

Promoting Microfinance: Policy Measures Needed

Jan Evers &
Stefanie Lahn
EVERS & JUNG,
Research and
Consulting in
Financial Services,
Hamburg

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Avec l'augmentation du chômage en Europe, le travail indépendant et le micro-entrepreneuriat permettent à des personnes menacées de pauvreté ou d'exclusion sociale de participer aux processus économiques et politiques.

Les bénéficiaires de l'aide sociale sont souvent confrontés à ce qu'il est convenu d'appeler l'effet « île flottante ».

1. EMN and MFC, steered by a working group, are preparing an update of this study and looking for a sustainable network of institutions completing regularly the country reports. For more information and for receive the PDF of the current study: info@eversjung.de.

This paper is based on the study 'Policy measures to promote the use of micro-credit for social inclusion', which was a part of the Commission's Action Programme on social exclusion. The study was conducted in 2004 by FACET, EVERS & JUNG and the new economic foundation (nef), with assistance from the European Microfinance Network and the Microfinance Center, for the European Commission DG Employment, Social Affairs and Equal Opportunities unit E/2¹.

Microfinance for new or existing small companies has received growing attention over the past years. Its role in integrating poor people and people at risk of poverty into the economy and society, particularly in developing countries, is seen as one of the development success stories of the past decade. But what is its role in Western Europe?

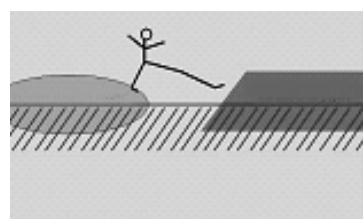
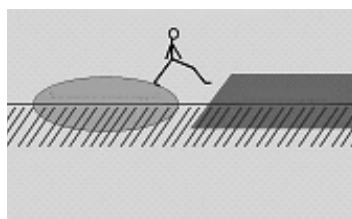
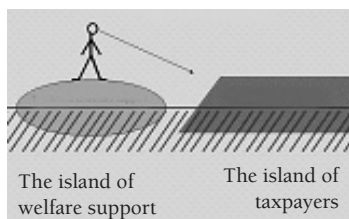
Thanks to European welfare systems, benefits programmes are available and appropriately provided to the needy. However, over the last years, high unemployment rates have stretched the public purse to its limits. Nowadays, within the group of welfare recipients, there are often many well-trained people of prime working age who are affected by long-term unemployment and have

difficulties to re-integrate into the working population. They constitute a new group within Europe, which is or is becoming socially excluded and at risk of poverty. Self-employment and microentrepreneurship have been identified as a way of enabling those at risk of poverty and social exclusion to participate in the economic and political processes of society.

The moving island effect

Welfare recipients often experiences what we term 'the moving island effect'. Once they decide to become active and want to leave their island of welfare support, they are confronted with more and more upcoming hurdles. For example, in earning the first euro they become obliged to contribute to national health and pension schemes. In particular, those wishing to create their own employment through entrepreneurship and who have lived in social and economic exclusion, sometimes for many years, find it difficult to access finance. Thus, they are facing problems, which are hard to overcome with the traditional means and options at their disposal. Microfinance, in this respect, aims to diminish these hurdles by targeting people who are regarded as non-bankable by the traditional financing sector.

Lorsqu'ils décident de devenir actifs et de quitter leur île d'assistance sociale, ils doivent surmonter certains obstacles.



Par exemple, en gagnant leur premier euro, ils doivent commencer à cotiser aux systèmes de santé et de retraite.

La microfinance vise à réduire ces obstacles en se concentrant sur des personnes qui n'ont pas accès au secteur financier traditionnel. Mais l'accès aux services financiers ne suffit pas. La microfinance ne peut remplir correctement son rôle que si les autres barrières à l'indépendance sont levées.

L'étude se concentre sur l'identification et l'analyse des mesures susceptibles de promouvoir la microfinance et de favoriser l'accès à l'indépendance.

Yet, access to financial services is not enough. There are additional barriers related to self-employment, which require the attention of governments and policy makers. In this respect, awareness has to be raised that microfinance can only perform

its role properly, if the environment is right.

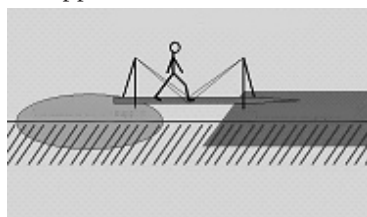
The study focused on the identification and analysis of policy measures that promote the use of microfinance and that make the environment more 'self-employment friendly'.

Ideally, these measures build bridges between the social welfare, employment, enterprise and financial systems.

Building Bridges

Using a transnational approach, policy measures of seven Member States (Czech Republic, France, Germany, Poland, Spain, Sweden, United Kingdom) and one accession country (Romania) were analysed and evaluated with regard to their effectiveness.

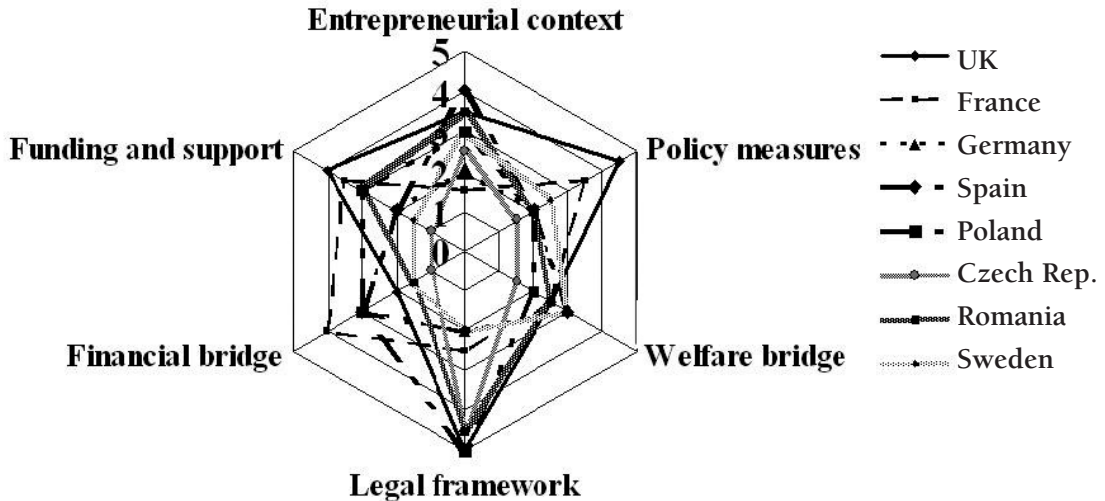
The policy measures assessed were: entrepreneurial context, microenterprise policy environment, welfare bridges, legal framework, financial bridges and microfinance funding and support.



The findings of the survey were divided into these six key aspects and have been illustrated in a radar diagram for each country (Diagram).

The figure shows that there is no leading country amongst the eight. Nevertheless, there are a number of effective and promising policy measures that, with the help of microfinance, support social inclusion through self-employment. This is the point from where political decision makers should start now to improve policy measures needed to promote microfinance in Europe. The advantage is, that not everything has to be developed from scratch. Rather, there exists the possibility of learning from best practices and experiences of other European countries. Particularly with regard to high scoring areas, countries can borrow ideas from one another. Bringing all this together could be a great resource for improving the environment for self-employment and further enable

Diagram. Policy measures and their effectiveness



A travers une approche transnationale, les mesures prises dans huit pays européens ont été évaluées au regard de leur efficacité. Les résultats de l'enquête sont analysés sous six aspects.

1. Contexte entrepreneurial

Dans une société qui encourage l'entrepreneuriat, le statut d'indépendant est une alternative respectable au salariat. L'échec d'une entreprise est perçu comme une expérience utile pour de futures activités.

European countries to develop their own European best practice model. In the following, policy measures and best practice examples are presented briefly for each key aspect surveyed.

However, the full study itself gives much more detail. Here we try to explain the principle.

Entrepreneurial context

How entrepreneurial is the society and how much does it support its entrepreneurs?

Policy measures, which promote the entrepreneurial context are:

- Awareness programmes promoting self-employment as a viable income generating activity;
- Reduction of legal, fiscal and administrative barriers related to self-employment.

A society supporting and actively encouraging entrepreneurship for all of its members is referred to as entrepreneurial. In an entrepreneurial society, self-employment is a respectable alternative to employment. Further, a business failure does not automatically lead to an end of the entrepreneurial career. Rather it is considered a valuable experience for future activities.

For instance, entrepreneurship training is an integral part of the school curriculum in Poland, the Czech Republic and the UK. This training promotes, at a young age, the idea that self-employment is a viable and valuable option for one's career. Additionally, projects with 'fictitious companies' promote practical entrepreneurship skills amongst young people.

Les mesures politiques susceptibles de promouvoir l'esprit d'entreprise sont : les programmes de sensibilisation présentant l'auto-emploi en tant qu'alternative valable et la réduction des barrières légales, fiscales et administratives liées à l'auto-emploi.

2. Environnement politique pour les microentreprises

Dans un environnement idéal, une combinaison d'initiatives publiques et privées est de nature à promouvoir le développement de l'auto-emploi et la création de microentreprises. Les mesures de politique qui améliorent l'environnement des microentreprises sont : les conseils à l'entreprise par des services flexibles de soutien par téléphone ou Internet, les fonds de prêts gérés par des ONG et/ou banques destinés aux microentreprises, et l'importance donnée aux microentreprises par les gouvernements.

With respect to the fiscal environment, in France, regional authorities established a pilot with lower VAT (value added tax) for private construction, home, and gardening services in order to encourage entrepreneurs in these sectors to make the transition from the informal to the formal sector.

Policy environment for microenterprises

Are there policy measures that promote self-employment in general, and for socially excluded in particular?

Measures, which improve the policy environment for microenterprises are:

- *Provision of business advice through flexible internet and telephone support desks;*
- *Loan funds run by specialised NGOs/banks focusing on microenterprises;*
- *Governments highlighting the importance of microenterprises.*

In an ideal policy environment, a mixture of public and private initiatives promotes the creation and development of self-employment and microenterprise. Business support services especially developed for the needs of microenterprises are available as well as financial services, which meet their demand. In many respects it is more useful for the latter to focus on motivation and capacity to repay than on more traditional means such as loan size and bank history. One example, which illustrates how policy measures supporting microenterprises can be improved, is the regional initiative 'Firmenhilfe' in Hamburg, Germany.

It is a telephone based support desk, which provides low-level, independent and confidential advice in order to (re) activate the self-help ability of the microenterprise owner and to enable him or her to overcome or prevent financial problems.

Another but different example is the French 'Plan Dutreil', which aims to reduce administrative procedures and requirements for microenterprises. As part of the 'Plan Dutreil' (2003) the support to microenterprises is streamlined. Microenterprises in certain sectors pay lower or are even exempted from VAT.

Welfare bridge

How developed is the system for taking people from unemployment to self-employment?

Policy measures, which help welfare recipients to move smoothly into self-employment are:

- *Income bridges;*
- *Collaboration between social welfare and employment/enterprise system;*
- *Active labour market policy.*

Active labour market policies increasingly use incentives to encourage people into work and penalise the unwilling. Preferably, these incentives should be part of a system developed to take welfare recipients smoothly from unemployment to self-employment. These so-called welfare bridges encourage the unemployed, without forcing them to become self-employed. Welfare bridges create a 'pull' rather than a 'push' environment. This is for instance realised by giving potential entrepre-

3. « Mesures-pont » sociales

Une bonne politique d'encouragement à l'emploi comporte des mesures incitatives et des pénalités pour les récalcitrants. Ces initiatives devraient faire partir d'un système ayant pour objectif de faciliter la transition du chômage à l'auto-emploi. De telles « mesures-ponts » devraient encourager les demandeurs d'emploi à l'indépendance, sans les y forcer. Cela pourrait être réalisé en permettant aux nouveaux entrepreneurs de tester leurs capacités avant de s'annoncer formellement en tant qu'indépendants. Parmi les mesures destinées à favoriser cette transition : les ponts de revenu, la collaboration entre système social et employeurs/entreprises, et une politique de marché du travail active.

neurs time to test their new income generating activity before needing to declare formally their self-employment status. In this respect, the Irish system is regarded as the most advanced in Europe. It provides income support on a decreasing scale for up to four years. In case of a business failure, the person can return into the welfare system without facing any penalties or barriers. Therefore, this system allows people to test the income-earning capacity of their enterprise extensively.

A similar approach has been adopted by the German 'Ich AG'. Here income support is decreasing in three steps over three years. Still, the system has to be improved further since it lacks any kind of filter to prevent free rider effects nor does it enable the combination with non-financial support. Thus, it is a promising approach for building bridges through transition periods.

Legal framework for microfinance

Is there a supportive legal framework for microfinance services?

Policy measures, which create favourable legal frameworks, are:

- Specific legislation;
- Reduced capital requirements;
- Favourable fiscal status.

As regulators today consider the protection of savings as a basic duty, ideally the same should be true for access to finance. Further, in addition to mainstream commercial banks, establishing alternative financial institutions, which concentrate on

microfinance and access to financial services for low-income groups and excluded people, would be a great success. Introducing specific regulations for microfinance providers will foster these developments.

For example, Polish and UK banking regulation is very limited. With respect to microfinance there exist no obstacles. However, usury regulations are lacking in both countries, which is problematic with regards to consumer protection. Yet, this gap could be closed with a usury law similar to the existing German one. Here, interest rates are limited to more than double of the average interest rate in the sector (real estate, loan, etc.) or may not exceed it by more than 12% points. The French banking regulation took a different path. It opened a special window just for microlending. Microlenders are allowed to provide the first most risky and most expensive credit to an entrepreneur. Bank services are not replaced by this credit provision, rather the contrary holds true: potential clients are prepared for bank finance.

Financial bridges

Are mainstream financial services available for excluded groups and self-employed?

Policy measures, which enhance access to mainstream financial institutions, are:

- Risk sharing loan instruments (financial bridges);
- Tax incentives for investors (banks);
- Outsourcing of activities related to loan transactions.

4. Cadre légal

Comme la protection de l'épargne, l'accès au crédit devrait être considéré par les régulateurs comme un droit de base. Introduire des règles spécifiques en faveur des organismes de microfinance tournés vers les personnes à faibles revenus et les exclus est une manière appropriée de favoriser leur développement. Parmi les mesures envisagées, il y a des exigences en capital réduites et un statut fiscal favorable.

5. Ponts financiers

Dans un monde idéal, des institutions financières diversifiées existent et servent efficacement leur clientèle cible avec des produits adaptés. De plus, elles y sont encouragées par les autorités publiques et l'environnement réglementaire. Les mesures politiques qui améliorent l'accès aux institutions financières classiques sont : les instruments de crédit à risque partagé (ponts financiers), les incitations fiscales pour les investisseurs (banques), et la sous-traitance d'activités liées aux transactions sur les prêts.

Ideally a wide range of financial institutions should exist. In this ideal world, each of them is very successful in serving its target group with products specifically designed to meet their needs. In addition, financial institutions are interested in innovating and developing products and delivery systems that contribute to social inclusion, since this is supported by public authorities and the regulatory environment.

In Finland, the public finance institution Finnvera finances micro-clients. After successful repayment and growth these clients are transferred to banks and become included into mainstream banking. Spanish saving banks developed and established units within their mainstream banks, which specialise in providing micro-finance services. Caixa Catalunya for example possesses a special not-for-profit unit. Specialised loan officers are based within the general branches of the bank hence not only providing access to finance, but also providing the opportunity for a smooth transition from specialised microlending services to the mainstream.

Similarly, the European Bank for Reconstruction and Development has provided support to the Czech Raiffeisen Bank in order to develop a product for micro-businesses.

Funding and support for microcredit providers

Is microcredit supported through direct and sustained funding?

Policy measures for mixed and long term funding of microfinance are:

- *Tax benefits for investors;*
- *Promotion of risk capital instruments for microenterprises.*

Preferably, microfinance providers cover their costs through their financial operations. This, however, seems hardly achievable in Europe. On the one hand, government legislated interest rate caps at low levels hamper covering risk and loan transaction costs. On the other, the often-expressed need for further (non-recoverable) services such as business support services for its clients makes it difficult for the providers to become financially sustainable. As such, the success of microfinance providers depends and will continue to depend directly on a sustained funding concept. In this respect it is crucial that funding is secured on a long-term basis and if possible is a mix of different instruments and sources. To solve this problem public sources and (private) grants could compliment the self-generated income of microlenders. After all, the aim is to build bridges between mainstream institutions and socially excluded people. Performance ratings could help to ensure the cost-efficient use of funds.

For example, the Polish microlender Fundusz Mikro serves currently about 8,000 clients. With interest rates around 20% and default rates below 5% it became profitable after 3 years and sustainable after 4 years of operation. At its start, a donor grant of \$ 20 million enabled Fundusz Mikro to accumulate capital and receive commercial loans. Although

6. Financement et soutien pour les organismes de microcrédit

Il est nécessaire d'assurer un financement à long terme, si possible en faisant appel à une diversité de sources et d'investissements. A cette fin, fonds publics et prêts privés pourraient compléter les revenus propres des microprêteurs. Les mesures politiques pour un financement diversifié et à long terme sont : les incitations fiscales pour les investisseurs et la promotion d'instruments de capital-risque pour les micro-entreprises.

Au-delà d'être un outil pour les pauvres et les exclus, la microfinance est un moyen sérieux de financer les microentreprises et de promouvoir l'auto-emploi. La microfinance sert en fait de laboratoire pour de futures techniques bancaires.

the donor set clear goals, Fundusz Mikro was free to make its own decisions regarding implementation.

In Northern Ireland (UK) the micro-lender Aspire uses its margin of 11% (2004/05: interest of 18% minus average loan loss rate of 7%) to partly cover its transaction costs. Nevertheless it competes successfully with schemes that provide free subsidies in the area.

The French microlender Adie and the international bank BNP Paribas signed a mutual agreement and are therefore an attention-grabbing model for a private partnership in this sector. BNP Paribas re-finances the portfolio of Adie, takes over a share of risk, and pays the transaction costs in part in the form of a grant of 10% of the amount lent. This kind of financing package promotes efficient and effective lending schemes.

An instrument for employment

For years now the focus of EU policies has been to make its economy more dynamic and inclusive. In order to continue this process successfully the EU has to address the joint issues of unemployment and inactivity. In this respect, microfinance can be a valid instrument, especially for

bringing unemployed back into the employment and enterprise system by encouraging self-employment and micro-enterprises' development. Yet, microfinance should not be seen as a tool only for the poor and socially excluded. Rather, the opposite holds true. Microfinance is a valuable means of financing micro-enterprises and self-employed by developing new criteria for credit worthiness evaluations and new forms of relationship management systems to widen the scope of mainstream banking. Microfinance is in fact a laboratory for future banking techniques.

Still, the question remains, why is microfinance so often connected to the target group of poor and socially excluded? Maybe it is because they are the perfect barometer of success. On the one hand, they provide the possibility of measuring the success of a microfinance provider. But, on a wider scale, they help to determine how 'self-employment friendly' an environment really is. If a society is able to make it possible for its poorest members and for the ones (partly) excluded from social life to become re-activated into economic, political and social processes, then anyone who is willing should be able to start his or her own business. •

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