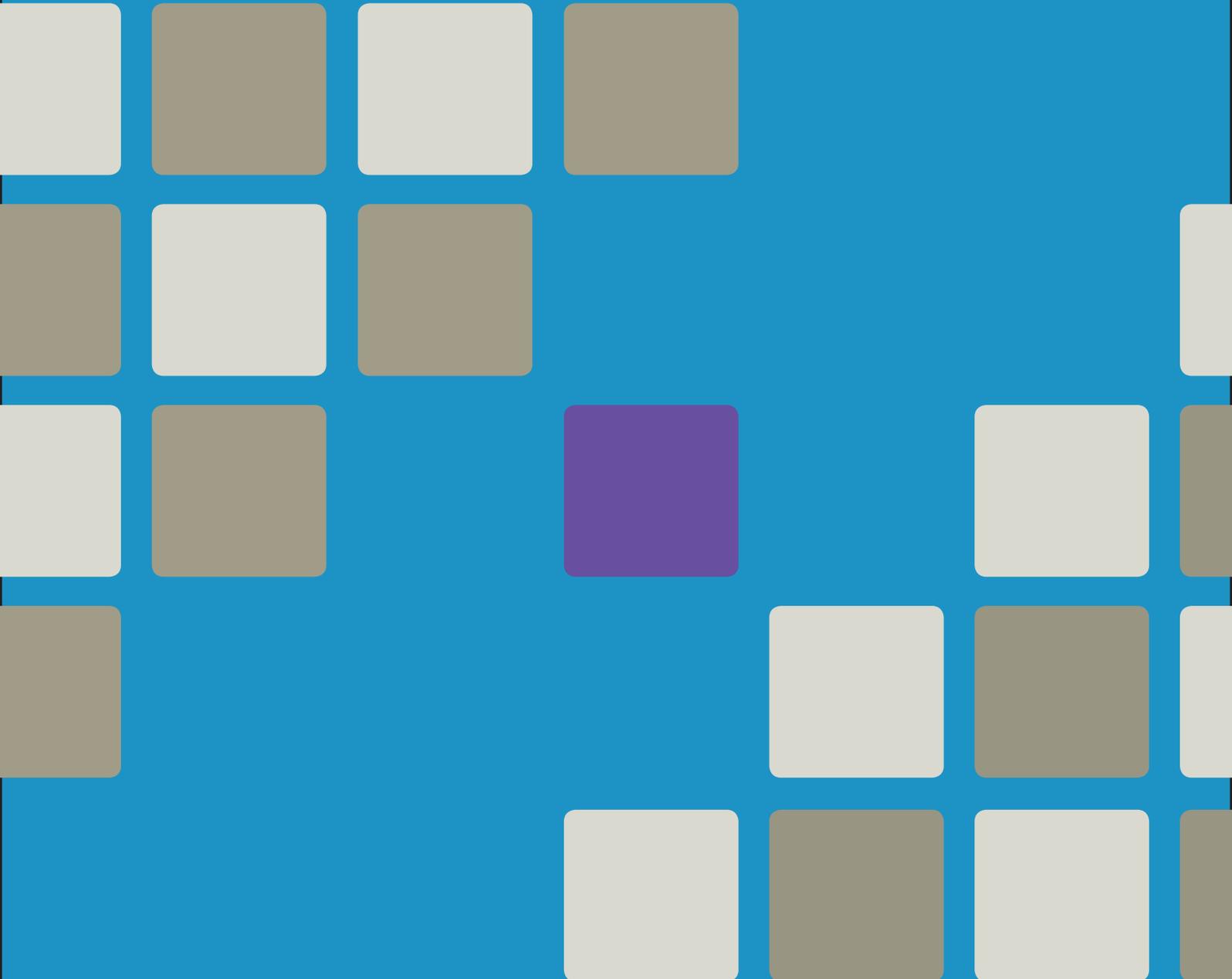
Our qualitative analysis represents the first step toward the outcome assessment of bank-MFI partnerships. Through analysis of fifteen case studies, we have identified interesting patterns and provided relevant hypothesis. Further research is needed to test our hypotheses using larger data sets. However, European microfinance data is scarce, partly due to the definition of microcredit

which is applied heterogeneously across different countries. For instance, in some European countries microcredit is provided but is not classified as such (European Banking Federation, 2010). Therefore, efforts should be made in data collection to measure the size and depth of the outreach, the transaction costs and the income generated by collaborations with the mainstream financial sector.

Finally, our qualitative analysis is silent regarding the cross-subsidisation opportunities. According to the case studies, partnerships with banks improve the financial performance of the MFIs and expand their lending activities. If these partnerships allow MFIs to reach more profitable clients, are the generated profits used to reach more unprofitable customers? Addressing this question will help identify indirect channels through which cooperation with banks enhances the social bottom line of MFIs.

7

# Case Studies





# Action Finance Initiative

The Greek Action Finance Initiative (AFI) is a new civil, non-profit company founded by Action Aid Hellas & Adie International and registered in 2014. It is the first microfinance institution in Greece. Its loan portfolio consists of 5 disbursed loans and 13 pending loan disbursements. Its primary mission consists of fighting economic and social exclusion by helping unemployed individuals create their own jobs through the provision of loans and business training delivery in partnership with mainstream banks. The MFI benefits from the indirect help of the European Union through an EIF guarantee on 75% of the loan with a 20% cap rate.

AFI attributes its cooperation with the banks to the current regulation and Banking Law, whereby there is no loan provision by microfinance institutions. Within the partnership model, the bank uses its own capital to serve the clients of the MFI.

The on-going cooperation with the Pancretan Cooperative Bank (PCB) started in June 2014. Within the partnership, AFI screens and selects the potential clients, provides business development services (BDS) during both pre- and post- loan disbursement, prepares the loan application with the client, evaluates applications, and forwards the approved prospects to PCB for a second evaluation. The bank either approves or rejects the application and disburses the loan. The bank is responsible for monitoring client performance through its information technology and performs any recovery actions. Accordingly, while the bank provides the loan funds, the warrant collateral is shared between the European Investment Fund (EIF) and AFI.

Importantly, the current Banking Law in Greece (3601/2007) states that organizations other than credit institutions which are licensed by the Bank of Greece (BoG) require a minimum capital of €18m in order to carry out financial or credit activities. Accordingly, the only possible way for AFI to offer microfinance services in Greece was through a partnership with a licensed bank. As such, the partnership is considered to be non-voluntary

(constrained by regulation). It is executed at the regional level, and has substantially increased the number of clients for the MFI.

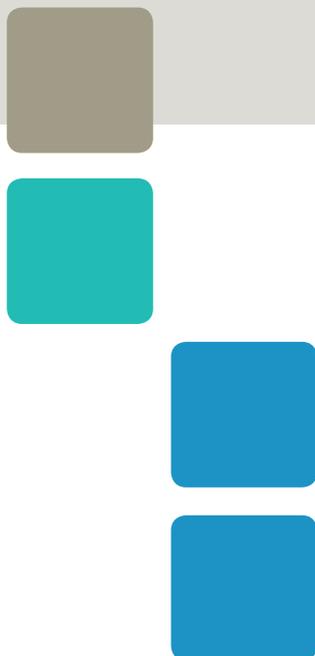
The partnership is also considered beneficial for the banks. They are able to serve more vulnerable segments of the market than would otherwise be possible for them. The partnership represents an alternative to PCB's standard business operations, bringing the human element to the forefront of decision-making that can also be utilised in branding. The interest revenue is kept by the bank while AFI absorbs the operational costs of client screening and preparation of the loan applications. For the clients, the partnership adds value through increased trust and creditability of a reputable bank institution.

Regarding disadvantages, the increased operational complexity results in additional bureaucracy for the MFI, which is both costly and delays final disbursement. AFI does not earn any revenue from interest. The MFI's staff declared that they find it challenging to explain the complex lending setup to prospective customers. Most clients are negatively predisposed towards banking institutions in Greece. Even in the most promising cases, the bank can refuse to accept the application. Accordingly, a 100% dependence on an external party evokes additional operational costs for AFI. To ease this situation, AFI engages in alternative partnerships with private investors.

According to management, there is a pressing need to ease the regulation and allow MFIs to perform financial or credit activities in Greece. Alternatively, the MFI envisions signing more partnerships with other commercial banks. In order for these to be effective, AFI campaigns for reducing the documentation requirements on pre- and post- disbursement applications. Finally, they recommend introducing a monitoring body that would control the partnership and ensure that both parties draw equal benefits. These measures should rely on guidance and streamlining by European, national and other regulatory bodies.



# Adie



Adie was created in 1989 in France. The current management describes the organization's mission as financing and supporting the unemployed who wish to create their own businesses and who do not qualify for a standard bank loan. Adie also offers experience-based expertise to suggest improvements to the existing regulatory framework

that governs microenterprises and microfinance institutions in France. In 1991, Adie was granted funding from the European Social Fund.

Adie is currently involved in two voluntary partnerships described as 'MFIs borrowing from banks' (I), and 'MFIs being subsidized by banks' (II).

## I. MFIs borrowing from banks

Each year, Adie borrows from over 40 French banks in order to finance its credit operations. These include Groupama Bank, Post Bank, HSBC, Credit Agricole, Credit Mutuel, Societe Generale, BNP Paribas and Banque Populaire among others. The first bank loans were issued in 2004 when French banking law reforms granted microfinance institutions an exclusive legal status. The reforms allowed institutions like Adie to borrow and to lend directly to customers. As of December 31, 2014, the outstanding loans from partnering banks amounted to €88.5 million, and cooperation continues to the present day.

Adie management is highly appreciative of this voluntary and effective form of partnership, implemented at both national and regional levels. They declare that partnering with banks has allowed them to increase the number of clients while improving the MFI's financial performance.

Had they been limited to their own funds, they would not have been able to scale and develop new products. The unique conditions (interest rates and guarantees) granted by the partnering banks lessen the financial constraints faced by Adie, positively influencing their annual results.

As for the banks, the Adie partnership offers a unique chance to access new population groups that otherwise would not be eligible as prospective clients. They may also use partnering with an MFI as a strategy to communicate their support to micro-entrepreneurs and microfinance in general. Borrowing from banks has certain disadvantages. Managing ongoing partnerships with over 40 banks substantially increases the operational costs for the MFI. Simultaneously, banks and MFIs are not in competition, as their target clients are two distinct groups.

## II. Subsidization by banks

Since the early 90s, Adie has also been involved in subsidization programs offered by banks, both at the national and regional levels. The banks' financial support takes different forms, from special loans that help maintain the MFI's operations, through participating in the losses on microcredits, to the steady flow of funds that warrant unsecured loans (quasi - equity loans) to Adie's customers.

In principal, in each partnership agreement, the bank agrees to cover some of the losses on the microcredits issued. The bank may also choose to offer an 'operating grant' to Adie, usually with reference to a specific project (e.g. opening of a new branch). Finally, some banks also provide grant funding to pay off some of the unsecured

microloans.

This form of support is deemed necessary by Adie's management in order to meet the operating expenses that are not covered in full by the margins. For the banks, subsidization constitutes a value-sharing opportunity, introducing them to new population groups that are not, in principal, potential bank clients.

According to Adie's management, this form of partnership has allowed them to increase the number of clients and has also improved MFIs financial performance. The only disadvantage is the potential cost of support borne by the banks.



# AgroInvest



Established in 2001 in Serbia, AgroInvest currently holds a loan portfolio of € 12.2m as of March 31, 2015. The mission of the MFI is to serve and empower rural families with high quality financial services and social programs in rural areas. The mission is being realized by establishing personal contacts with clients, and by taking every opportunity to highlight the importance of each client and the community in which they live.

AgroInvest operates through the delivery of both business (start-up, development) and individual (basic needs, housing, and agriculture) loans. The partnership between AgroInvest and Société Générale Bank (implemented since 2013) provided financing for 22,546 new clients as of December 31, 2014. AgroInvest does not receive any EU funding.

## I. AgroInvest acts as a guarantee fund to its partner bank

This partnership occurs through an initially agreed upon deposit (of a fixed percentage of the outstanding portfolio) by AgroInvest into the bank. This guarantee triggers disbursement of loans to clients by the partner bank. Additionally, AgroInvest obtains some of its funding through international investors in the form of letters of guarantee which allows the MFI to benefit from local commercial loans. These local loans are used to finance the guarantee fund. This partnership represents a constrained strategy, as it has been brokered in the absence of regulation pertaining to the MFI's legal status and function.

Since the company started in 2001, it has worked in cooperation with banks. The current partnership dates back to 2012 and is the result of a need for funding. It was initiated and led by the MFI and is being implemented at the national level.

AgroInvest approaches potential clients, screens them and prepares their files for the bank to review. The bank gives the final approval and disburses the loan. During the loan cycle, AgroInvest tops up the deposit if the client is late with repayment

instalments.

Partnering with banks has allowed AgroInvest to increase the number of clients, including poor and very poor clients, the financially excluded as well as rural and unemployed clients.

On the part of the banks, the partnership is source of income with very low risk. The clients are able to enter the mainstream financial system and develop their enterprises.

The partnership holds trade-offs for the MFI. On the side of operational income, this partnership is more costly for the MFI since they share their margin with the bank. However, on the side of financial expenses, funding is much cheaper than a stand-alone model as the MFI only needs to borrow funds for 25% of its total outstanding portfolio. Cooperation between the bank and MFI could be improved by reducing the margin taken by banks or by reducing the deposit percentage given to the bank. This can only be achieved with the introduction of MFI-specific regulation law, or by inviting more banks to compete for MFI partners.

## II. Provision of microfinance services in cooperation with banks due to the absence of regulation

In this type of partnership, the bank disburses loans that were processed by MFIs. AgrolInvest has an ongoing partnership of this kind with Société Générale Bank in Serbia. The partnership is fairly new, and is a result of the regulatory context. As such, it represents a constrained partnership and is being implemented at the national level.

While MFIs are responsible for the entire credit process, from client acquisition to credit decision, it is the bank that signs contracts with clients on its premises and disburses funds that AgrolInvest previously deposited into the bank. The bank also has to provision more funds due to regulatory requirements of the Central Bank for unregistered businesses. Repayments of the loans are done by clients directly to the bank.

Using this strategy, the MFI is able to serve its target clients and issue loans to 'unbankable' individuals despite the regulatory constraints; this allows banks to earn additional revenues.

On the side of internal control, the partnership represents a very good model because each loan is reviewed by the bank, which ensures the 'Know Your Customer' process and guarantees that the files are complete.

For the banks, the partnership imposes additional provisioning costs, as the Central Bank requires 100% provisioning for unbankable and unregistered clients. Moreover, the bank faces the uncertainty of the partner MFI survival in the long term (the bank mitigates this through a supra national guarantee of top quality). On the other hand, the partnership creates cross selling opportunities for the bank (offering complementary services such as transfers and insurance).

This form of partnership could be improved if the banks lowered their administrative requirements and agreed to accept lower loan warranties from the MFI. Despite these inconveniences, AgrolInvest views this partnership as a win-win arrangement.



# Bank of Valletta

Bank of Valletta (BOV) was formed in 1974 in Malta. The Bank offers universal financial intermediation services for individuals, start-up businesses, micro-enterprises, SMEs and corporate customers. The array of products and services are designed around customers' individual needs including deposit taking in Euro and other major currencies, personal and business short-to-medium and long-term financing, foreign exchange services, payment services, credit/debit cards, wealth management, investment banking, stock broking, trade finance, fund management and trustee services.

Since 2010, Bank of Valletta has developed a new **focused strategy** aiming to position the Bank as the Maltese SME bank through the development of new SME and microenterprise financing products, including microcredit programs. One distinctive feature of SMEs is the lack of financial information and possibly tangible collateral, making access to mainstream finance particularly difficult. Nevertheless, they have viable business plans and strong economic potential. To address this 'financing gap', Bank of Valletta launched the Joint European Resources for Micro to Medium Enterprises (JERMIE) product in the framework of EU financial instruments funded under the European Regional Development Fund (ERDF). As of March 2015, the Bank has committed a total of €61.8 million in facilities, assisting a total of 650 SMEs with a total investment amount of €103 million when also accounting for the customer's share of contribution in the project.

To complement the BOV JERMIE product, the Bank launched the **BOV Start Plus** in January 2014.

This product was launched in collaboration with the EIF in the framework of the Competitiveness and Innovation Framework Programme (CIP), which provides a guarantee on microcredits. As of March 2015, the Bank has committed a total of €1.5 million in micro-credit facilities to assist 90 micro-enterprises in generating a total investment amount of €3 million.

This strategy had no significant impact on the Bank's financial performance in the short run, considering that it represents a small percentage of the overall portfolio. However, this type of financing should be seen as a long term investment where a number of SMEs assisted through these products will develop and grow, eventually representing a pool of new, profitable clients. In this regard, the focused strategy has allowed the bank to access a 'new' customer segment of start up companies. The main advantage of this strategy for the clients is improved access to finance. EU guarantees substitute the lack of collateral and also provide a reduction in the SME's financing costs, freeing up cash flow potential and thereby increasing their chances of financing.

The main challenge encountered by the Bank of Valletta in the implementation of the BOV Start Plus product is the size of the Maltese market, which is particularly small when compared to other EU Member States. In this context, it is reasonable to conclude that the growth potential of such micro-businesses is particularly challenging and therefore focusing on SME financing, including micro-enterprises, makes more sense in small markets.



# Community Developing Finance Association - CDFA

The management of CDFA describes their mission as 'supporting the development of a thriving and sustainable community finance sector'. The objective of this British network of MFIs (or CDFIs - Community Development Finance Institutions) was described as financing disadvantaged and underserved communities and, in the long term, contributing to the increase of prosperity and general wellbeing in these communities.

CDFA, which incorporated in 2002, offers their services to organizations operating community finance loan funds. They also work individually with network members in order to create an operating environment that is favourable to all the CDFIs and their potential markets. CDFA's objectives comprise increasing access to capital and improving revenue

as well as supporting and developing their member organizations.

As one of the biggest institutions (outstanding loan portfolio of €216m) in the sample, CDFA members are actively engaged in a number of partnerships, including borrowing from banks, having banks participate in their board of directors, co-financing projects with banks and supporting banks creating MFIs. The 'MFIs borrowing from banks' partnership is described.

While CDFA is not involved in any specific EU partnership, their members are eligible to receive European Regional Development Fund (ERDF) funding and access the EIF guarantee scheme.

## I. MFIs borrowing from banks

The borrowing partnership between CDFA and banks started in 2012 and aimed to increase access to funding for MFIs in the network. Half of the necessary funding was obtained via the Regional Growth Fund Grant, while 50% was borrowed from the banks, including the Unity Trust Bank and the Co-Operative Bank.

The CDFA and the Department of Business Innovation and Skills (BIS) initiated the partnership, which is managed by the CDFA. The loans are issued at the national level. While the partnership is still active and mutually beneficial, it is also constrained by market fluctuations.

In the case of the CDFA, the partnership was a necessary condition for the creation of the fund. The CDFA's Regional Growth Fund grant amounted to £30 million. The government funder, the Department of Business Innovation and Skills (BIS), required that the grant be matched by an equal contribution from a private investor. The CDFA then engaged with Unity Trust Bank and the Co-Operative Bank who matched the BIS grant with a loan to the MFIs.

Borrowing from banks had many beneficial

effects for CDFA members. According to CDFA management, the loan allowed them to increase the number of the clients, increase outreach and include the poor, very poor and the financially excluded. It increased the number of women clients and improved the general financial performance of MFIs.

The obvious advantages of the partnership for the CDFA include increased access to sustainable funding and more opportunities to lend. The banks, on the other hand, are penetrating new markets via relatively safe investment, and participating in a social value creation chain. Clients gain increased access to finance.

The short life-span (3 years) is the most serious shortcoming of this form of partnership. A long-term contract would provide a more stable and sustainable source of funding for CDFA members, allowing them to engage in ventures with a longer profit cycle.

CDFA members are not in competition with banks as their target clientele represent separate markets. The MFIs also engage in alternative partnerships such as peer-to-peer platforms.



# Créa-Sol

Created in 2005 at the initiative of the French Savings Bank in Provence Alpes Corse (Caisse d'Épargne Provence Alpes Corse or CEPAC in French), Créa-Sol targets both micro-entrepreneurs and private individuals by promoting their bank

history rehabilitation. With a portfolio of €6 million, the MFI engages in various forms of partnership. Since 2012, the MFI has been receiving EU funding from the EIF (initiative PROGRESS).

## I. MFIs borrowing from banks

Créa-Sol is licensed by the Ministry of the Economy, Finances and Industry to borrow from banks in order to obtain funds for issuing microcredits. The first such loan was obtained in 2009 from CEPAC. This partnership is still active and is constrained in terms of structural needs (market constraint). The partnership was initiated by the MFI and is executed at the regional level. The borrowing scheme depends on Créa-Sol's current needs.

Borrowing from banks has allowed the MFI to increase their number of clients, in particular for those who are financially excluded, unemployed, women and very young entrepreneurs. Thanks to

the bank loans, Créa-Sol can issue more credits, while the banks participate in social value creation by supporting its social mission. Customers benefit from microcredits that do not require a collateral pledge.

At the same time, the cost of the bank loan must be included in the microcredit prices, raising the interest charged on clients. The management of the MFI believes that the loan made to Créa-Sol, set at market prices, could be much cheaper. As such, lowering the rate could be part of the banks' corporate social responsibility strategy and thus decrease the interest rates charged to MFI clients.

## II. MFIs subsidized by banks

Subsidization is commonplace at Créa-Sol, starting with its very creation by the savings bank Provence Alps Corse in 2005. This partnership is still active today and completely voluntary. It was initiated by the bank, and is jointly led by the MFI and the bank at the regional level.

At present, the subsidization scheme consists of an annual subsidy that covers the operating costs of Créa-Sol. Moreover, the bank has allocated two qualified staff members to work for the MFI. Their wages are paid by the banks. This allocation is a form of indirect subsidization.

This form of partnership has allowed the MFI to

increase the number of clients, in particular the financially excluded, the unemployed, women and very young entrepreneurs.

The main advantage of subsidization for the MFI is having strong structural support and access to the expertise of qualified staff. The bank integrates the partnership in its corporate social responsibility framework. The clients benefit from microcredit rates that do not include the operating costs of Créa-Sol. The only drawback of the arrangement is the constant necessity to explain to potential partners that Créa-Sol is available to work with other banks.

### III. MFIs co-financing projects with banks

Following the 2009 regulatory changes, Créa-Sol has lowered the microcredit ceiling from €40,000 to €10,000. To continue financing the same projects, Créa-Sol started co-financing with banks. This has allowed the MFI to continue to support many projects and in particular, finance the working capital needs of clients.

This partnership is active and voluntary. It was initiated by the MFI and is being jointly led by the MFI and the bank, operating at regional level.

Co-financing allowed Créa-Sol to increase the number of clients, including the unemployed,

women and young entrepreneurs.

Its primary advantage allows the MFI to support larger projects that still fail to obtain funding from mainstream banks. Créa-Sol finances the cash requirements of the newly created businesses, whereas banks are reluctant to finance such needs, especially for new businesses. Overall, the MFI and the bank are complementary in terms of financing. The only drawback entails the difficulty to communicate with multiple stakeholders (time consuming). This issue could be resolved by conducting joint interviews with the client and banking partners.

### IV. MFI's Board with banks members

Since 2005, CEPAC integrated the board of directors of Créa-Sol as the founding member. This partnership is still active and voluntary. It was initiated and jointly led by the MFI and the bank at the regional level.

The Board members representing the banks bring their expertise in terms of financial risk management. They help increase the financial sustainability of the MFI. However, Créa-Sol should continuously ensure that bank's board members are aligned with the MFI's social mission, guaranteeing

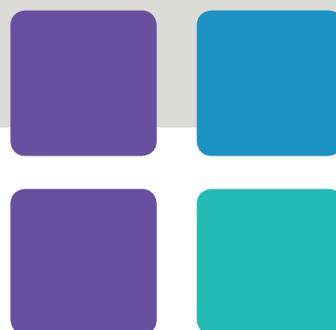
that Créa-Sol favours those who are excluded from traditional banking.

Having bank members on the Board has allowed the MFI to increase the number of clients. In particular, the MFI registered more poor, financially excluded, unemployed, women and young clients.

Créa-Sol is not in competition with banks. It engages in alternative partnerships with crowdfunding platforms.



DMI



The German MFI-bank partnership model consists of the **provision of microfinance services in cooperation with MFIs in the absence of regulation**. Deutsches Mikrofinanzinstitut (DMI) was founded by several pioneer microfinance organisations in April 2004 to provide an alternative way for small-scale businesses and entrepreneurial start-ups to access capital markets. The DMI is an association of 50 members representing various financial sectors and institutions (MFIs, banks, research institutes, public authorities, NGOs and associations). Mikrokreditfonds Deutschland is 60% funded by the European Social Fund.

The mission of DMI is to develop and to ensure responsible, high quality microcredit provision in Germany. The main targets of the member MFIs are women, migrants, unemployed or businesses in a particular sector of activity (services, gastronomy, trade, craft, etc.). In 2014, the average microcredit amount was €7,100. 33% of MFI clients are women and 35% have migrant backgrounds (based on the portfolio since 2010). MFIs extended 50% of their loans to existing entrepreneurs, 32% to unemployed people willing to start a business and 18% to other project holders. DMI's motto is 'Banks finance business plans. We finance people'.

Due to the lack of adequate regulation, DMI only provides microfinance services in cooperation with banks. Between 2005 and 2014, DMI worked in close cooperation with the ethical-ecological bank GLS. The German collaboration model relies on four main actors: banks, MFIs, the guarantee fund and DMI (quality assurance).

DMI has already worked with three partners from the banking sector. The first guarantee fund was Mikrofinanzfonds Deutschland (from 2006-2009) which provided funding of €2m and the second partner was Mikrokreditfonds Deutschland with

€100m. Until mid-2015, GLS bank was the banking partner. At present, the MFI's funding structure is being revised and negotiations are in progress with Grenke Bank.

All three partnerships were set up to provide funding for business creation and development to small entrepreneurs from private banks and public loan programmes. In the context of bank monopoly, the only possible way to reach this goal was through collaboration. Traditional German banks are not willing to finance new businesses lacking collateral, credit or business history (e.g. women, youth, migrants, unemployed) or start-ups and existing enterprises in particularly risky sectors (e.g. food and accommodation, trade and craft sectors). Moreover, public, promotional loan programmes have not succeeded in closing this gap. This collaboration model aims to correct this market failure.

The collaboration model was initiated and jointly led by the MFI and the bank (GLS) at the national level. However, since 2014, the collaboration with GLS bank is no longer active. Unterberg et al. (2014) presents one reason for quitting this collaboration model: 'GLS Bank is facing an increasingly tougher regulation of the credit business, which makes it more and more difficult to grant microcredits within the framework of the existing system.'

Partnering with banks allowed Mikrokreditfonds to increase the number of clients, including the poor and very poor, the financially excluded, unemployed, women, immigrants and young clients. It also improved the MFI's overall financial performance.

The biggest advantage of the partnership is specialization: both the MFI and the bank can concentrate on their areas of expertise. The model

introduces a clear sharing of the tasks and roles of the partners, as well as cost and risk sharing definitions.

For the bank, microcredit provision through collaboration reduces the processing costs by outsourcing the monitoring and screening processes to partner MFIs (MFIs in this model are consultants, start-up centres, accountants, etc). In addition, the bank bears no risk for the microcredits, as MFIs and the guarantee fund (financed by public and social investors) cover 100% of the losses. From a financial perspective, the bank receives a part of the interest rate charged to the client (currently 8.9% APR on average). Finally, the partnership improves the bank's social image through microcredit provision to otherwise excluded borrowers.

For the MFI, the collaboration model represents the only possible way to implement its mission. The MFIs do not support the administrative charge of loan disbursement (banking, legal and data protection issues are too burdensome for small MFIs), which is under bank's responsibility.

For the client, this model eases access to finance

and high quality, non-financial services despite being ineligible for classical credits. Indeed, MFIs use a holistic approach mixing business analysis and the personality of the client. Moreover, MFIs accept alternative guarantees (personal guarantors, references). This collaboration model represents an opportunity for clients to build their credit history and progressively become bankable. Finally, the client can choose the MFI corresponding exactly to his/her needs (adapted type of training, mentoring, pre-, post- loan support).

The biggest disadvantage is that the partnership is highly dependent on the bank partner. To fix this, the MFIs should be given more decision-making power. Harmonising the reporting and management tools despite high heterogeneity represents a challenge for the MFIs. For banks, working with heterogeneous MFIs is also particularly challenging. Banks should additionally integrate microfinance activities into their long-term strategy and accept their role as loan administrators in this circuit.

Obviously, German MFIs are not in competition with banks, as they cater to different segments of the market.



# National Federation of French Savings Banks

National Federation of French Savings Banks (Fédération Nationale des Caisses d'Épargne, or FNCE in French) represents a network of French Regional Saving Banks. It was established in 1818. It is engaged in a plurality of partnerships and organisational strategies. It engages with MFIs through subsidization (e.g. Créa-Sol, see below), bank representation on the MFI's board of directors (e.g. Créa-Sol, see below), partnerships with MFIs by screening and monitoring potential clients

for the bank and with MFIs providing Business Development Services to the bank's clients. FNCE also has a downscaling strategy through 'Parcours Confiance', a specialised microcredit unit within the bank.

In particular, FNCE enables MFIs to grant microcredits and to work with other social partners. FNCE does not receive EU funding.

## I. Banks granting microcredit (downscaling strategy)

FNCE developed its own microcredit program. It is based on a network of associations called Parcours Confiance. The strategy started in 2005 and is focussed on personal microcredits.

The objective of the partnership is to tackle the issue of financial exclusion. Initiated and led by the bank, the partnership is being implemented at national and regional levels (Caisses d'Épargne, or Savings Banks, are decentralized by regions).

The philosophy of Parcours Confiance is to assess vulnerable clients' credit worthiness through a customized, in-depth budget and social analysis. Nowadays, most banks rely on highly industrialized screening processes based on automated credit scoring. In the pre-selection phase, Parcours Confiance works closely with a number of social partners (non-governmental organisations, not-for-profit corporations), relying on their expert knowledge on social inclusion. Following creditworthiness assessment, Parcours

Confiance closely monitors the clients' repayment performance.

This partnership has allowed the bank to increase its number of clients, including poor and very poor, and the financially excluded. It is a social and financial innovation 'laboratory', in which Caisses d'Épargne uses cutting edge financial engineering to respond to unmet social needs.

FNCE finds itself in competition with other institutions providing microfinance services. Today, all banks provide some kind of personal or business microcredit, but FNCE prefers market-sharing to 'hard' competition. FNCE targets marginal markets with low or negative profitability. 'Soft' competition fuels innovation. However, it should not be an obstacle in fruitful collaboration. As socially-oriented organization, FNCE provides transparent information to their clients, assisting them in choosing the best provider to meet its needs.

## II. Banks working with other social partners

FNCE engages in partnerships with other organizations in the sector, like Réseau France Active (see below) or Initiative France (these partners provide BDS, guarantees or “prêt d’honneur”) for business microcredit. This partnership started in 1990s to promote entrepreneurship and small business creation, especially among the unemployed. FNCE is also involved in both national and local collaborations with 17 local Savings Banks and regional associations of France Active and Initiative France.

It is a voluntary, balanced partnership, executed at national and regional levels. This partnership allowed the bank to increase the number of the clients, but has had no positive effect on overall financial performance.

The main advantages for the bank are the benefits from the expertise of partners who screen, monitor and advise micro-entrepreneurs. Therefore, the risks taken by the bank are minimized through the decreased probability of borrower default and the Réseau France Active guarantees for potential losses.

On the other hand, clients benefit from adapted financial products (microcredits guaranteed by the social partners, 0% rate ‘prêt d’honneur’ which are used to leverage bank credit) and BDS. Direct microcredit provision by the bank allows immediate financial inclusion of the customers. However, the initial screening performed by a specialised unit (Parcours Confiance) and social partners adapt the screening process, which is specific to microcredit customers.



# Micro Development



Micro Development L.L.C. is microfinance focused institution established in 2009 with the mission to offer financial and none financial support services to entrepreneurs and other beneficiaries in order to improve socio-economic living standard of economically active or poor people in Serbia, sustainable. Micro Development Gross Outstanding portfolio amounts to € 2,318,659 as

of 31/12/2013. It has never received funding from the EU. Micro Development is involved in two types of partnerships with mainstream banks: 'Provision of microfinance services in cooperation with banks due to the absence of regulation' (I) and 'Transactions to/from clients throughout the bank accounts' (II).

## I. Provision of microfinance services in cooperation with banks due to the absence of regulation

The provision of microfinance services in cooperation with banks due to the absence of regulation has taken place under two frameworks. First, until 2008, Micro Development Fund started providing microfinance services in the framework of a **commission contract**. The banks involved in the partnership were Meridian Bank and the Commercial Bank Belgrade.

The agreements with the two banks were signed in 2003 and 2004 and were a consequence of the lack of regulation that would enable MFIs to conduct direct operations. These partnerships are no longer active (not renewed since 2008) since the banks' decisions became predominantly aligned with the opinion of the National Bank. The partnership with the bank was considered constrained, due to the lack of regulation regarding the microfinance sector. It was initiated and led by the MFI at the national level.

When still active, the partnership represented a commission-based contract. The banks disbursed loans to the clients in its name for the account of MFI. The MFI in turn screened and signed all the contracts with the clients, sending the bank the list of applications approved for loan disbursement. Micro Development Fund collected the necessary documents, provided the funds for loan disbursement and collected the repayments. The MFI was also responsible for the monitoring of

repayments while the role of the banks was limited to signing the loan contracts with clients, based on the list received from Micro Development, disbursing the loans and collecting repayments.

This form of partnership allowed Micro Development to increase the number of clients, including poor and very poor, the financially excluded and the unemployed, women and immigrant clients, as well as clients in rural areas. It also improved the MFI's overall financial performance. The partnership provided a legal form that ensured the continuous functioning of the MFI. The benefit for the bank was the fee paid by the clients. On the client side, the 'unbankable refugees', internationally displaced people and other vulnerable groups gained access to funding.

At the same time, the partnership was imposed by the lack of regulation (constrained partnership). The cooperation was subject to external risk (excessive dependency on the bank). Micro Development was also exposed to the risks resulting from the irregularity of bank administration, while the banks were exposed to criticism from supervisory authorities, in addition to being unfamiliar with the MFI's unique way of operating. The cost of the bank intermediation made the loans more expensive for clients.

This partnership could be improved by proper

legislation, securing both the bank and partnering MFI for the potential risk of law interpretation by the supervisory authorities.

Since 2008, the second framework operates under a **guarantee deposit contract**. This unique partnership between Micro Development and the banks (first Privredna Banka Belgrade, and since 2014, VTB) involved the creation of a Guarantee Deposit Contract. The cooperation with PBB ended in 2013 due to PBB's bankruptcy. This strategy constitutes an interesting and mutually beneficial legal form. It is also a constrained partnership as the MFI is excessively dependent on its bank partner. The partnership was initiated and is being implemented by Micro Development at the national level.

Within the Guarantee Deposit Contract, the bank disburses the loans in its name to its own bank account. Micro Development screens the clients, prepares the application files and finally sends the bank the list of clients eligible for loans. The MFI transfers 105.3% of the loan funds to the bank (covering the loan amount plus the bank obligatory reserve of 5.3%), and the bank issues the loan.

The strategy has allowed Micro Development to increase the number of clients, including poor and very poor, the financially excluded and the unemployed, women and immigrant clients, as well as clients in rural areas. It also improved the MFI's overall financial performance.

The main advantage this form of partnership provides is a legal form for the MFI to continue its operations. However, it has proven to be very costly and time consuming. The partnership brought significant risk-free income to the bank.

The drawbacks for the MFI include increased dependency on the bank as well as the risk of bank bankruptcy. On the part of the banks, some stated that serving the vulnerable groups exposed them to reputational risk due to serving clients who are considered 'unbankable' according to bank policies. The Guarantee Deposit Contract is also considered administratively demanding for the bank and the MFI.

This partnership could be improved by the proper legislation regarding the microfinance sector, as it would enable partnering with banks on a voluntary basis.

## II. Transactions to/from clients throughout the bank accounts

This strategy was first established by the MFI in 1998 as a less risky alternative to loan delivery and collection. It entailed partnerships with the commercial banks Commercial Bank Belgrade and Bank Post Savings.

In cooperation with the banks, Micro Development Fund disburses loans throughout the bank branches at a scheduled time. All repayments are made by clients directly to the MFI bank account. For each transaction, the bank charges its standard fee (paid by the client).

This partnership has improved the financial performance of Micro Development Fund. Transferring the money through the bank branches is less risky than disbursing directly to clients and translates to lower costs. The bank has a new revenue source (fees paid by the clients for each transaction). Clients have numerous bank branches available to make a fast deposit, including the rural areas of the country. However, clients bore the

cost of the scheme, as they were charged for each repayment at the branch.

Micro Development remains in constant competition with banks who are reaching out to new client groups as a reaction to the global economic crisis. The competition is advantageous for clients: they are offered better loan conditions and repayment schemes. Nowadays, banks attract potential clients by offering no-interest loans to clients with current accounts. Clients with a long loan history with the MFI are eligible for higher loans at the banks.

The banks are thus taking over the client base that Micro Development strived to build over the years. In some cases, the banks refuse to provide Credit Bureau information to the MFI about potential clients, trying to coax them into applying for credit directly with the bank.

The MFI is now looking into mobile banking and peer-to-peer platforms.



# Microfinance Ireland

Created in 2012, Microfinance Ireland has an active loan portfolio of €7,027,874. From their mission statement, the MFI strives 'to promote economic development and to increase employment and enterprise, including facilitating social inclusion, to newly established and growing enterprises across all industry sectors with commercially viable proposals'. Microfinance Ireland issues credits

from their Microenterprise Loan Fund and receives the benefit of a guarantee under the European Progress Microfinance Facility.

There are two ongoing partnership strategies that the MFI's management identified as 'voluntary and active'.

## I. MFIs borrowing from banks

Microfinance Ireland has three ongoing voluntary partnerships with the three major banks in Ireland. These loan funds have been granted on a commercial basis and are subject to commercial terms and conditions. They are meant to assist the MFI with the funding of its current and future customer loan book and operations.

The partnership was initiated as part of the overall funding arrangements of Microfinance Ireland by the banks and the public body, Department of Jobs, Enterprise & Innovation. In practice, the loan funds have been granted to Microfinance Ireland's parent company who then on-lends to Microfinance Ireland. At the present moment, the MFI has completed a club deal with all three banks where agreement has been reached to provide funding on matching terms and conditions.

The partnership has allowed Microfinance Ireland to increase the number of clients, as well as the number of poor or very poor clients, the number of financially excluded clients, the number of clients living in rural areas, the number of disabled people financed, the number of unemployed clients, the

number of female clients, the number of immigrant clients, the number of young clients and to improve the MFI's general financial performance.

For the banks, the partnership became part of their corporate and social responsibility programs. In addition, once the customers of Microfinance Ireland develop satisfactory profiles they will most likely become borrowing clients of one of the three banks.

The shortcomings on the part of Microfinance Ireland include the costs of this form of funding, which are higher than preferred. Also, complying with the terms and conditions of loan funding brings additional reporting requirements, which in turn increase the operational costs.

In contrast, the possibility that Microfinance Ireland is unable to repay their loan commitments constitutes a potential risk for the banks. The two are not in competition, as Microfinance Ireland is lending to customers that are not eligible for regular bank loans.

## II. Co-financing projects with banks

Microfinance Ireland co-funds projects with banks in instances where banks are unable to provide the full funding requirement of customers. This voluntary form of partnership was initiated by the MFI and is being executed at the national and regional levels.

Microfinance Ireland has met with the banks to confirm that in instances where the bank is able to fully support the clients funding needs, that Microfinance Ireland will consider funding the balance on a bi-lateral basis. Microfinance Ireland strives to increase the awareness of the Microfinance Ireland loan product across all banks, by way of meetings and presentations across all levels within the banks.

The advantages for the MFI and their clients are the same as in the case of the previous strategy. In addition, Microfinance Ireland obtains access to a wider potential customer base. Later on, the banks

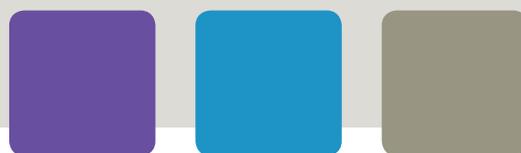
will retain the client as a bank customer.

At the same time, the terms and conditions of Microfinance Ireland loan may not match those of the bank, putting the MFI in a subordinated position. A clear disadvantage for the clients is the complexity of the double-loan product, as payments require better cash management skills and discipline.

The automatic referral to Microfinance Ireland of those customers declined by banks would significantly improve the flow of customers seeking loan funding from Microfinance Ireland. Microfinance Ireland has made representations in this regard to the Irish Government and to the banks. While it will bring logistical challenges to Microfinance Ireland and the banks, the proposal has been accepted by the Government and the banks. The proposal will be implemented as soon as the related legislation is amended.



# microStart



microStart, a Belgian MFI created in 2010, is a group of innovative socially-oriented firms, oriented towards job creation through microcredit. The management of microStart describe their mission as financing and supporting those excluded from

the banking system (jobseekers, recipients of help from Public Social Welfare Centres and the self-employed, etc.), to create or develop a small independent business.

## I. MFIs borrowing from banks

This form of partnership started in 2010 to answer unmet market demands (i.e. very poor people wanting to start a business and lacking access to finance). microStart and the bank initiated this voluntary partnership. It is being implemented by the MFI at the national level.

Borrowing from banks allowed the MFI to increase the number of clients, including the poor and the very poor, the financially excluded, the unemployed, women, immigrants and young people. It improved

the microStart's overall financial performance.

The MFI is provided with financial resources and competences to improve its efficiency. The bank is able to safely explore a new potential market, while the clients get the opportunity to build credit history before accessing commercial banks.

Bank participation in equity and bank subsidies are additional partnerships for microStart started both in 2010.



# Opportunity Bank Serbia

Opportunity Bank Serbia (OBS) started operations in 2002 and had a loan portfolio of €66,627,857 as of March 31, 2015. By providing financial solutions and training, the bank's social mission is to 'empower the underserved and the financially excluded to transform their lives, their children's futures and their communities'. OBS does not receive any funding from the EU.

OBS represents an **upscaling strategy for MFIs (MFIs becoming banks)**. It was first established in 2002 as a Savings Bank, but since the Law on Banks in Serbia changed in 2005 allowing only banks to disburse loans, it has made a strategic decision to become a bank. In 2007, OBS obtained its banking license from the Serbian Central Bank. Since the transformation was imposed by a shift to a more strict and conservative banking legislation, the strategy is seen as constrained by the change in legislation.

Opportunity Savings Bank went through the process of transformation into a fully-fledged bank, which was a cumbersome and time-consuming exercise due to a very conservative central bank. Simultaneously, the management was taking the necessary steps to introduce additional products and services at the future bank. The strategy was executed at the national level.

The upscaling strategy allowed OBS to increase its number of clients and to disburse loans independently. OBS remains different from the mainstream banks and thus has better visibility. From the clients' perspective, the services offered are now more accessible, and the range of services has widened.

At the same time, strict banking regulations require excessive reporting and documentation, which significantly increases loan-processing expenses for OBS. As a bank, OBS is seen as a different type of financial institution compared to the other banks in Serbia. However, an MFI-turned-bank is in competition with the regular banks in Serbia, as similar products are offered to the same target groups (except for small farmers in rural areas). Some clients have been lost to competitors, mainly due to confusion with the excessive offer of packet services.

OBS thus offers competitive interest rates (as forms of protection from excessive interest rates), and innovative products that traditional banks do not engage in. It actively engages in alternative partnerships, including insurance providers and transfer companies.



# PerMicro

Created in 2007, PerMicro describes its mission as creating employment opportunities and promoting social inclusion by providing professional microcredit services to the sectors of population that are excluded from the traditional channels of credit due to poor credit history or precarious employment status. These include financial education and coaching services for start-ups. PerMicro targets competent entrepreneurs with a sound business idea, as well as people with primary financial needs (housing, health, education) who are not eligible for bank loans. PerMicro's outstanding portfolio amounted to €29,939,583

by 31/12/2014. In 2013, the MFI received a loan from European Investment Fund (through SEFEA - European Ethical and Alternative Financing Company) and in 2014 from the Council of Europe Development Bank.

PerMicro engages the following forms of partnerships: (I) borrowing from banks, (II) having banks participate in their equity and (III) sharing front-office, back-office, branches, ATMs and IT with banks. Moreover, PerMicro has banks' representatives participate on its Board.

## I. MFIs borrowing from banks

PerMicro borrows from various banks in order to fund and disburse loans to clients. It has active, voluntary partnerships with Monte dei Paschi di Siena (from 2007), Banca Regionale Europea (from 2009), BNL - Gruppo BNP Paribas (from 2011), Banca Prossima (from 2013) and CEB (from 2014). PerMicro needs bank loans to fund its operations and to disburse microloans. This strategy allows the MFI to increase their number of clients, including the poor and the very poor, financially excluded, unemployed, women, immigrant and

young entrepreneurs. It also improved its overall financial performance.

The banks earn interest on the loans and participate in social value creation by supporting a social enterprise. More loans are available to clients and the only drawback is the interest that the banks charge PerMicro on the loans. PerMicro needs the bank funds to continue operating and to reach more clients, but they should attempt to obtain funds at a lower cost.

## II. MFIs having banks participate in their equity

PerMicro is having some of the banks participate in their equity (BNL - Gruppo BNP Paribas (2012 - 23,2%). The partnership was put in place as a response to the MFI's need to have an industrial partnership with a national bank that was sensitive to the issue of financial inclusion.

This strategy allowed the MFI to increase their number of clients, including the poor and the very poor, financially excluded, unemployed, women,

immigrant and young entrepreneurs. It also improved its overall financial performance. The bank partner provides funding (not determinate cost), solidity (to third parties), and operational/commercial support. Moreover, BNL provides support in the identification of other funding instruments convenient for the MFI. In turn, PerMicro introduces the bank to a new market of potential clients.

### III. MFIs sharing front-office, back-office, offices, ATM and IT with banks

Since 2012, PerMicro is sharing offices and support services with the BNL - Gruppo BNP Paribas. BNL was interested in investing in the microcredit sector and evaluated PerMicro as the best Italian partner. This partnership is still active and voluntary, initiated jointly by the MFI and the bank, led jointly by the MFI and the bank and executed at the national level.

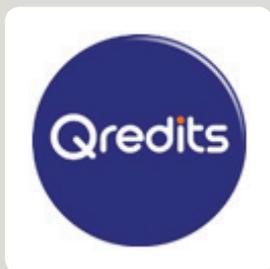
BNL offers funds, logistical support (PerMicro's headquarters and 5 branches are hosted in BNL offices) and IT base. BNL, through PerMicro, can reach and serve financially excluded clients. The partnership also resulted in the creation of the Associazione PerMicroLab Onlus: an innovative initiative that links retired executives and micro-entrepreneurs in a mentorship program.

The partnership between PerMicro and BNL is also

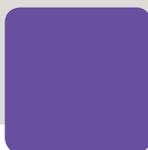
very important in terms of public relations and Corporate Social Responsibility. BNL can expand its range of products with high social value and use them in their visibility strategy. Indeed, PerMicro offers other BNL products (opening of a bank account, insurance, etc.).

This strategy allowed the MFI to increase their number of clients, including the poor and the very poor, financially excluded, unemployed, women, immigrant and young entrepreneurs. It also improved its overall financial performance.

PerMicro also engages in alternative partnerships: insurance providers, peer-to-peer platforms and commercial collaborations (with local banks BCC, BPER).



## Qredits



Qredits offers coaching services and small credit to start-up entrepreneurs in the Netherlands. Started in 2009, Qredits targets customers who do not have access to financial services through the regular circuit, allowing them to obtain economic, financial and social independence. Qredits was

granted EU funding via the Progress Microfinance Facility in 2009. At the present moment, the MFI has a loan portfolio of €43,359,520. In order to widen their range of services, Qredits partners with insurance providers and traditional banks through borrowing and co-funding.

## I. MFIs borrowing from banks

Qredits has a loan from a consortium of Dutch banks, Rabobank, ABN Amro, Triodos and ING. In order to finance its operations and to continue to grow, Qredits applied for a loan with the banks through a voluntary partnership agreement. The partnership was initiated and fostered by the public body: Dutch Ministry of Economic Affairs. It is being implemented at the national level.

The partnership has allowed Qredits to increase

the overall number of clients, as well as the number of poor or very poor clients, the number of financially excluded clients, the number of unemployed clients, the number of female clients, the number of immigrant clients, the number of young clients, and to improve the MFI's general financial performance. On the part of the banks, the partnership allows them to participate in issuing loans with a high social value.

## II. Co-financing projects with banks

Since some of the lenders require funding that exceeds the Qredits's range of lending totals, they have a unique opportunity to apply for funding in combination with either a bank loan, via crowdfunding or through another form of lending. Management believes that multiple borrowing can strengthen the applicant's business model, proving their entrepreneurial skills and commitment. The strategy of co-funding is thus initiated by the entrepreneur and implemented at the SME specific level.

The strategy of co-funding with banks has allowed Qredits to increase the overall number of clients, as well as the number of poor or very poor clients, the number of financially excluded clients, the number of unemployed clients, the number of female clients, the number of immigrant clients, the number of young clients and to improve the MFI's general financial performance. On the part of the banks, more funding partners translates into a more reliable mix of financial resources.



# Réseau France Active

Réseau France Active (RFA) is a French microfinance network established in 1988 with a long tradition of fostering job creation, especially for groups excluded from the labour market. RFA receives EU funding from the European Social Fund (ESF) and European Regional Development Fund (ERDF).

RFA partners with banks that are active in the French financial market. The partnership is based on the concept of 'secured bank micro-credit'. In other words, Réseau France Active provides a guarantee for microcredits granted by banks in France.

The objective of Réseau France Active's network is to promote access to bank loans on favourable conditions (market rates, protection of personal assets) to micro-entrepreneurs, and in particular, to the unemployed who rely on minimum income support (welfare benefits) or clients having 'too / more risky' profiles such as women entrepreneurs and young entrepreneurs.

In order to accomplish their mission, Réseau France Active uses several tools. First, the RFA **guarantees (on average 60%) the loan granted by the bank** to the micro-entrepreneurs. Therefore, Réseau France Active engages in risk-sharing with the client. In return for the guarantee, the bank removes the requirement of personal assets of the micro-enterprise owner as collateral (excluding personal guarantees).

The second tool consists of **mentoring and advising the client** during the funding research phase. The counselling/mentoring performed by Réseau France Active aims to increase the viability of the business plan via the economic, human and financial expertise made directly with the project holder. Support from RFA also helps to mobilize other financial resources to fund the business (for example, a 0% loan from the public NACRE – Nouvel Accompagnement pour la Création et la Reprise d'Entreprise - device). Thus, the label of Réseau France Active facilitates access to the bank for micro-business creators. 82% of very small

businesses accompanied by France Active are still active three years after their creation.

This is still the main strategy of Réseau France Active. The network is pursuing the development of new partnerships with banks, the latest including the BNP, a leading banking body in France.

This strategy was initiated and supported by Réseau France Active, with the support of public partners, including the State and the Caisses de Dépôts et Consignations, as well as the local authorities (Regions, Provinces, Towns and Communities).

The partnership was initiated and led by Réseau France Active and is now being implemented at the national level.

The partnership has allowed RFA to increase the number of customers, including the poor and very poor, the unemployed, women and young entrepreneurs. It also improved RFA's overall financial performance.

The positive relationships created with banking partners in recent years now make it possible to move to a new stage of collaboration. Several banks have expressed interest in participating in the capital increase of Société France Active Garantie. The agreement is now in the stage of realization.

Banking networks can develop their activities targeting the creation of very small businesses by entrepreneurs who are considered to be more fragile in a secure framework. The banking networks are recognized as the first promoters of the concept of 'mentored business creation'. At the same time, the entrepreneur can access a credit from a bank from the outset of the entrepreneurial activity. He/She benefits from market credit conditions and builds a quality relationship with the bank.

The services offered by Réseau France Active are highly complementary with bank services. Réseau France Active is fully integrated in the 'business support chain' and is now partnering with crowdfunding platforms.

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# Appendix

## → List of participants

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