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# Policy measures to promote the use of micro-credit for social inclusion

**Study conducted on behalf of the European Commission DG  
Employment, Social Affairs and Equal Opportunities, unit E/2**

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# TABLE OF CONTENTS

## **PART 1 BACKGROUND AND BASICS**

---

<b>1</b>	<b>CONTEXT.....</b>	<b>1</b>
<b>2</b>	<b>RESEARCH METHODOLOGY .....</b>	<b>4</b>
<b>3</b>	<b>WHO ARE THE SOCIALLY EXCLUDED AND THOSE WITH INADEQUATE ACCESS TO FINANCE?.....</b>	<b>7</b>
<b>4</b>	<b>BARRIERS TO ENTERPRISE .....</b>	<b>12</b>
<b>5</b>	<b>PROVIDERS OF MICRO-CREDIT IN CASE-STUDY COUNTRIES.....</b>	<b>16</b>
<b>6</b>	<b>MICRO-FINANCE AND INCLUSIVE ECONOMIC GROWTH .....</b>	<b>20</b>
6.1	FACTORS THAT DETERMINE THE POTENTIAL OF MICRO-FINANCE .....	20
6.2	LESSONS LEARNED SO FAR .....	22

## **PART 2 DETAILED DIMENSIONS**

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<b>1</b>	<b>THE SIX DIMENSIONS.....</b>	<b>1</b>
1.1	ENTREPRENEURIAL CONTEXT .....	1
1.2	POLICY MEASURES PROMOTING MICRO-ENTERPRISES .....	6
1.3	WELFARE BRIDGE AND EMPLOYMENT POLICIES .....	12
1.4	LEGAL FRAMEWORK FOR MICRO-CREDIT AND RELATED SERVICES .....	18
1.5	FINANCIAL BRIDGE .....	22
1.6	FUNDING AND SUPPORT FOR MICRO-CREDIT PROVIDERS.....	26

## **PART 3 BUILDING BRIDGES**

---

<b>1</b>	<b>CONCLUSIONS .....</b>	<b>1</b>
1.1	TOWARDS AN IDEAL MICRO-FINANCE MODEL THAT CONTRIBUTES TO SOCIAL INCLUSION .....	1
<b>2</b>	<b>POLICY RECOMMENDATIONS.....</b>	<b>9</b>
2.1	DIMENSION 1: ENTREPRENEURIAL CONTEXT .....	9
2.2	DIMENSION 2: PROMOTING MICRO-ENTERPRISES.....	9
2.3	DIMENSION 3: WELFARE BRIDGE AND EMPLOYMENT POLICIES.....	10
2.4	DIMENSION 4: LEGAL AND REGULATORY FRAMEWORK FOR MICRO-FINANCE.....	10
2.5	DIMENSION 5: FINANCIAL BRIDGE.....	11
2.6	DIMENSION 6: FUNDING AND SUPPORT FOR MICRO-FINANCE PROVIDERS.....	11

## **PART 4 COUNTRY CASES**

---

<b>1</b>	<b>CZECH REPUBLIC .....</b>	<b>3</b>
<b>2</b>	<b>FRANCE .....</b>	<b>8</b>
<b>3</b>	<b>GERMANY .....</b>	<b>15</b>
<b>4</b>	<b>POLAND.....</b>	<b>22</b>
<b>5</b>	<b>ROMANIA.....</b>	<b>29</b>
<b>6</b>	<b>SPAIN.....</b>	<b>34</b>
<b>7</b>	<b>SWEDEN .....</b>	<b>42</b>
<b>8</b>	<b>UNITED KINGDOM .....</b>	<b>49</b>

**PART 1**

**BACKGROUND AND BASICS**

## 1 CONTEXT

In 2000 the European Council agreed on the implementation of the Lisbon Strategy, which aims to make the European Union the most competitive economy in the world by 2010, while maintaining its social cohesion.

The Directorate General (DG) Employment, Social Affairs and Equal Opportunities' unit for Social protection and social integration (E/2) of the European Commission facilitates the realisation of the Lisbon Strategy through an open method of co-ordination.

The key elements of the open method of co-ordination are:

- Common objectives on poverty and social exclusion.
- National Action Plans against poverty and social exclusion.
- Joint memoranda on social inclusion (definition of policy priorities).
- Joint reports on social inclusion (peer review, evaluation, monitoring).
- Common indicators to provide means to monitor progress and compare best practice.
- Community Action Plan to encourage co-operation between Member States.
- Studies contracted by the European Commission.

The present document is the result of this last type of activity under the open method of co-ordination and it seeks to identify policy measures to promote the use of micro-credit.

In the second set of National Action Plans 2003–2005 submitted by the Member States on 31 July 2003, micro-credit and related self-employment schemes were hardly mentioned as an instrument to promote social inclusion and generate employment. The joint report on social inclusion (based on an evaluation done in 2002 of the first set of National Action Plans (2001–2003), does not mention any action/project in the field of micro-credit. The same holds true for the pre-action plan (*Joint memorandum on social inclusion*) that was drafted by Poland and the Czech Republic in 2003. The Commission considers micro-credit as a possible effective instrument in employment and social inclusion programmes.

Economic growth with social cohesion as defined in The Lisbon Strategy seeks to involve and enable all European Union citizens to contribute to the realisation of growth. Policies should make participation in economic growth possible for those at risk of poverty and social exclusion.

Worldwide, micro-credit and related self-employment promotion schemes 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 through self-employment. This has led to the following objective for this study:

*The study seeks to identify and analyse the most effective policy measures in the area of access to micro-credit and the related combination of services for self-employment projects or micro-enterprise development offered to people facing poverty or social exclusion.*

The recently published progress report<sup>1</sup> on the realisation of The Lisbon Strategy states that the lack of firm policy measures is the main cause of the disappointing results in terms of

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<sup>1</sup> Facing the Challenge – The Lisbon Strategy for Growth and Employment by High level Group directed by M. W. Kok, November 2004.

economic growth and competitive advantages of the EU economy. The Strategy Report recommends that Member States focus on five priority areas in the coming five years:

1. Enhancement of the knowledge economy.
2. Completion of the internal market including enhanced competition in financial services market.
3. Creation of an enabling environment for businesses.
4. Creation of a flexible and inclusive employment market.
5. Implementation of environmental strategies that support growth and productivity in the Member States.

The current study feeds into objectives 2, 3, and 4 as it seeks to define policy measures that include those at risk of poverty in the economy through business creation, and access to appropriate financial products.

This study builds upon earlier studies and conferences related to micro-finance and self-employment (see virtual library of [www.european-micro-finance.org](http://www.european-micro-finance.org)):

- *Micro-credit European Conference: Paving the way to a micro-credit industry in Europe.* Conference organised by the DG Enterprise in collaboration with the European Microfinance Network (EMN), September 2004 in Brussels during which measures to improve the micro-finance sector were proposed.
- *Policy level response to financial exclusion in developed economies: lessons for developing countries<sup>2</sup>* is the latest report on policy measures that fight financial exclusion.
- *Micro-credit and Micro-enterprises: Fighting exclusion through self-employment.* Conference hosted by France presidency of the EU in December 2000, during which the need for enabling policies in micro-enterprise creation and micro-credit provision was assessed.
- *Micro-finance for self-employment: enterprise creation by the unemployed.* Conference and publication of ILO (International Labour Organisation) Social Finance Unit, 2000/2001 in which the credit gap for unemployed people entering into self-employment has been analysed and possible solutions have been proposed.
- *Micro-credit for small businesses and business creation: bridging the market gap* focuses on the provision of micro-credit and makes recommendations to enhance micro-credit provision. (DG Enterprise, 2003)
- *Micro-lending, a case for regulation in Europe* provides an overview of legal barriers for micro-finance and makes recommendations for an appropriate legal and regulatory framework. (DG Employment and Social Affairs, 2002)
- *Benchmarking in Micro-credit* compares eight successful micro-lenders in industrial countries and draws conclusions. (DG Enterprise 1999/2000)
- *Integration of the socially excluded through self-employment* studies the legal and regulatory framework for the integration of the socially excluded. (DG Research, 1999)
- *Benefit systems and active labour market policies* reports on the progress made in building bridges between benefit systems and labour market policies. (DG Employment and Social Affairs Unit A/2, 2004)

The added value of this research is that it seeks to identify bridges and barriers between the social welfare system, employment/enterprise system and financial system that already exist, can be abolished, or can be built. This integrated view on the different systems is, in

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<sup>2</sup> Kempson E., Atkinson A. and Pilley O., Personal Finance Research Centre University of Bristol, September 2004. See for other documents [www.pfrc.co.uk](http://www.pfrc.co.uk)

our opinion, necessary for turning self-employment and micro-finance into effective policy tools for social inclusion.

The terms 'self-employment' and 'micro-enterprise' are both used in this report. Self-employment is used to indicate the alternative to waged employment; micro-enterprise is used to indicate the size of the enterprise (less than five employees) as related to small and medium-sized enterprises (SMEs). In both cases the entrepreneur might be in need of micro-credit and related business development services. This study identifies the best policy framework for reaching that objective.

## 2 RESEARCH METHODOLOGY

We believe that this study's results are relevant to the open co-ordination method in which policy-makers have responsibility for the realisation of The Lisbon Strategy. We have developed a tool, a *matrix scorecard*, to be used by policy-makers from all Member States to facilitate the process of open co-ordination. It is presented through easy-to-interpret radar plots that show the relevant policy areas. Improvements in these policy areas provide the micro-entrepreneur with a more conducive environment for self-employment and micro-credit. It also shows policy-makers which countries have already designed and implemented policy measures for self-employment and micro-credit promotion. In using the matrix scorecard, policy-makers share and build their know-how and experience with their peers in other Member States.

The use of the matrix scorecard will lead to mutual learning and exchange of experiences and best practises among policy-makers. This process will contribute to continuous updating and fine-tuning of the scorecard itself. In other words we have developed the model and initial baseline data for the matrix scorecard; it is now up to the policy-makers to take the tool further and translate ideas and experiences into their own context.

The matrix scorecard is based on extensive literature research, expert interviews and practitioners' experience. It includes six dimensions of a favourable policy environment subdivided into approximately twenty sub-dimensions. Policy measures in all these areas could contribute to a more favourable environment for self-employment and micro-credit.

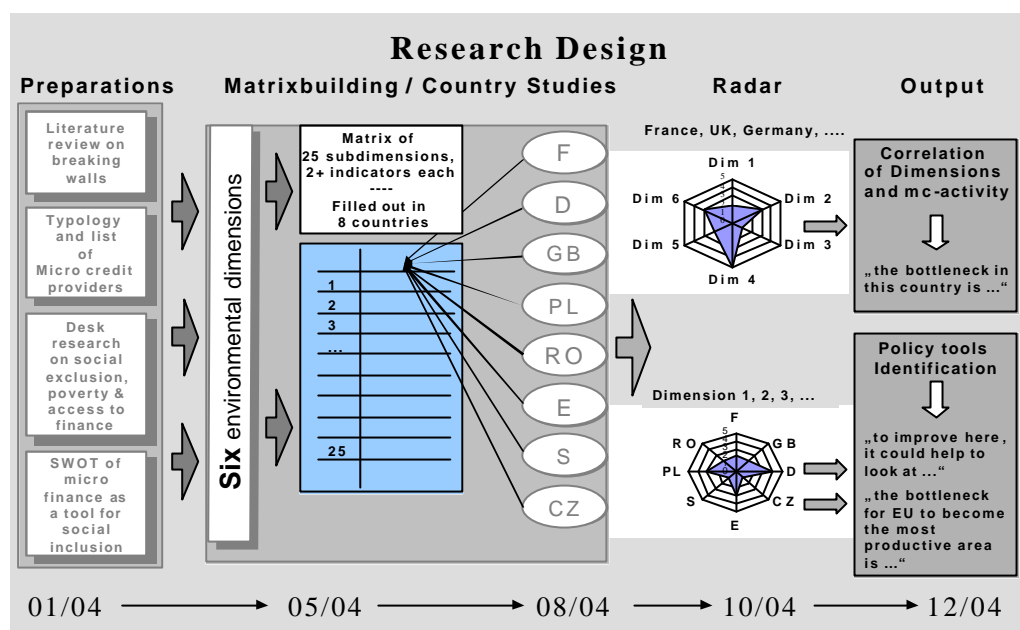
We determined indicators and scoring for each of the sub-dimensions and, after the finalisation of the country case studies, we calibrated the results in order to make sure that each team member scored on the same basis. The scoring is pictured in two types of radar diagrams:

1. **Radar diagram per country:** These radars are presented in Part 4 and indicate those areas the country that are conducive for micro-enterprise development and those areas that can still improve their policy framework. The examination of policies in other countries can help identify ways to overcome bottlenecks.
2. **Radar diagram per dimension:** These radars are presented in Part 3 and show the country that is most advanced in developing policy measures for that particular dimension. While the highest-scoring country can be an example for other countries, even low-scoring countries can be explored for good ideas and instruments.

The research consisted of five stages:

1. **Inventory:** Who are the socially excluded? Who are the entrepreneurial poor that have inadequate access to financial services? What are the barriers they face in accessing financial services and related services for self-employment and micro-enterprise development? Which organisations provide micro-credit?
2. **Analysis:** Which factors influence demand for and supply of micro-credit for self-employment? Building a matrix scorecard.
3. Eight country case studies.
4. Calibration of the matrix and final scoring.
5. Documentation of policy measures that work to make micro-credit an effective tool to combat social exclusion.

The research design is presented in Figure 1.



The following eight countries have been reviewed as part of this research: the Czech Republic, France, Germany, Poland, Romania, Spain, Sweden and the United Kingdom. Selection of these countries was based on three main criteria:

- 1) **State of micro-finance:** In most selected countries, there is strong interest from all sectors i.e. public, private and civil society in the use of micro-finance as a key tool for stimulating local development and employment. At the same time, the micro-finance sectors in the selected countries are at different stages of development, although all are at stages where learning of impact and policy can be derived. The delivery strategies also vary from specialised institutions and methodologies to more mainstream/general through public and banking sectors. In all selected countries public support measures are currently in place.
- 2) **Welfare model:** The selected countries represent different welfare state models, which allow for contextual analysis based on geographical setting, institutional arrangements, and historical experiences. The welfare models used have been best developed by Paul Abrahamson, and include the Southern European model, the Continental model, the Nordic model, and the Atlantic model.<sup>3</sup> Selection based on these different welfare state models will help analysis from an administrative, social and institutional point of view.

<sup>3</sup> Even though this classification is not undisputed as more and more agreement is reached on a welfare mix approach, it provides a good base for understanding institutional setting and historical factors, as they originate from different historical experiences and have developed along qualitatively different trajectories.

Table 1: Welfare models and selected countries

	<b>Countries selected</b>	<b>Criteria for entitlement</b>
<b>Southern model</b>	Spain	Need (contribution)
<b>Continental model</b>	France, Germany	Contribution
<b>Atlantic model</b>	Poland, Romania, UK, Czech Republic	Need
<b>Nordic model</b>	Sweden	Right

- 3) Linkages with key actors:** Selected countries have also been chosen based on the knowledge and contacts from the partners in the proposed consortium for this research.

### 3 WHO ARE THE SOCIALLY EXCLUDED AND THOSE WITH INADEQUATE ACCESS TO FINANCE?

This section unpacks the concept of the socially excluded and those facing poverty. It identifies the people that could be addressed with policy measures that promote the use of micro-credit and reduce barriers in becoming self-employed.<sup>4</sup>

At the Laeken European Council (December 2001) a first set of eighteen common statistical indicators that measure the risk of social exclusion was endorsed. This set of indicators allows monitoring in a comparable way of Member States' progress towards the objective to fight poverty and social exclusion in the EU. The indicators cover four dimensions of social exclusion: financial poverty, employment, health, and education. The common indicators now form a key basis for analysis and EU policy-making in the social area, given that Member States include them in their National Action Plans on social inclusion that are submitted every second year.<sup>5</sup>

In a recent report from the Dutch Social and Cultural Planning office an attempt is made to define the term social exclusion and to develop a model with characteristics and causes of social exclusion.<sup>6</sup> The model provides an insight into the characteristics of social exclusion itself instead of its risk factors. The model makes clear that social exclusion is not only a matter of having a low income; it also arises in cases where a low income leads to material deprivation (e.g. indebtedness, insufficient money to meet basic needs). Low income is therefore not a characteristic of social exclusion, but a potential cause of it.

The four dimensions of social exclusion identified at the Laeken European Council have been captured in the following list of characteristics of socially excluded people:

- 1) **Inadequate social participation:** a lack of participation in formal and informal social networks, including leisure activities; inadequate social support; and social isolation.
- 2) **Insufficient cultural/normative integration:** a lack of compliance with core norms and values associated with active social citizenship. This is reflected in a low work ethic; low willingness to be educated; abuse of the social security system or delinquent behaviour; deviating educational views; and deviating views on the rights and duties of men and women.
- 3) **Material deprivation:** shortages regarding basic needs and material goods; 'lifestyle deprivation'; problematic debts; and payment arrears (in particular housing costs).
- 4) **Inadequate access to government and semi-government provisions ('social rights'):** waiting lists and/or financial and other obstacles to health care, education (especially of children), housing, legal aid, social services, debt assistance, employment placement services and social security, but also to commercial services such as banking and insurance.

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<sup>4</sup> The lack of access to financial services for excluded people in general (not necessarily the potential self-employed) is a subject that is extensively surveyed and documented by different research institutions, notably the Personal Finance Research Centre in the UK and the Centre Walrus in France. This issue will not be addressed in this research.

<sup>5</sup> Eurostat Statistics in Focus, *Poverty and social exclusion in the EU*, 16/2004; Statistics in Focus, *Monetary poverty in EU Acceding and candidate countries*, 21/2003. The data were based on different years between 1996 and 2000.

<sup>6</sup> Hoff and Vrooman, *The poor side of The Netherlands*, results from the Dutch poverty monitor 1997–2003, Social Cultural Planning Office and Statistical Office, The Netherlands, June 2004.

It is clear that some of the characteristics mentioned above are an important barrier in becoming self-employed. Social exclusion is characterised by inadequate access to services (including financial) and problematic debts. Research in each of the Member States along these characteristics would assess the current degree and type of social exclusion in the country concerned. This would result in a better understanding of the characteristics of a person at risk of social exclusion and assist policy-makers in addressing the barriers in self-employment.

### Some statistics on social exclusion

In 2001, 15 per cent of the EU population was at risk of poverty, i.e. living in households with an income below 60 per cent of the median equivalent income of the country they live in.<sup>7</sup> Figure 2 shows the percentage for the countries involved in the research.<sup>8</sup>

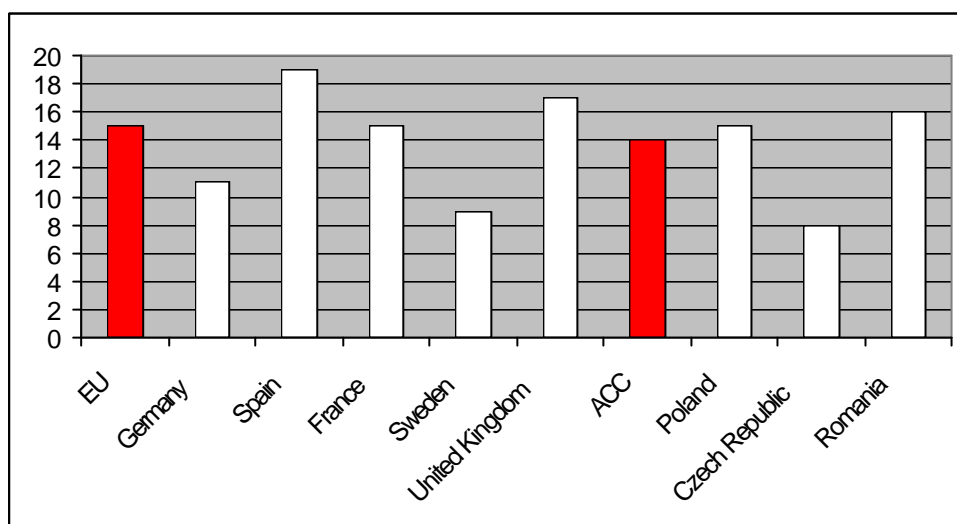


Figure 2: % of population at risk of poverty Eurostat, Statistics in Focus 16/2004; 21/2003

### Who are the socially excluded?

There is a remarkable resemblance between the investigated countries regarding to the groups at risk of social exclusion. The vulnerable groups in the majority of the European countries are: single parents, older people, youths, children, the disabled, immigrants, asylum seekers, minority groups, the homeless, drug addicts and those infected with HIV/AIDS.

*In **France** a special group of socially excluded people has been identified: the 'working poor'. These are people who are underemployed, active at least six months out of twelve, working for at least one month. and live in a poor household.*

### The causes of social exclusion

A major cause for social exclusion is **unemployment**, especially long-term unemployment. This often occurs in combination with other factors, such as low educational qualifications, age and cultural background.

<sup>7</sup> EU refers to the 'old' fifteen Member States.

<sup>8</sup> ACC refers to the ten 'new' and the two accession Member States of Romania and Bulgaria.

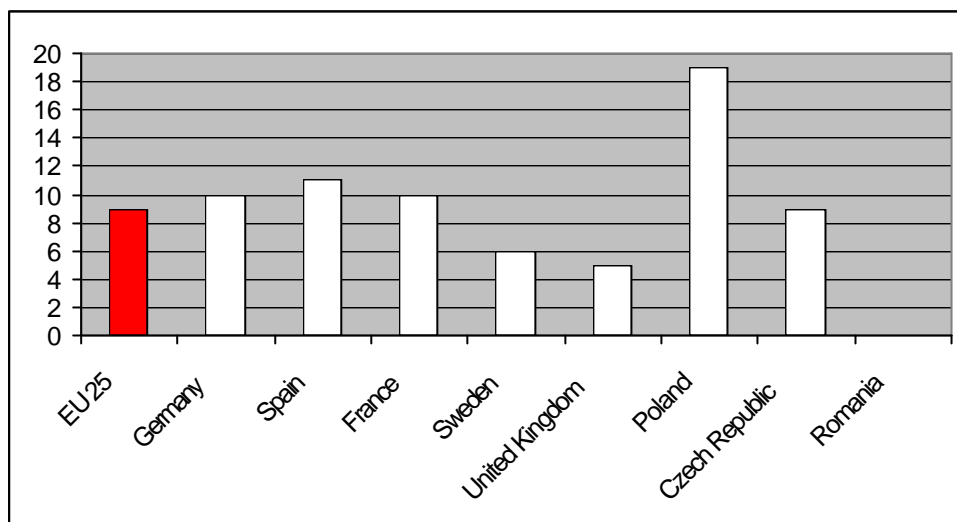


Figure 3: Percentage of unemployment in 2004, Eurostat, 'Euroindicators' 122/2004

Compared to other European countries, the unemployment rate in **Poland** is very high. Unemployment is identified as the main cause of poverty and social exclusion, especially related to youth and low education.

Social exclusion and poverty appears to be a **gender** problem. The majority of single parents are women. Lone mothers and single older women are more likely to have persistently low incomes and be more vulnerable to poverty. In most countries the unemployment rate for women is higher than for men. Related to this is the poverty risk of children.

Social exclusion in most countries has a clear relation to **age**. In many countries **youth unemployment** (16–19 years) is high and, in relation to the worsening economic circumstances in many countries, this group is increasingly at risk of poverty.

In **Germany** the age group between 16 and 24 has the highest poverty-risk rate in terms of relative income poverty. Roughly one in five of this age group lives in a low-income household, with young women being more affected than men (23.6 per cent of women vs. 19.9 per cent of men).

Besides the youngest, it is mainly **older people over 65** who live below the poverty line or are at risk of poverty. These people have small pensions and don't have additional sources of income.

Household composition is another factor that affects the risk of poverty. In many countries **large families** (more than three children) belong to the vulnerable groups.

**Ethnic and cultural factors** also play an important role in relation to poverty and social exclusion in many European countries. In some countries minority groups such as the Roma's (Spain, Poland, Romania, Czech Republic) have a higher poverty risk. In other countries, immigrants belong to the vulnerable groups due to lower levels of education and unemployment.

In **Spain**, immigration is a relatively new phenomenon. Since 1998 the number of immigrants has increased from 1.6 per cent of the total population in 1998 to 6.2 per cent in 2003. The main countries of origin are Morocco, Ecuador and Colombia. These new immigrants are at a higher risk of social exclusion.

Another characteristic of social exclusion is the **geographical dimension**. In most European countries there are large regional differences in social exclusion. In some cases the poverty risk is higher in specific regions or provinces; in other cases it is mainly concentrated in specific urban areas in larger cities. These concentrations are frequently found in inner cities in the UK whereas in France they are often in the suburbs (*les banlieues*).

The **self-employed** are also at risk. In some countries (such as France, Sweden and Poland) there are large numbers of self-employed in the agricultural sector. However, the poverty risk amongst the unemployed is much higher than amongst the self-employed.

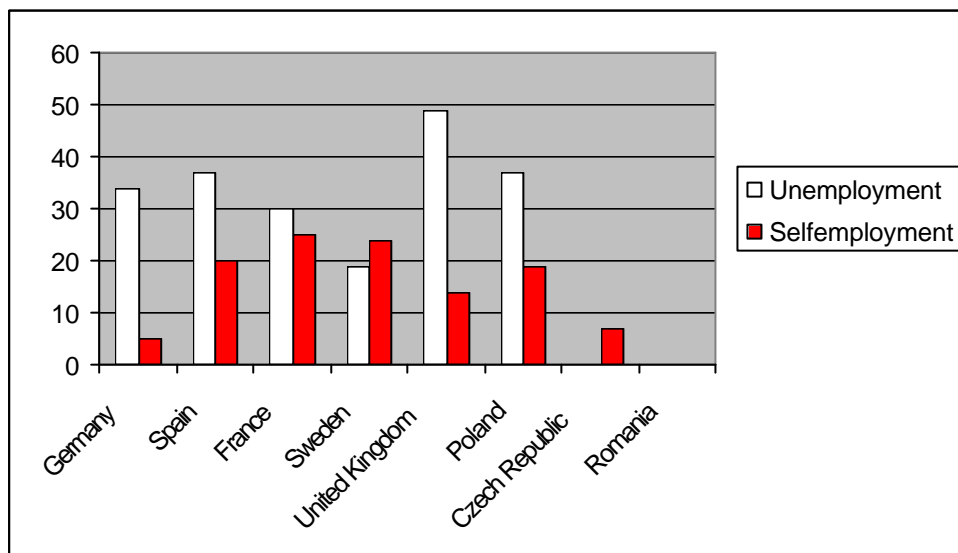


Figure 4: Risk of poverty rate of self-employed and unemployed

Source: Eurostat, *Statistics in Focus*, 'Poverty and social exclusion in the EU'. 16/2004

The objective of encouraging the unemployed to become self-employed as a means of overcoming poverty and social exclusion is not uncontroversial. Peter Brennan<sup>9</sup> wrote:

*"While some argue that it (self-employment) leads to self-exploitation and creates unsustainable businesses, others see it as an instrument of welfare reform, to help reduce public sector expenditure and the burden on social security systems. For some it is the bridge to more and better entrepreneurship, to expand the frontiers of the private sector, while to others it only increases the pool of working poor, those whose wages are too low to make a decent living and who end up taking on other income-generating activities. The ambivalence surrounding the notion of self-employment reflects the multiple policy objectives, which this type of measure is supposed to help achieve. It is, originally, a measure of active labour market policy, but other policy objectives have attached themselves to this primary purpose, such as regional or local economic development, private sector promotion, and entrepreneurship policy. This ambivalence is reflected in the terminology. The term 'self employment' suggests a labour market objective. The term 'micro-enterprise creation' suggests something qualitatively different; it is a more forward-looking concept with its emphasis on the creation of something that has not existed*

<sup>9</sup> Peter Brannen, Director ILO London in *Enterprise creation by the unemployed in Ireland: Role of micro-finance*, 2000.

*before. The former status may have been 'unemployment', but not necessarily so. The activity is interpreted more comprehensively, reaching beyond the labour contract to encompass a range of business functions."*

The present study focuses on self-employment and micro-enterprise creation as tools for social inclusion. Micro-enterprise is defined as an activity carried out by a person moving from unemployment or other inactivity into self-employment.

We have seen how socially excluded people are characterised by inadequate access to financial services and/or problematic debts. This is an important barrier for people who would like to become self-employed; micro-credit aims to overcome this barrier. The other characteristics of socially excluded people that form a barrier for self employment are often addressed through the provision of related services: assistance with administrative procedures and regulations, filling in of forms, creating access to government institutions, etc.<sup>10</sup> In this study we identify policy measures that make the environment more 'self-employment friendly'. An improved policy framework for self-employment would reduce the need for such 'micro-credit-related' services.

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<sup>10</sup> Street UK, First Step (Irl) and Adie (F) employ 'bureaucracy experts' to assist the self-employed in developing their activity.

## 4 BARRIERS TO ENTERPRISE

What barriers exist for those at risk of poverty or socially excluded in accessing financial services and related services for self-employment and micro-enterprise development?

Based on interviews and literature we conclude that the barriers in accessing financial services and related services for self-employment and micro-enterprise development are:

1. Barriers relating to individual circumstances.
2. Pre self-employment barriers.
3. Barriers between the different systems responsible for successful implementation of self-employment programs.
4. Barriers that result from poor exit strategies (bridges to mainstream institutions) of support programs.

### *1: Barriers relating to individual circumstances*

The main problems relating to individual circumstances are covered by the characteristics of socially excluded people mentioned in Part 3. More specifically, the problems identified are:

- Lack of self-confidence as a result of long-term unemployment or past experiences in work and employment.
- Lack of skills (language, technical, managerial) to start an enterprise.
- Cultural resistance against self-employment and entrepreneurship.
- Health-related barriers that make entrepreneurship difficult.
- Care responsibilities (e.g. for children, the elderly and people with disabilities)
- Other family barriers (e.g. women prevented from setting up a business by their husbands).

### *2: Pre self-employment barriers*

If a person is able and willing to start a micro-enterprise, the following barriers exist before that creation becomes a realistic option:

- The inactivity trap: people who want to start their activity are afraid of losing their low but stable income, such as welfare or disability benefits.
- The self-employed contribution to social security systems can be so high that it is a deterrent.
- Information asymmetries and the lack of one-stop assistance (one person/mentor/coach) for start-ups.
- Blacklisting: if an earlier attempt to start a micro-enterprise fails or another registered misfortune occurs, it is difficult to get access to services, especially for ex-detainees, people included on a credit register or a register of misuse of a bank account.
- The need for a business plan as a condition for accessing finance.
- Banks with high productivity and international access to capital markets set a minimum loan size often exceeding the amounts needed by self-employed people or start-ups. While the minimum loan size aims to save costs and increase profits, banks increasingly withdraw loan availability from those who need small amounts.
- Regulatory requirements for business creation and registration can form important barriers to self-employment.

3: *The existence of barriers between the systems that should make micro-credit and self-employment work.*

The different actors that determine the environment in which micro-credit and self-employment instruments work are:

- *Social welfare systems*  
Traditionally the social welfare organisations' primary objective was to provide a minimum income base to those unable to earn their own income. The focus was less on moving people out of the social security system through employment or self-employment. Over the past few years, as social security systems become too expensive and the need to make better use of the decreasing available human capital in Europe increases, many Member States are focusing on getting people out of the benefit system into the labour market. The new Member States that have not yet built up a comprehensive welfare system are engaged in processes to bring their systems in line with the older Member States.
- *Employment agencies / enterprise systems*  
The primary objective of most employment agencies is to find jobs for unemployed people. In some countries they also ensure that unemployed people receive benefits. While traditionally their focus has been on finding waged employment, most labour market policies also focus on matching unemployed people with jobs.
- *Financial systems*  
The financial sector's primary objective is to safeguard people's money and to invest the entrusted funds in low-risk, high-yield projects. The focus on low risk and high yields traditionally excludes the financing of small and micro-enterprises because these projects involve high risks and profits that do not compensate for these risks.

From the above simplified picture of the three systems involved in making micro-credit work we conclude:

*Diverting objectives and attitudes vis-à-vis those at risk of poverty vary between:*

- Preventing poverty through provision of minimum income.
- Finding waged employment for those to be found 'employable'; if too difficult to find match no further action is taken.
- Avoiding risky clients that might misuse their bank account or not repay their credit.

*Different actors are responsible for success:*

The level of intervention of the different actors varies depending on the welfare model. In each country, the State, local authorities, social partners, private sector, semi-public organisations, NGOs and associations play different roles in the three systems. Making micro-credit work means mobilising different actors depending on each Member States' system.

The contrasting objectives and variety of actors often lead to barriers between the three systems which prevent micro-finance working for those at risk of poverty as illustrated in Figure 5.

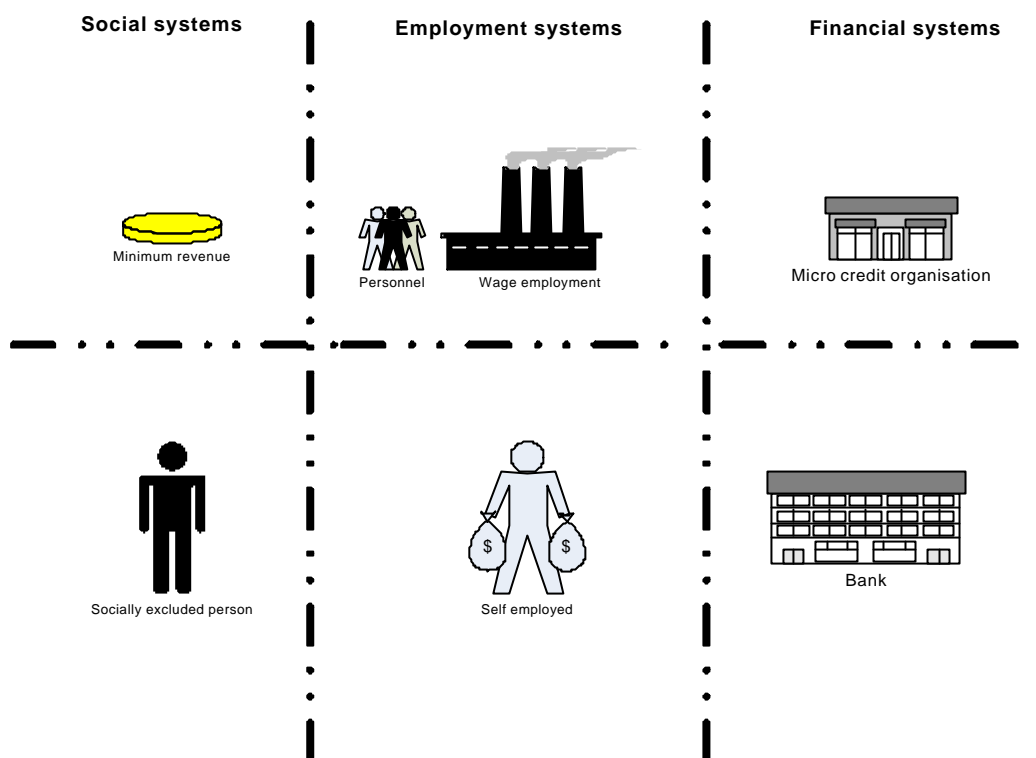


Figure 5: Barriers between social, employment and financial systems

Figure 5 identifies the following barriers:

The barrier between the social system and employment/enterprise system caused by:

- **The carousel effect or revolving door.** Where participation in an active labour market policy serves mainly to re-qualify participants for benefits rather than to help them acquire a job, the move from unemployment into sustained work does not take place (e.g. this effect used to exist in Sweden).
- **The inactivity trap.** If social welfare benefits are higher than the potential earnings that can be obtained in self-employment or waged employment, the incentive to search for an activity decreases (e.g. France, Sweden, and Germany).

The barrier between wage employment and self-employment caused by:

- The bias towards waged employment by employment agencies (e.g. Spain, France, Germany, Sweden, UK, Poland).
- Wage-related benefits, like insurance against unemployment, and pensions are lost in the transition to self-employment.
- Loss of stable income in case of self-employment.
- Difficulty in getting higher revenue compared to social benefit at the beginning of the business.

The barrier between self-employment and business support agency caused by:

- Business support agencies that have a strong bias towards developing services for SMEs rather than for micro-enterprises, not to mention socially excluded micro-starters.

- Situations where too many scattered initiatives exist so that a person who wants to become self-employed will not get the assistance needed.
- Short-term interventions that cannot be sufficiently promoted and understood by the target group. In this case the programme does not reach the potential self-employed person.

The barrier between micro-finance organisations and banks caused by:

- Micro-credit being provided by organisations exclusively focusing on those at risk of poverty without involving banks. Clients will continue to be detached from the mainstream financial sector, leading to a marginalisation (exclusion) of those in poverty.
- Banks not being interested in the market of small loans thus ensuring that a referral system for micro-finance clients will not work.

The barrier between micro-enterprise support organisations caused by:

- Conflict between the aim of supporting weak entrepreneurs and the need to build financial sustainability by lending to strong entrepreneurs.
- Lack of collaboration between Business Development Services and institutions providing finance.
- Lack of co-ordination between different support programs.

The barrier between socially excluded people and social systems that provide minimum revenue caused by:

- Lack of 'social rights'. Socially excluded people do not have access (or have difficulty in getting access) to social and other services (e.g. homeless people and illegal immigrants).
- The ending of minimum income during the starting period of self-employment.
- Complicated administrative procedures or transitions from one benefit system to another that can make people drop out of the system.
- A cultural clash for the public-authority employee when an assistance-dependent person wants assistance to become an independent entrepreneur.

*Support programs often lack bridges to mainstream institutions*

Most support programs focus on the start-up phase and on soft and income support for the self-employed person. Within support programs, barriers are manifested as a lack of exit strategies. For the smooth transition from a supported self-employed person to an independent self-sufficient entrepreneur, two transitions need to take place:

- 1) The transition from income support to enterprise earnings capable of meeting household income needs. These may be supplemented with low-income tax credits or other benefits.
- 2) The transition from support programs to bank and business advisory access to fulfil the financial and business development services needs of the enterprise.

Barriers can result from the limited duration of financial support, which leads to a situation in which:

- The enterprise does not yet generate enough income to assure sufficient household income and access to commercial business development services.
- The track record built up with the micro-finance support program is not yet strong enough to assure bank financing.

These issues have been pointed out in several studies, notably in the ILO research: *Enterprise creation by the unemployed: the role of micro-finance*.<sup>11</sup>

*"The micro-enterprises most frequently launched by the unemployed are in service sector activities such as retail, repair, catering, personal and business services, all of which do not require much capital but do require more initial investment than the unemployed individual or welfare recipient can usually mobilise out of personal savings or liquidation of other assets. This credit/equity gap exists at the creation of the micro-enterprise, when public or private assistance comes in, and even more seriously, once this assistance ends and as long as the new entrepreneur has failed to establish stable relationships with a bank. In many Member States this transition period is too short, (e.g. UK where it is only 6 months). This is especially so for working or development capital and stands in marked contrast to the provision of income support and other forms of soft business support. However, like income support, soft supports tend to be primarily focused on the start-up phase, with business starters finding their developmental needs less well responded to. Consequently, as their businesses develop, the self-employed find their income support decreasing and ultimately withdrawn at the same time as the provision of soft supports declines and their need for development capital goes unmet. This is a difficult scenario, worsened by the lack of integration between providers, and appears to be a factor in the failure rate and in the vulnerability of a component of survivors."*

## 5 PROVIDERS OF MICRO-CREDIT IN CASE-STUDY COUNTRIES

This section defines micro-credit, the challenges faced by the sector, and identifies the providers of micro-credit in the case-study countries.

The members of the EMN share a common way of looking at micro-finance in Europe and agree on the following charter:

- The goal of micro-finance is to give access to financial services to those who are financially excluded.
- The maximum amount of a micro-loan is set to €25,000.
- These loans are used to finance investment or cash flow for the start-up or the development of existing businesses (some micro-lenders focus on one or the other).
- Micro-lenders often, but do not always, offer additional business consultation or support to the micro-businesses they finance.
- Financial and operational sustainability is targeted but may vary across micro-lenders, and depend on the vision of sustainability (see Part 2 Dimension 6) and diverse factors, such as the amount of consultation services offered, the economies of scale that can be achieved linked to the size of the portfolio, and the interest rates that are (and can be legally) charged from country to country.
- Extension of micro-credit is almost never secured by collateral. Micro-lenders have therefore developed a number of innovative practices to reduce risk of default and ensure repayment, including extension of stepped loans and peer-group lending.

Micro-credit has proven to be an efficient and effective tool for promoting entrepreneurship, a key catalyst for individuals willing to create and develop their own business. The next step is to use micro-credit as a more accessible instrument to facilitate European growth, competitiveness and cohesion. In Europe, more than 90 per cent of enterprises are small enterprises. Moreover, there is a growing trend towards the creation of one-person self-employed businesses. Such businesses have specific financial needs: those who require

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<sup>11</sup> Duggan Carmel et al., *Enterprise creation by the unemployed in Ireland: role of micro finance*, ILO London, 2000.

external financial resources often request small amounts. This is a challenge for the financial sector. Many of these small businesses face difficulties in accessing credit, in particular micro-credit.

The deficiency in credit provision to small enterprises is often explained by its high transaction cost partially caused by non-conducive policy frameworks and the financial providers' perception of a high-risk and low-return activity.

To overcome these difficulties and build an efficient micro-credit industry, the recently held Conference on micro-finance<sup>12</sup> endorsed the following conclusions and recommendations in the field of micro-finance promotion:

- To favour the small-enterprise environment by reducing administrative burdens and adapting tax and social insurance packages to their specificities and constraints.
- To improve the legal and regulatory framework for micro-credit, in particular the limitations of giving loans as a non-bank in all European countries apart from a few such as UK, Ireland and France. Where necessary, the impact of the usury rate should be assessed as it has a direct effect on micro-credit providers' ability to get an appropriate return from their activities.
- To promote micro-credit in Europe by disseminating best practices.
- To strengthen networking and co-operation between micro-credit organisations and business support services.
- To provide technical assistance and training programmes to the various organisations involved.
- In the case of public support to micro-finance institutions, funds should be granted on the basis of a multi-annual rather than yearly agreement to help them achieve the sustainability of their micro-credit activities.
- The micro-credit guarantee facility, under the Multi-annual Programme (MAP) for enterprises and entrepreneurship, managed by the European Investment Fund on behalf of the European Commission, has continually demonstrated its impact and added value and should be pursued in the future.
- To achieve better synergies between the MAP financial instruments and those of European regional and social development funds.
- To monitor the progress of micro-credit activities in the EU on a regular basis.

The micro-finance providers in the eight case-study countries show a large variation in size, legal status, client groups, products and services delivered, and funding. Many providers cannot be seen as full micro-finance institutions (MFIs) due to size, outreach, sustainability and design. The following types of institution have been identified:

1. Non-governmental, specialised micro-credit institutions such as:

- ⇒ Association pour le Droit à l'Initiative Economique ADIE (F)
- ⇒ Opportunity International (RO)
- ⇒ HIRO Association Help Integra (RO)
- ⇒ Inicjatywa Mikro (PL)
- ⇒ Fundusz Mikro (PL)
- ⇒ Fundacion Un Sol Mon (E)
- ⇒ The Prince's Trust (UK)
- ⇒ Aspire Micro-finance (UK)
- ⇒ Siebte Säule, Monex, and others (D)

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<sup>12</sup> Conference on micro-credit 21-23 September 2004 in Brussels organised by DG Enterprise in collaboration with EMN, MFC and NEFI (Network of European Financial Institutions for SMEs).

2. Specialised banks for small enterprise financing or banks with a micro-finance window such as:

- ⇒ Banque du développement des petites et moyennes entreprises (F)
- ⇒ KfW Mikro-Darlehen and Startgeld issued through the banking sector (D)
- ⇒ MIRO Bank (RO)
- ⇒ Crea tu empresa: Caja general de Ahorros de Granada (E)

3. Public institutions that provide micro-finance such as:

- ⇒ ARP-Kredit Berlin, Starthilfe Baden-Württemberg, BWA Hamburg, ProGES Kassel, Starthilfefonds Bremen (D)
- ⇒ France Initiative Réseau (F)
- ⇒ Instituto de Crédito Oficial (E)

4. Co-operative financial institutions such as:

- ⇒ SKOK (PL)
- ⇒ JAK Bank (S)

It is not yet possible to provide a comprehensive overview of the portfolio and outreach of these providers; in most cases they are new to micro-credit provision. The EMN, whose creation has been supported by the European Commission (DG EMPL), has just completed a survey of over 32 organisations in Europe that provide micro-credit. The results of this survey, which was conducted by **nef**, will be published in early 2005 (see [www.european-micro-finance.org](http://www.european-micro-finance.org)). Some of the findings are:

- Between January and December 2002 the MFIs in the survey made a total of 9,117 loans, which increased to 10,351 loans in 2003. The breakdown of the number of loans made is shown in Figure 6.

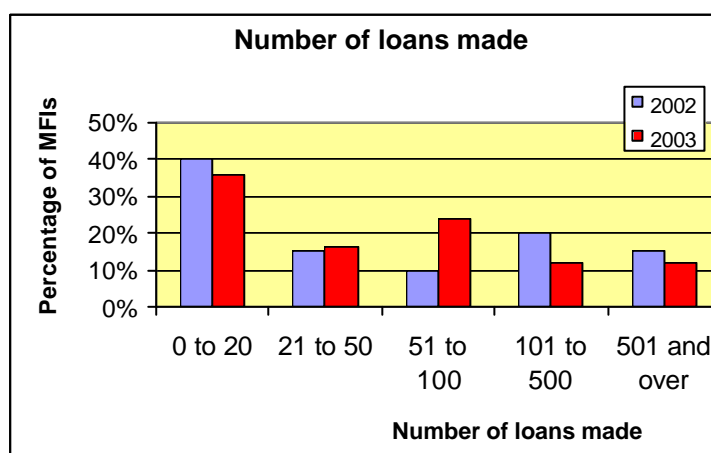


Figure 6: Number of loans made by MFIs surveyed 2002/2003

- Fifteen MFIs supplied information on their outstanding loans as at the end of December 2003. The average was €1,468,608. This excludes a very large national fund with outstanding loans valued at €142.1 million.
- Eighteen MFIs supplied information on the number of active borrowers as at 31 December 2003. The total number of active borrowers was 26,223; however, 25,000

of these were clients of just two MFIs. The majority of funds had a much smaller number of active borrowers and, in fact, more than half of the MFIs (56 per cent) had less than 50 active borrowers.

- There are two clear groupings of MFIs in terms of loan sizes – those making loans of up to €5,000 and those making loans of between €7,500 and €10,000

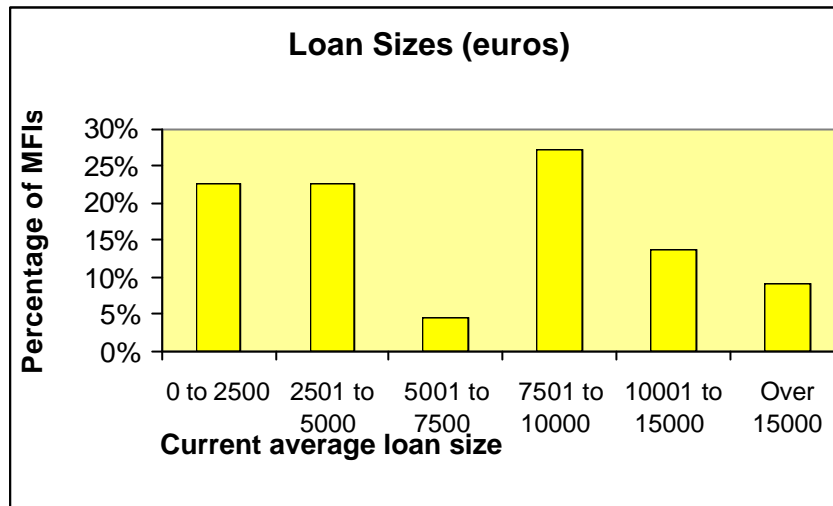


Figure 7: Average loan size in euros

## 6 MICRO-FINANCE AND INCLUSIVE ECONOMIC GROWTH

### 6.1 Factors that determine the potential of micro-finance

#### *Welfare model*

The contribution micro-finance and policy measures can make to prevent or mitigate effects of social exclusion through self-employment and micro-enterprise development in any specific country depends on the prevalent socio-economic model. The welfare model determines the main actors in social welfare and employment/enterprise systems (the social model or welfare diamond described below)<sup>13</sup> and therefore determines the possibility for collaboration and reduction of barriers. Each of the models has varying forms and degrees of inactivity traps and credit gaps that need to be transformed into welfare and financial bridges.

These main actors, who should be targeted with the policy measures that will be presented in this study, can be summarised as follows:

Table 2: Welfare models and its main actors

Socio-economic model	Main actors	Sample country
Atlantic model: limited, poverty-oriented emphasis, with moderate welfare expenditures.	Market and private sector. Entitlements based on needs assessment, with citizens expected to take care of themselves through market activities and family.	UK
Southern model: less developed variation of the continental model. Welfare expenditure moderate and from various sources.	Emphasising the subsidiarity principle giving priority to family and local community and church when trying to satisfy needs of citizens.	Spain
Nordic model: citizens granted extensive social rights. Welfare expenditure high.	Strong emphasis on personal social services organised and financed by regional bodies combined with state.	Sweden
Continental model: affiliation to labour market pivotal for social benefits and services. Welfare expenditure high.	NGOs, specialised semi-public agencies and important role for social partners.	France, Germany

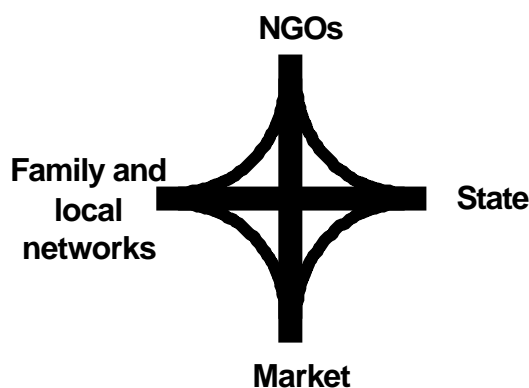
Lines between the four distinct socio-economic models in the EU are becoming increasingly blurred, as countries recognise that no one approach has delivered unqualified success in achieving desired outcomes of poverty reduction, social inclusion and full employment in a financially sustainable way. These models, Abrahamson argues, are thus becoming a thing of the past as member states increasingly look for a pluralistic welfare approach based on a mixture of the four major primary socio-economic models. It is expected that the new Member States like Poland and the Czech Republic and accession countries like Romania are in the process to design their welfare model along these lines.

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<sup>13</sup> Harrison, Andrew, *Current Issues in Business*, 2004.  
 Espening-Andersen, G., Gallie, D; Hemerijck, A. and Myles, J., *A New Welfare Architecture for Europe?* Report submitted to the Belgian Presidency of the European Union, 2001.  
 Abrahamson, Peter, *Futures of the European Social Model*, 2000.  
 Ferrera, M., *Modèles de solidarité, divergences, convergences: perspectives pour l'Europe*, 1996.

Thus, "...where the liberal tradition pointed to the market as the major institution, the conservative tradition pointed to the family, and social democratic tradition pointed to the public sector, the welfare mix emphasises cooperation between these three institutions and the development of new institutions based on partnerships among them". This means various combinations of delivery mechanisms; including market actors, the public sector, voluntary organisations and families and local networks. In other words, a mix of institutions within what Abrahamson describes as the "Welfare Diamond" (see Figure 8)

**Figure 8: The Welfare Diamond**



This research identifies good practices from the different models, which could be useful for countries with differing social models.

*Environmental factors to consider*

We identified six dimensions that determine the potential of micro-credit and self-employment as a tool to realise economic growth with social cohesion. They are:

1. **Entrepreneurial context:** How entrepreneurial is the society and how much does it support its entrepreneurs?
2. **Policy environment for micro-enterprises:** Are there policy measures that promote self-employment in general, and for socially excluded in particular?
3. **Welfare bridge:** How developed is the system for taking people from unemployment to employment (including self employment)?
4. **Legal framework for micro-finance:** Is there a supportive legal framework for micro-finance services?
5. **Financial bridge:** Are financial services available for excluded groups and self-employed?
6. **Funding and support for micro-credit providers:** Are MFIs supported through direct and sustained funding?

These dimensions are translated into sub-dimensions and related indicators in the matrix scorecard, which will be described in detail in the following sections. The matrix scorecard is a tool to assess the extent to which the environment in each country is favourable for micro-credit as a tool in creating inclusive economic growth. Micro-credit also contributes to innovation in the financial sector as it seeks to develop methods that will make small lending feasible and profitable. These innovations are important for the competitiveness of the EU economies, indirectly contributing to welfare improvements.

The micro-credit and related business support measures can only contribute to inclusive economic growth if there is a demand for it and if a sustained supply becomes available. This analysis leads to the followings key questions that need to be answered by each policy-maker who thinks of micro-credit as a tool in her/his Member State:

*Demand-related factors:*

- Are socially excluded people potential entrepreneurs?
- Does the social system guide socially excluded people towards the (self) employment/enterprise system? If so, how? Is there a bias towards promoting wage employment (vs. self employment)
- What are the incentives and disincentives for the socially excluded to move from the social system to self-employment?
- How is the business environment for the self-employed, are 'bureaucracy experts' needed to guide potential self-employed through rules and regulations?
- Are there micro-credit services available?

*Supply-related factors*

- Is there an awareness of micro-credit and its potential for self-employed people at the financial institution level?
- What are the possible incentives for the financial system (banks, credit unions) to provide services to the self-employed?
- Is micro-credit provision allowed under the current bank law and if so by whom? Banks, non-banks? What are the conditions and barriers? How about fair/unfair competition?
- What is the feasibility of sustainable micro-credit provision? How can micro-credit-related costs decrease and default and credit risks be managed?
- What funding opportunities are available to make micro-credit successful?
- How can the negative effects (indebtedness and predatory lending) of micro-credit be avoided?

## **6.2 Lessons learned so far**

Micro-finance can be a successful tool for social inclusion if demand and supply factors are matched. The following questions arise:

- Do integrated self-employment promotion programmes for the socially excluded exist? Who provides funding? What is their intention? What is the role of micro-credit and related services?
- Do different systems (social, employment and financial) collaborate to promote self-employment of the socially excluded?
- To what extent are the different instruments (business development services and financial services) complementary and synergic?
- Are other services needed (coaching, training, marketing, advice) to make micro-credit an effective instrument for self-employment in case the policy environment becomes more self-employment friendly?

Derived from literature and practitioners' information, a SWOT (strengths, weaknesses, opportunities and threats) analysis of micro-finance as a tool to promote inclusive economic growth is shown in Figure 9.

This SWOT indicates:

1. What micro-finance can achieve under which conditions (strengths).
2. What improvements are needed for more effective and efficient implementation (weaknesses).
3. How policy measures can enhance the strengths of micro-finance (opportunities)
4. Which pitfalls should be avoided (threats).

<p style="text-align: center;"><b>Strengths</b></p> <ul style="list-style-type: none"> <li>• Encourages forums for informal economy</li> <li>• If well implemented provides good value for money per job /enterprise</li> <li>• Fosters entrepreneurship</li> <li>• Possible to reach difficult-to-reach target groups</li> <li>• Could graduate people to bank lending (mainstreaming)</li> <li>• Empowers and provides positive personal development</li> <li>• Creates social capital</li> <li>• Increases tax revenue while decreasing social welfare payments</li> <li>• Recycles public money / creates revolving funds</li> <li>• Important for micro-enterprises economic growth</li> </ul>	<p style="text-align: center;"><b>Weaknesses</b></p> <ul style="list-style-type: none"> <li>• Too many small-scale operators</li> <li>• Hardly any effective and efficient blueprints available; lack of performance standards</li> <li>• In many cases poor implementation, especially low number of loans and small geographical coverage</li> <li>• Difficult to operate in welfare states with deep inactivity trap</li> <li>• Lack of awareness and absence of performance standards for industry</li> <li>• Non-recoverable business support costs or non existence of appropriate Business Development Services for micro-enterprise</li> <li>• Limited range of products available</li> <li>• Financial bridge is not working: graduation of clients to commercial banks does not work</li> <li>• To be self-sufficient you need volume and high pricing</li> </ul>
<p style="text-align: center;"><b>Opportunities</b></p> <ul style="list-style-type: none"> <li>• Changes perception of self-employment and micro-enterprise (from a problem to an asset)</li> <li>• Transforms welfare society into inclusive society</li> <li>• Fosters sector development approaches (i.e. cultures, social enterprise)</li> <li>• Identifies the most effective micro-finance models for specific context</li> <li>• Combination of ESF and ERDF funds</li> <li>• Better integration with local development approaches</li> <li>• Diminishes role of loan sharks</li> <li>• Improves understanding of active labour market policy</li> <li>• Increases availability of local services providers</li> </ul>	<p style="text-align: center;"><b>Threats</b></p> <ul style="list-style-type: none"> <li>• Wrong expectation to be the solution for rescuing the poorest of the poor</li> <li>• Over-indebtedness and other negative side-effects if poorly implemented</li> <li>• Public support without appropriate models and environment will deliver disappointing results</li> <li>• Inappropriate actors entering the market (i.e. enterprise agencies, local authorities, predatory lenders) causing lower outreach for 'professional' MF operators</li> <li>• Short-term view inhibits sustainability</li> <li>• Market distortion (subsidies) destroys good practise</li> </ul>

*Figure 9: SWOT of micro-credit as a tool to promote social inclusion*

**PART 2**

**DIMENSION DETAILS**

## 1 THE SIX DIMENSIONS

This section describes and analyses the six dimensions of the radar diagram and the findings of the country studies. Each section consists of:

1. Relevance of indicators
2. Scoring explained
3. Most interesting and important issues
4. Good and improvable policies and practices

Each issue is illustrated with examples from the country case-study findings. As we did not assess the efficiency or effectiveness of the policy measures identified, we have not expressed an opinion on the policy measures presented.

### 1.1 Entrepreneurial context

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

Relevant indicators used to assess the entrepreneurial context are:

- 1) Economic prosperity: GDP growth and number of business start-ups.
- 2) Entrepreneurial culture: Number of self-employed people and attitude towards entrepreneurship.
- 3) Diversity of entrepreneurship: Are people at risk of poverty represented?
- 4) Size of informal sector.

We chose these four sub-dimensions to assess the entrepreneurial context and culture in the different Member States. These indicators relate to the question of whether people in general, and those at risk of poverty in particular, are entrepreneurial and whether the macro-economic situation is favourable for business creation.

In this dimension we make a distinction between self-employment out of necessity (push) and self-employment out of opportunity (pull).

If an individual wants to pursue a business opportunity he/she is pulled into self-employment. On the other hand, if the individual has no other way to earn an income other than to become self-employed, he/she is pushed into self-employment. We consider pulled self-employment as a factor positively contributing to the entrepreneurial context. In a country like Romania, where 23 per cent of the population is self-employed, we cannot conclude that people are entrepreneurial because, to a large extent, it is the decrease in and the lack of waged employment that has pushed people into self-employment.

A large informal sector can be explained in two ways:

- 1) Many people want to start an enterprise (positive score).
- 2) The administrative procedures or inactivity trap make it unattractive to enter into the formal business sector (negative score).

### 1.1.2 Scoring of countries

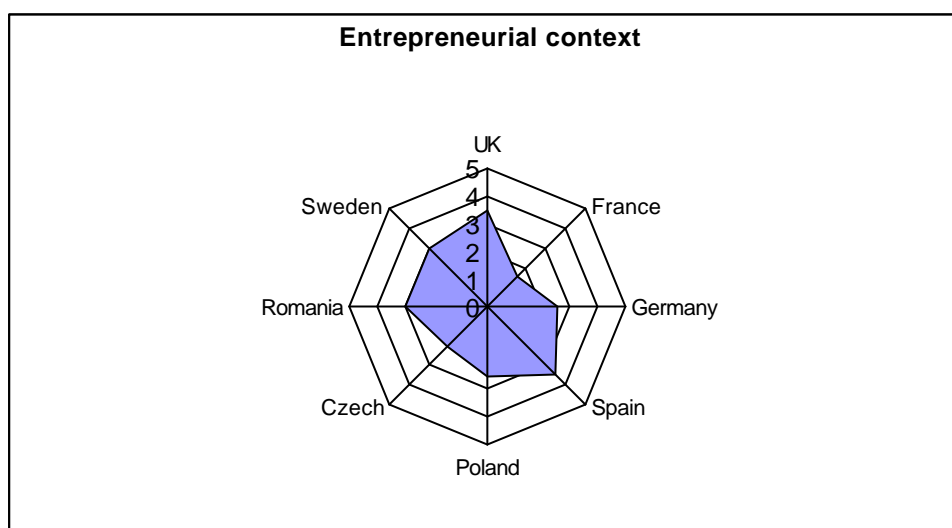


Figure 10: Entrepreneurial context

Table 3: Scoring explained

Country	Argument
UK 3.5	GDP growth is good; good scoring in GEM <sup>1</sup> study; informal sector is small (but because it is easy to be formally self-employed it is, in fact, a good thing).
France 1.5	Low GDP growth, low score in GEM report (31 out of 31), high number of university management programs but mainly geared towards management functions in large companies. Low number of start-ups.
Germany 2.5	GDP growth was decreasing, start-ups minus deregistered companies was not high. Positive: High rates of unemployed moving into self-employment (mix of necessity and opportunity). Diversity weak: potential of migrant and women entrepreneurship is unmet.
Sweden 3	Low GDP growth. Over-representation of migrants in self-employment; large informal sector.
Romania 3	High GDP growth but off a very low base; high number of self-employed but mainly out of necessity and in agriculture; large informal sector (because employers' contributions to labour costs are so high that they employ workers informally).
Poland 2.5	High number of self-employed but mainly out of necessity and in agriculture; good economic prosperity; large informal sector.
Czech Rep. 2	High GDP growth; high number of self-employed but mainly out of necessity and in agriculture; large informal sector. Lack of data; research should be done to find out what the issues in self-employment development are.
Spain 3.5	High GDP growth; high score in GEM survey; high number of start-ups (and increasing).

Table 4: Annual GDP growth in period 2002–2004:

	UK	France	Germany	Sweden	Romania	Poland	Czech Republic	Spain
2002	1,8%	1,2%	0,2%	1,9%	4,9%	1,3%	2,2%	2,0%
2003	2,2%	0,5%	-0,1%	1,5%	4,9%	3,8%	2,9%	2,4%
2004	2,2%	2,4%	1,7%	2,4%	5%	6,9%	3,6%	2,6%

Source: divers

<sup>1</sup> GEM: Global Enterprise Monitor, yearly published statistics on enterprises and their environment.

Table 5: GEM ranking:

	UK	France	Germany	Sweden	Romania	Poland	Czech Republic	Spain
National proportion of Nascent Entrepreneurs	3,44% Rank <b>18</b> out of 31	< 1%, Rank <b>31</b> out of 31	3,49%; Rank <b>17</b> out of 31	2,03%, Rank <b>26</b> out of 31	n.a.	3,67%, Rank <b>20</b> out of 37 (GEM 2002)	n.a.	4,39%, Rank <b>12</b> out of 31
Support of entrepreneurial skills and attitudes by the primary and secondary educational system	Rank <b>12</b>	Rank <b>31</b>	Rank <b>25</b>	Rank <b>21</b>	n.a.	n.a.	n.a.	Rank <b>23</b>

### *The highest score*

Spain has a high score on entrepreneurial culture but that should be seen in the context of the push against pull self-employment mentioned earlier. Entrepreneurship in Spain has grown out of necessity (push) because:

- The social security system is very basic.
- Participation of women in the (wage) labour market is low.
- Temporary contracts are very common (33 per cent of all the contracts!) due to the soft legislation on contracting and firing for companies.

These 'push' or 'out-of-necessity' indicators can also be found in Romania and Poland, which, in combination with high GDP growth, explains their relatively high ranking in this dimension.

For Spain, the 'push self-employment' is supplemented with 'pull and opportunity self-employment'. The interviews confirm that the entrepreneurial environment in parts of Spain (Valencia and Catalunya) is improving. Together with an above-average number of start-ups and many school-based programs that foster entrepreneurship, this explains the highest score for Spain.

The entrepreneurial context has improved in terms of:

- Culture: more people are interested in starting their own business (especially the number 'autónomos' which has increased during the last couple of years, 102,000 start-ups in 2003).
- Policy: there is a growing promotion of entrepreneurship by means of all kind of incentives
- Presence of organisations and institutions: a wide range of organisations is involved in financial and non-financial programs for start-ups.

### *1.1.3 Most interesting or important issue*

#### ***Which poverty groups or people at risk of social exclusion could become self-employed?***

Although very relevant and important for our research, there is little information available on the self-employability of people at risk of poverty. One reason is that data on self-employment are not kept in a disaggregated way. In France this type of figure is not kept as a matter of principle (no distinction made among French citizens); in other countries this type

of information is not collected in a systematic way. As indicated earlier, when reference was made to the Dutch study on social exclusion, there is a need for each country to get more insight into the characteristics of socially excluded people, as these are indicators for some of the barriers in starting self-employment.

In some countries information is available on specific groups and their rate of self-employment. The general conclusion is that a difference in entrepreneurial attitude can be found on the basis of country of origin and gender.

#### *The UK*

In the UK currently 11 per cent of economically active people are self-employed. Women and some ethnic groups such as Black or Black British are currently under-represented amongst the self-employed while both groups have been identified as over-represented in the at-risk-of-poverty group.

#### *Sweden*

Compared to the native Swedish people, more immigrants in Sweden are self-employed. They are over-represented in self-employment as against waged employment (13.8 per cent of self-employed are foreign born while 9.7 per cent of all employed are foreign born). Research has made clear that it is not the host country that affects the rate of self-employed but the fact that they are immigrants. In all countries one sees the same pattern that of over-representation.<sup>2</sup>

#### *Germany*

Women are under-represented in the self-employed workforce (28 per cent in 2002, compared with 51 per cent women in the total population). This is a subject of political debate in Germany in particular, due to a higher potential for growth there. Much has been done to support women entrepreneurship and the proportion is rising. The share of migrants (7 per cent) is also under-represented in the self-employed workforce (9 per cent of the total population in 2001, 6.9 per cent in waged employment in 2003). This issue has recently attracted attention from the national government, KfW and from the regions. Experts state that the cultural background of migrants makes a huge difference and has to be kept in mind. Some come from a strong entrepreneurial background (for example, Turkish and Dutch). Other groups are less entrepreneurial. The attention of migrant-specific barriers in entrepreneurship development is still low and has to be mainstreamed, for example through the chambers of commerce. Disability entrepreneurship is not attracting much attention.

More research should be done on the self-employability capacities of the people found to be at risk of social exclusion.

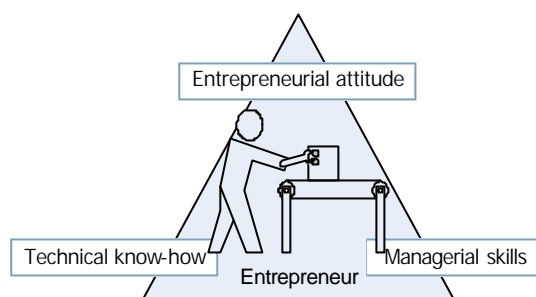
#### *1.1.4 Good and improvable practices and policies that advance the entrepreneurial context: enterprise creation awareness and training programs.*

Although some of the dimensions of the entrepreneurial context are the result of macro economic policies (GDP growth, number of start ups) we did identify policy measures in the area of enterprise creation training and awareness programs that influence the appetite and attitude towards entrepreneurship in a more direct way. Figure 11 shows the model used in enterprise creation training:

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<sup>2</sup> Source: University of Stockholm, Pernilla Andersson.

Figure 11: Enterprise creation training model



- 1) Technical know-how: Knowing how to make a product.
- 2) Managerial skills: Knowing how to run a business.
- 3) Entrepreneurial attitude: Knowing yourself and your entrepreneurial attitude.

All three elements are important for self-employment. Someone who wants to start to earn his/her own income should have the technical skills enabling him/her to produce a saleable product. Some managerial skills are also important to make sure that the product is sold, regulatory compliance is assured, and some profit is made. Finally it is important for potentially self-employed people to gain self-confidence, to know themselves and their capabilities, and to become motivated to start their own activity.

In some countries the attitude towards entrepreneurship and self-employment is negative: waged employment has a higher status, or people are too risk-averse to start their own activity. This appetite for and attitude towards self-employment can be influenced through the education system.



Some countries have good and improvable practices to promote entrepreneurial appetite and attitude through the education system.

### *Poland*

Experts state that the Polish society does not encourage personal initiative and entrepreneurial spirit sufficiently, nor does it provide sufficient instruction in market economic principles, entrepreneurship and new-firm creation. This was mainly blamed on deficits in the educational system. While the status quo of school-based programmes on fostering entrepreneurship is still weak, the educational developments in the process of the EU-accession are more promising. In 2002 a national educational framework for entrepreneurship was established and entrepreneurship is explicitly included as a separate school subject in the national curriculum of second level education. Two programmes mentioned are of particular interest. First, loans to graduates starting self-employment – even in the absence of specific details, this sounds like an innovative idea to reach promising micro start-ups through the education system. Secondly, the self-improvement of teachers was fostered in 2002 when 600 teachers were sent to University for entrepreneurial education so that students and teachers could create virtual businesses in schools.

### *The Czech Republic*

At secondary and vocational schools in the Czech Republic, subjects like Entrepreneurial Skills, Small Business Entrepreneurship and Management are being taught. Entrepreneurship is being promoted amongst young people through the 'fictitious company' project in which both vocational schools and economically oriented universities are engaged. For example, young people practice the business registration process. There

are also a number of entrepreneurship awards that are handed out by business associations.

### France

In France many entrepreneurship programs exist within universities and technical schools. However, these are mainly focused on management skills for potential employees of large companies. The already-existing bias towards waged employment in France is reinforced through this single-dimension type of training programs. Promotion of an entrepreneurial attitude or entrepreneurship training could complement the programs and also orient students towards self-employment or enterprise creation.



Some countries have measures that make it easier for micro-enterprises in the informal sector to move to the formal sector.

Also in France, the regional authorities tested a system with lower VAT for private construction and home and garden services to foster the transition of informal entrepreneurs into the formal economy

### UK

In the UK, tax officers were seconded to the micro-finance institution Street UK to interview clients who struggled with the transition from the informal to the formal economy. Results are currently being analysed and solutions for smooth transitions will be prepared. One of the aims was to change attitudes among tax officials that people working in the informal economy are not 'benefit cheats and tax dodgers' but people who mostly use cash transactions to try to make enough money to live off.

## 1.2 Policy measures promoting micro-enterprises

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

Indicators used to assess the policy for micro-enterprises that are created by those at risk of poverty and social exclusion, are:

- ⇒ Policy to finance micro-enterprise (Research done? Programs to target financing of micro-enterprise?)
- ⇒ Does government support financing of micro-enterprises (incentives, action plans?)
- ⇒ Presence of local development initiatives to foster self-employment?
- ⇒ Existence of programs for Business Development Services for micro-enterprises?
- ⇒ How difficult or easy is it to start a micro-enterprise?

In this area we look at the policy measures that support the creation of micro-enterprises and the type of measures that can target provision of financial and non-financial services to micro-enterprise. But measures can also be taken to make the business environment more micro-enterprise friendly. This type of measure decreases the need for non-financial assistance, as these services are often necessary to deal with regulations and to overcome administrative barriers. These measures can be in the area of registration, tax holidays, exemption from social security contributions and so on.

## 1.2.2 Scoring of countries

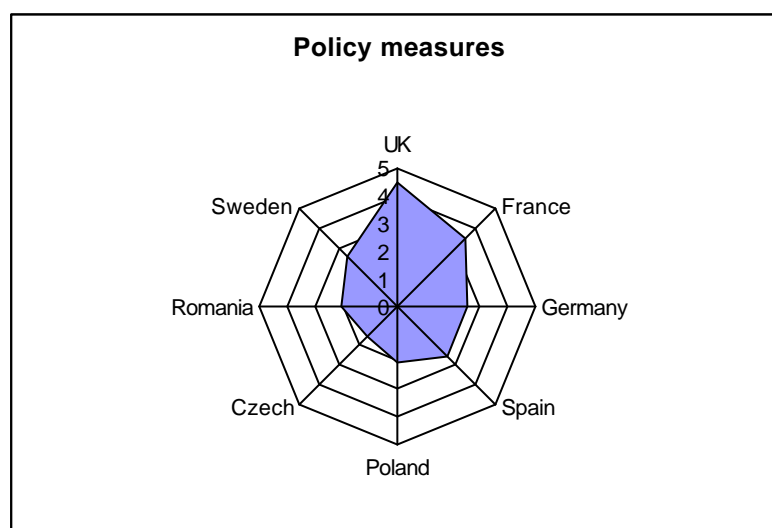


Figure 12: Policy measures

Table 6: Scoring explained.

Country	Argument
UK (4.5)	Central banks and public authorities take an interest in and conduct research on micro-enterprises; they also put money into micro-enterprise financing initiatives. Entrepreneurship is recognised as a key way for the socially excluded. Number of local initiatives is large. Business registration process is easy.
France (3.5)	Much research done in France on micro-enterprise development and finance. There are many initiatives to streamline the support to micro-enterprises and self-employment is an issue (there is action!). Micro-enterprises have exemptions from VAT declarations. There is a law to develop job centres for self-employment based on existing infrastructure Business registration is said to be easy but all registrations and compliances with social security are difficult. For less educated people it is still difficult to register a business.
Germany (2.5)	Central bank doesn't care about micro-enterprise finance but this is changing. High density of public-authority-driven local initiatives originating from the 1970s. Business registration is difficult – government tackles that slowly. Political debate on micro-finance but little action. Good GEM-Rank for government support programs but business support is SME oriented, not micro-enterprise minded. Good infrastructure but poor quality due to SME bias. An average time of 45 days is needed to register a business in Germany.
Sweden (2.5)	Policies are focused on waged employment. No debate on micro-finance going on. No SME-friendly bank system. Focused on large companies. Administrative procedures to start business are complicated. People are encouraged to start a business but tax and administration makes it difficult for them to be successful.
Romania (2)	Policy focus is on waged employment. There is no policy for self-employment as a tool. There are many local initiatives driven by NGOs and not by banks or public authorities. Business registration has been improved but ongoing compliance with administrative procedures is a big burden for small enterprises.
Poland (2)	Access to EU and ongoing debate on micro-finance has also changed Poland's thinking that micro-finance could be a tool in poverty alleviation or social inclusion. Many local initiatives for self-employment but mostly NGO-driven. Business support services are SME-friendly but not micro-enterprise friendly The business registration process in Poland comprises 10 procedure steps and has an

Country	Argument
	average duration of 31 days.
Czech Rep. (1.5)	There is recognition of the importance of SMEs but this hasn't trickled down towards micro-enterprises and the promotion of self-employment.
Spain (2.5)	Not really an SME-minded banking system except for the savings banks. ICO (European Investment Fund financed) is a national programme for micro-credit. National Action Plan on social inclusion mentions micro-credit as a tool. Long and difficult business registration process (108 days).

Table 7: GEM ranking:

	UK	France	Germany	Sweden	Romania	Poland	Czech Republic	Spain
Quality of <b>government support programs</b> for new and growing firms	Rank 15	Rank 7	Rank 2	Rank 23	n.a.	n.a.	n.a.	Rank 6
Ease and speed of <b>governmental regulation</b> in the <b>business registration</b> process and <b>taxation</b> of new and growing firms	Rank 12	Rank 18	Rank 23	Rank 22	n.a.	n.a.	n.a.	Rank 9

Source: GEM-report 2003.

### *The highest score*

The UK scores high on this dimension because the Government has highlighted the importance of access to financial services and affordable credit as a means of tackling poverty; it is focusing on making the environment for small business more conducive.

Its approach to helping small firms identifies seven strategic themes and key drivers for economic growth, improved productivity, and a wider involvement in enterprise for all:

1. Building an enterprise culture.
2. Encouraging a more dynamic start-up market.
3. Building the capability for small business growth.
4. Improving access to finance for small businesses.
5. Encouraging more enterprise in disadvantaged communities and under-represented groups.
6. Improving small businesses' experience of government services.
7. Developing better regulation and policy.

One of the ten guidelines of the National Action Plan on Employment is focused on job creation and entrepreneurship.

The actors in the financial system have been encouraged by the Government to provide services to the socially excluded, and they are at times put under more pressure to act. The Treasury's Social Investment Task Force encouraged voluntary bank disclosure, although there are no real incentives for this. The community investment tax relief provides incentives for investing in community development finance institutions (CDFIs), and the Small Firms Loan Guarantee Scheme provides an incentive for banks to lend to businesses that they may not normally lend to. There are many co-ordinated initiatives at policy level with different actors to get self-employment and financial and non-financial support for it, on the agenda:

- The Bank of England has taken a significant interest in finance for SMEs and has published research into the financing of small firms, including in deprived areas and social enterprises.
- The Small Business Service is now taking forward work on finance for SMEs.
- The British Bankers' Association has taken an interest in the area and has published a report on promoting financial inclusion.
- The Financial Services Authority is taking an interest in CDFIs initially from the perspective of consumer protection.
- There is a national network of enterprise agencies, which focuses on the provision of business support to micro-enterprises. There are also a number of one-off schemes, funded through the Government's Phoenix Fund, which provide targeted support to more specific groups. The quality of all of this support is not clear.
- There is a large number of development and regeneration initiatives across the UK but these are currently not well linked.
- The Small Business Service's Phoenix Fund provides grants for CDFIs targeting micro-enterprises. Social Investment Scotland and Community Finance Wales support social and micro-enterprises in these regions. HM Treasury is also working on this issue, and has widened the availability of the Small Firms Loan Guarantee, and has widened the Research and Development (R&D) tax credit to include smaller and entrepreneurial businesses.
- Regional and local programmes are more variable. However, regional government is taking an increasing interest in this area and will soon receive increased funding to support the financing of businesses and CDFIs.

The other indicator related to a favourable environment for micro-enterprises also yields a high score for the UK: registration of a micro-enterprise is easy and straightforward and takes less than one day.

### *1.2.3 Most interesting or important issue*

#### ***Do countries have comprehensive policy measures promoting micro-enterprises that allow for scale and impact?***

Many of the special programmes to support micro-enterprise creation are very small. These examples from the Czech Republic and Germany also prevail in other countries: different instruments with different conditions each with very limited outreach, hence the high administrative costs per product. The example of the UK proves that national governments can take the lead in promoting and marketing national initiatives that can be locally implemented. The UK has also acknowledged that a reduction in administrative barriers has more effect than supporting business development initiatives that in most cases are only necessary to deal with excessive rules and regulations and non-conducive environments.

#### *The Czech Republic*

There are a number of schemes to support SMEs with funds coming from the Ministry of Industry and Trade, the Ministry for Regional Development, the EU, and PHARE. Many of these schemes are administered through the Czech Development Bank (CRMBZ). Three programs fall within the definition of micro-loans: the Small Loans, Start, and Credit programmes.

- In 2002, the Small Loans programme made loans to 116 entrepreneurs averaging €25,000. These loans are zero per cent interest for four years.

- The Start programme is for new entrepreneurs. They need to be running a business for six months and complete a training scheme called *Grounds for Enterprise*. The average loan amount is around €13,000 with zero per cent interest. Borrowers are personally liable for credit.
- The Credit programme made loans up to €12,800 with duration of six years and interest rate of seven per cent.

### Germany

There are many regional initiatives in Germany, "too many too judge" as one expert stated. In most regions there are local economic developers existing who (in the best case) visit enterprises and give practical advice and a helping hand. However, in many cases they wait in their offices for enterprises to come to them. The structural issues of Germany's economic development scenery pose other problems:

1. Too many initiatives competing.
2. Instruments are too old and not properly redesigned.
3. Cost effectiveness of instruments is not a number one criterion.
4. New governments add new initiatives and are afraid of abolishing outdated schemes.

It seems that a more co-ordinated and widespread approach is developing.

There is no national government action plan to fight poverty with micro-finance or directly work with MFIs. Micro-finance as a tool to overcome unemployment is getting more popular and things are moving to a certain extent. Some *Länder* started to build or redesign their programmes. KfW, as a public bank, implemented a micro-finance tool (*Mikro-Darlehen*) in October 2002 but without integrating MFIs – the housing banks are to sell any loans that prove to be a bottleneck. In April 2004, KfW started an initiative to develop a concept of a triangular arrangement between the local MFIs, a bank and the KfW *Mikro-Darlehen* product. The National Ministry for Labour and Economics (BMWA) is interested in the subject but so far has been careful and passive. Some other ministries have adopted a similar waiting position. The National Minister for Labour and Economics started to talk about micro-lending in 2004 on television but it is uncertain how embedded this initiative is.

### Poland

While SME financing is starting to be a government issue with some national programmes implemented, targeting micro-enterprises is not very developed so far. There seem to be some changes with two new programmes 'Capital for Entrepreneurs' and 'First Job' which will run from 2003 to 2006 but micro-finance experts doubt that the design will be appropriate for reaching micro-enterprises effectively. One expert stated: "It is more a media issue than a real one. Our clients have rarely access to government programmes." Another expert stated: "Access to government programmes is similarly difficult as access to banks for micro-enterprises."

#### 1.2.4 Good practices and policies in case-study countries



Good practice: Streamline business registration and administrative procedures

In France, Poland, Romania and the UK there have been efforts to simplify business creation and registration. The most common concept is the 'one-stop shop' where a starting entrepreneur can arrange all formalities related to business registration. In June 2001, a one-

stop-shop system for business incorporation and registration was set up in Romania within the national network of the Chambers of Commerce and Industry. The system seems to work fairly well but most agree that registration isn't a hindrance to formally incorporating a business. The problem is conforming to the myriad of regulations on an ongoing basis. The *Plan Dutreil* (implemented in France in 2003) was focusing especially on improving the business environment through a set of 24 measures that made registration, financing and the switch between unemployment and self-employment easier. Most of the measures have been implemented and the first results might be visible in the 2004 statistics.

A comment from people who want to become self-employed and who find regulation and administrative matters too complicated was that it is not only the one-stop shop that is needed but also a 'one-support-person' approach. Starters, and especially those at risk of social exclusion, find it difficult to deal with many different people to whom they have to explain their situation over and over again. Non-financial support programmes try to address this barrier, but the removal of the barriers is, of course, a more structural answer to the problems mentioned.



Good policy practice: Link social inclusion to micro-finance. Create target-group-oriented programmes.

### Spain

The Second National Action Plan on Social Inclusion in Spain explicitly mentions the promotion of micro-finance and self-employment as an objective for access to employment for people at risk or suffering from exclusion. Although the commercial banks don't show much interest in SMEs, there are a number of micro-finance programmes at national and local level. The main national programme is the Micro-credit Programme from ICO (Ministry of Economic Affairs) that started in 2002 and was funded by the European Investment Fund. Some *Cajas de Ahorro* have their own micro-credit programmes (e.g. Caixa Catalunya, Caja de Granada, Caixa Galicia) as part of their social objective. NGOs like Caritas and the Red Cross are involved in micro-finance as well.



Good policy: Specific policy measures and support services for self-employed people.

### Germany

In Germany, there is one regional telephone-based support scheme for self-employed and micro-enterprises in Hamburg. *Firmenhilfe* ([www.firmenhilfe.de](http://www.firmenhilfe.de)) is specialised in counselling and supporting micro-entrepreneurs in financial and general crisis situations. The telephone, as a support instrument, seems to work for sole traders, start-ups and micro-enterprises (< four employees). Tailor-made support can be given on the job without bureaucracy and the need to make appointments.

The social welfare office of the city of Kassel has been running a promotion for business starters on social welfare since 1997. The loans are allocated on the basis of the flexible § 30 of the Federal Social Welfare Law and the lending conditions are therefore not firmly defined. Practically, however, the interest-free loans are around €10,000 maximum, while the average loan is €5,000. In some cases non-repayable subsidies can also be granted (for instance to redeem a solemn assurance because of a smaller unpaid bill and to be able to regain the support of a credit institution). Sometimes a social welfare contract is signed with the entrepreneurs, which states that they will continue to receive

social welfare during the initial phase (max. 1–1½ years). In those cases, the company's profits will, in all events, have to be reinvested into the business. Approximately 270 loans, with a total volume of €550,000, have been allocated, which allowed Kassel to save around €1.8 million in social welfare (after deduction of loan capital and personnel costs). On average the supported businesses created two more jobs, which were usually taken up by unemployed or people on social welfare. This model shows the potential of a culture of entrepreneurial activation and motivation in social welfare offices. However, at the moment this is clearly an exception in Germany.

### *Poland*

In Poland, some interesting policy measures exist regarding the taxation of micro-enterprises and self-employed people. For some kinds of entrepreneurs (mainly individual business activity), it is possible to pay taxes by lump sum. They have to register their income and the requirements regarding tax accountancy are very low. The applied tax rates differ from 8.5 per cent to 3 per cent depending on the kind of business activity (services, production, trade etc.). For the self-employed in certain kinds of business activities, like transport services with one car, teaching at home etc., there exists a very specific form of the lump-sum method, the 'tax card'. Under this method, the entrepreneur pays a fixed fee each month. The amount depends on the kind of business activity; the size of the hometown; and the existence of additional employees. There is no need to keep accounts when using this method.

## **1.3 WELFARE BRIDGE AND EMPLOYMENT POLICIES**

### *1.3.1 How developed is the system for taking people from unemployment to employment (including self employment)?*

Relevant indicators used to assess the welfare bridge and employment policies are:

- ⇒ Scale and nature of the inactivity trap (long-term unemployment rate, labour market policies, etc.).
- ⇒ Existence of schemes that foster self-employment and of bridges between different systems involved (employment agencies and social systems for example).
- ⇒ Uptake of schemes and a focus on people at risk of social exclusion.

In this area we look at the measures that address the barriers described in Part 1 Section 4.3: do the welfare benefit systems and employment agencies collaborate and do they consider and offer self-employment as a viable option out of unemployment or inactivity to people at risk of poverty?

### *1.3.2 Scoring of countries*

How do the countries ensure that socially excluded people have pathways from unemployment through to self-employment?

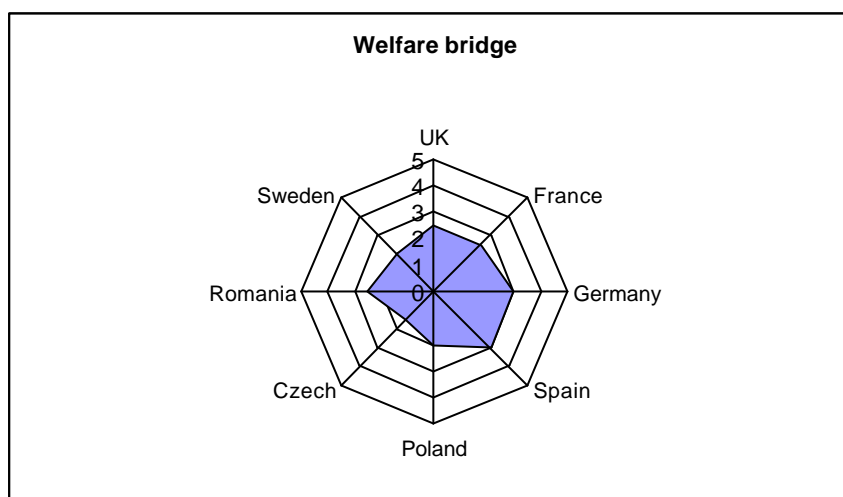


Figure 13: Welfare bridge

Table 8: Scoring explained

Country	Argument
UK (2.5)	Government tries to make the inactivity trap smaller through means tests that determine rights to benefits, but they are not yet there. You lose housing benefits and tax exemptions if you become self-employed. Job centres are focused on waged employment. Authorities are activating the unemployed, except the disabled.
France (2.5)	High contributions for self-employed to social security system. Bias towards waged employment in job centres. High long-term unemployment. But there are many initiatives to make bridges: the self-employed can maintain their full welfare benefit for six months and half of it during the second six months. There are exemptions from payment of certain social security contributions during the first year, so bridges are being built.
Germany (3)	The sticks for the inactive are not working (reformed for 2005) but the carrots to activate the unemployed are good. Successful programmes for start-ups through employment agencies (Ich AG) have been set up. High contributions for self-employed to social security system make low income level self-employment unattractive and creates an inactivity trap.
Sweden (2)	Taxes are high for self-employed. Emphasis is on waged employment. System is used to care for everybody so inactivity trap is there but Sweden is working to change it.
Romania (2.5)	Many are entrepreneurial by necessity because social benefits are low so there is no trap! You have to work. But there is no active self-employment policy. Underemployment (part-time while you want full-time) is high. Contributions to the social benefit systems to be paid by employers are 120 per cent of wages paid.
Poland (2)	Long-term unemployment is very high (54 per cent). Labour market policy is more and more activating. Self-employment is also becoming more important. A lot seems to be done but what are the results and impact? Youth unemployment is high and while the programmes are there, implementation is still poor.
Czech Rep. (1.5)	Situation is similar to Romania but the Government has recognised it. For families with children the minimum blue-collar wage is lower than social benefits! So for these groups there is an inactivity trap! Government is working on this issue by raising the minimum wage.
Spain (3)	Ambiguous finding: social security is low, not comfortable to stay. There are many short-term unemployed due to temporary contracts. But certain groups (the elderly) remain long-term unemployed. For these groups there is an inactivity trap.

### *Highest score: Ireland*

The most important welfare bridge to make the transition from welfare benefit or wage income to self-employment is the (temporary) provision of a stable income and access to wage- or benefit- related facilities.

Welfare bridges exist in at least five of the research countries but in most cases the bridges are short-term, only covering part of the social security and income allowances and most schemes are biased towards waged employment. None of the countries stands out in terms of the welfare bridge. The most generous and well-designed income bridge for the self-employed exists in Ireland: the 'Back to Work Enterprise Allowance'.<sup>3</sup>

Self-employed people participating in this scheme retain a percentage of their social welfare payment along with secondary benefits for a period of up to four years. The Back to Work Enterprise Allowance is not subject to taxation or social insurance. If people become self-employed, they will receive income support for four years as follows:

- 100 per cent of weekly social welfare payment for the first year.
- 75 per cent of weekly social welfare payment for the second year.
- 50 per cent for the third year.
- 25 per cent for the fourth year.

This period allows people to test the income-earning capacity of their enterprise and in case of failure to return to their former income situation without penalties. In addition to the income bridge, people also receive secondary benefits like fuel allowance, medical card, schooling allowances, rent/mortgage interest supplement and other benefits. Besides these there are additional funds for training and family income supplement.

Amongst those eligible for the Back to Work Enterprise Allowance various groups of people at risk of poverty or social exclusion are mentioned:

- (Very) long-term unemployed (> 3 years)
- Disabled people
- Former prisoners
- Single parents
- Retired people

For people entering waged employment, the income bridge doesn't last as long: during the first year they receive 75 per cent of their social welfare payment and in the fourth year no income support will be provided. This is the only case found whereby the bias was in favour of self-employment.

#### *1.3.3 Most interesting or important issue*

##### ***Are bridges built between different systems?***

In this section we analyse whether unemployed people or those receiving social benefits have an incentive to become active on the employment market or in self-employment. There are two aspects of the welfare bridge: one aspect is the bridge between the social system and the employment/enterprise system, which addresses the inactivity trap; and the second

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<sup>3</sup> [http://www.oasis.gov.ie/employment/returning\\_to\\_work/back\\_to\\_work\\_enterprise\\_allowance.html](http://www.oasis.gov.ie/employment/returning_to_work/back_to_work_enterprise_allowance.html)

aspect is the bridge between waged employment and self-employment, which addresses the poverty trap and bias issues.

For these aspects we can draw on a recent report on benefit systems and active labour market policies written for DG Employment and Social Affairs.<sup>4</sup>

The following factors are important in building the bridge between the unemployment/ social assistance benefit systems and (self-) employment:

- ⇒ Level and duration of benefits.
- ⇒ Presence of income or means tests.
- ⇒ Degree of taxation of benefits.
- ⇒ Indicators for the existence of unemployment and poverty traps.
- ⇒ Existing and planned policies.

First it was observed that some EU Member States – notably the southern ones – are still adjusting their benefits in an upward direction, in order to bring their levels more in line with the EU average. In these countries, equity considerations are, for the moment, more important than the need for activation of benefit recipients. Since various other EU Member States are reducing the generosity of their systems, a certain degree of convergence is taking place. The following tendencies emerge:

- ⇒ A strong point in some countries, but clearly a weak point in others, is the situation of single parents and one-earner couples with children, especially with low incomes. Some EU Member States have addressed this issue through reforms in childcare benefits. These reforms may inspire other countries to develop measures that fit their own systems.
- ⇒ There is a relatively rapid increase in the introduction of in-work benefits in EU Member States, which can be considered an overall strong point.
- ⇒ Several countries have implemented a combination of benefit reforms in order to address unemployment and poverty traps. It is unclear, however, how effective these measures are.
- ⇒ The number of benefit reforms targeting specific groups is low in comparison to problems identified for them, which is an overall weak point.
- ⇒ The combination of income from benefits and work, i.e. the exemption of a portion of earned income from the means tests for social assistance benefits is addressed in various ways by some EU Member States, but not by others.
- ⇒ Participation rates in activation programs remain low for women and, in particular, older workers in all EU Member States.

Relevant findings for the current study:

- People at risk of poverty (single parents, specific groups, elderly and women) are not yet reached by most of the labour market measures taken.
- Measures (incentive for work and penalties for inactivity) have been taken to support the move from the welfare system to the employment/enterprise system. However most of these measures are biased towards waged employment.
- In countries where the benefit system is not yet providing sufficient income (southern countries and new Member States), self-employment emerges out of necessity. In these cases the people eligible for benefits have no choice other than to start their own activity in order to supplement their income. This has led to a fast developing micro-credit sector in, for example, Poland, Romania, Bosnia, Montenegro and Kosovo contrary to the slow growth in Western Europe.

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<sup>4</sup> *Benefit systems and their interaction with active labour market policies*, Employment and Social Affairs unit A/2, by Ecorys 2004.

### 1.3.4 Good and improvable practices in case-study countries



Good and improvable practices: Welfare bridges exist in at least five of the research countries but in most cases the bridges are short-term, only covering part of the social security and income allowances and most schemes are biased towards waged

#### Sweden

The national instrument to assist the unemployed is *Startlinjen*. People get their living expenses covered in the first six months if they start an enterprise. There has been criticism because there is not enough mentoring for the new entrepreneurs to guide them through the complicated enterprise policy environment.

#### France:

Since 1977 France has *ACCRES* (Aide aux Chômeurs Créateurs et Repreneurs d'entreprises) an instrument to build the income bridge. With *ACCRES*, new entrepreneurs coming out of a social welfare situation can maintain their welfare benefit for six months or one year for some types of welfare recipients. In addition, they can get vouchers to buy business development services. The self-employed do not pay some of social security contributions (illness, pregnancy, old-age) during their first year of operations. This waiver varies for each type of welfare benefit recipient. In 2002, 31,570 unemployed benefited from *ACCRES*, rising to 42,000 in 2003. *ACCRES* can be combined with a specific instrument called *EDEN*, designed to assist the unemployed in business creation. This advance of between €6,000 and €9,000 has to be complemented with other (bank) funds totalling at least half of the advance. *EDEN* had 4,247 beneficiaries in 2000 (the grant was at that time a repayable loan) and 7,142 beneficiaries in 2003. At end of 2004, the *Borloo* law was passed by Parliament to reform *ACCRES* but implementation is still unclear. The idea is that entrepreneurs get an exemption to pay contributions to the social welfare system if revenue is less than the RMI (minimum revenue). If the revenue earned is above the RMI level but under the SMIC level (minimum salary) then the entrepreneur gets an exemption for the dues at RMI level.

#### Germany:

The universal national scheme *Überbrückungsgeld* (in operation since the 1980s) supports unemployed starters for the first six months granting them their welfare payment level plus social insurance (on average nearly double their previous unemployment benefits). The scheme *Ich-AG* (started in 2003) grants a decreasing amount of support for up to three years (€600 per month in the first year, €360 in the second year and €240 in the third year). This improves the transition period considerably: a) time is longer; b) the gradual decrease forces the business to become sustainable. Success in the number of applicants has been enormous. Apart from starters within *Überbrückungsgeld* and *Ich-AG*, the unemployed lose all benefits when they start a business or a new job if they do not fall back into unemployment within three years. For entrepreneurs there is the possibility to get housing benefits and theoretically to get social welfare. In general, the transition into employment presents a considerable risk to people who receive welfare benefits.

#### UK:

Moving from the benefits system to self-employment can be difficult and there are a number of disincentives. The Government is trying to tackle this through tax credits and test-trading periods. However, the system does not give the flexibility needed for many new businesses, which may be started on a part-time basis, with fluctuating income and a long set-up period. Some of the barriers that still exist include the low amount that can be earned without it affecting the receipt of benefits, problems in covering childcare

costs, delays in housing rent support, and loss of mortgage support. There is no standalone government programme for the self-employed; however, self-employment is an option in more general employment and training schemes. The New Deal for the Self-employed provides support to people who qualify for New Deal to start a business. The support can include a six-month test-trading period, during which time people still receive benefits, and any money generated from the business must be put back into the business. Work-based Learning for Adults (or Training for Work) is a combination of customised training, structured work experience and guidance and in some areas also includes a three-month test-trading period for those wishing to enter self-employment. The eligibility criteria and support offered through these schemes has been criticised for being too restrictive. There has been a relatively low take-up of New Deal for the Self-employed and it is not widely published compared to other, more well-known, New Deals.

*Spain:*

There are some subsidies (*Subvenciones de apoyo al empleo autónomo*, 'Pago Unico'), but all are rather small. There are no income bridges and the emphasis is on waged employment. Self-employed people have no social security rights.

Improvable practice: Enterprise has failed, income is non-existent, and a personal debt has been built up! It would be better if no long-term negative consequences remain for an individual who has tried to come out of unemployment.

*Poland:*

The self-employment assistance in Poland is based on the French lump-sum model (EDEN) except that repayment is required. Assistance is provided from the Labour Fund to a selected small fraction of registered unemployed through a loan program. The maximum loan is rather small, with the size limit being 20 times the national average wage. Loans are made at market rates of interest and must be repaid immediately, in full, if the planned enterprise is not initiated. This program cannot be considered an income bridge: in case of failure the funds have to be repaid!!

*France:*

People who start their own enterprise can defer their social security contribution to Years 2, 3 and 4. During Year 1 of the enterprise creation the self-employed person builds up a personal debt to be repaid in a later stage even in case of failure of the business. This often turns out to be an unexpected burden for already vulnerable people.

Improvable practice: welfare system and labour market policy could move away from being passive benefit payment machines through policy measures that provide incentives for activation with equal weight for self-employment.

*Sweden:*

The carousel effect used to exist in Sweden. Labour market policies mainly serve to re-qualify participants for unemployment benefits rather than to help them to find a job. However, there is a relatively rapid increase in the introduction of in-work benefits in all EU Member States that should continuously aim to reform the benefit payment and employment agencies.



Good practice for large uptake: Simple, nationwide instruments that last for a longer period. Nationwide instruments allow for economies of scale and recognition by potential beneficiaries. Longer term means the possibility for learning and continuous refining of the instruments.

*France:*

ACCRES, EDEN and PCE (small loans for enterprise creation) are three instruments that are well known by most people because they are nationwide and old (ACCRES has been in existence since 1977; 53 per cent of those trying to get out of unemployment in France by starting their own enterprise use some type of instrument or support program.

*Germany:*

Ich-AG is a new initiative but it is straightforward, standardised, simple and nationwide. Already 200,000 people have benefited from the scheme.

## 1.4 LEGAL FRAMEWORK FOR MICRO-CREDIT AND RELATED SERVICES

### 1.4.1 Is there a supportive legal framework for micro-finance services?

In this dimension, the analysis focuses on:

- ⇒ The banking legislation and regulation
- ⇒ The policies on interest rate setting.

Micro-finance is often offered by organisations that operate outside the banking sector. These associations have the capacity and willingness to reach out to people who are in need of micro-credit in a cost effective way. In order to be able to cover the higher transaction costs, micro-finance institution needs to charge higher interest and or fees. In countries where usury laws exist this might become a problem. The legal and policy barriers that create the need for non-financial services have been addressed under Dimension 2: the policy measures section.

### 1.4.2 Scoring of countries in this dimension

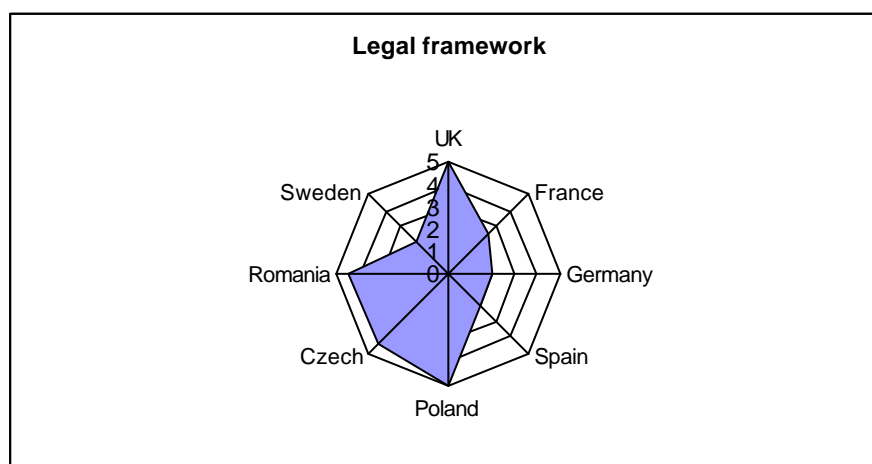


Figure 14: Legal framework

Table 9: Scoring explained

Country	Argument
UK (5)	No usury law and non-banks are allowed to lend but they must comply with the Consumer Protection Act. While the Act is being updated, it is still fairly weak and indebtedness for some and predatory lending for others are major problems.
France (2.5)	The Banking Law has a regulatory window, which is positive but there are restrictions for ADIE to lend. Usury law is different for consumer lending (20 per cent) and business lending (10 per cent). Business loans can only be given when you have a business account.
Germany (2)	Interest gap is flexible and micro-lenders are consumer friendly. Legal bank framework is very restrictive: non-banks can't give loans, except for the public authorities. Business loans can only be given when you have a business account.
Sweden (2)	There is a usury law and no possibility for non-banks to lend except for ALMI that is publicly owned. Outside of Government, lending is not possible.
Romania (4.5)	No usury law but in new draft law there are provisions for disclosure of effective interest rates and administrative fees. Draft of MFI regulatory framework has been written and is currently in the lobbying process.
Poland (5)	No usury law. Non-banks are allowed to lend. UK-based predatory lending (Provident Financial) came to Poland.
Czech Rep. (4.5)	No usury rate in the Czech Republic. The civil code prohibits disproportionately high rates of interest but the law does not fix the height of the interest rate. Non-banks can lend money.
Spain (2)	Usury law exists. No regulatory window. No special bank definition. Non-banks are not allowed to provide loans.

### High score

Poland and the UK are the two countries in our study with the most 'light touch' regulation for non-bank consumer lending. In both countries, non-banks can lend and neither country sets a ceiling on interest rates. However, financial lenders in the UK have to comply with the Consumer Credit Act and unfair lending is viewed as unlawful. This light touch regulatory environment makes it easier for micro-credit institutions to become operational and sustainable, but it raises questions on consumer protection against predatory lending. Therefore there are discussions whether a usury law should be developed to prevent predatory lending and protect borrowers from indebtedness. At the moment, the UK Government opposes such a measure. The UK and Polish model could be complemented with a regulation similar to the German system, which delivers consumer protection but at the same time leaves room for risk-adjusted lending and cost coverage through some interest spread. The heights of interest rates are limited by a usury law that forbids charging more than double the average interest rate in the sector (e.g. real estate, loans), or exceeding the average interest rate in the sector by 12 percentage points or more. This regulation would leave enough freedom for German MFIs to price their loans on a financially sustainable level like we see in Eastern Europe. But for reasons unknown they don't use this freedom: in 2002/2003 the average interest rate of micro-finance providers in Germany amounted to merely 6 per cent.

Figure 15 gives an overview of the interest rates charged by 32 MFIs that participated in the EMN research in 2004. It is clear that interest rates in the UK are much higher than in other countries.

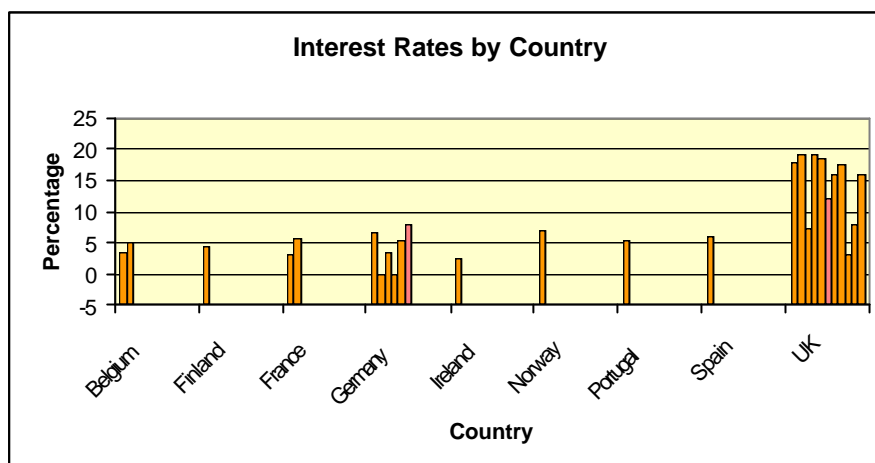


Figure 15: Interest rates by country

#### 1.4.3 Most important or interesting issue

##### **Does European banking regulation become micro-finance proof?**

The European integration process leads to the progressive transfer of banking regulation from the national to the European level. The Member States have established two banking directives (1977 and 1989) and their subsequent amendments, formulating three main objectives of banking directives:

- Harmonisation of banking legislation between Member States (in view of completing the internal market).
- Protection of savers (compulsory deposit-guarantee of up to €20,000 for each European depositor).
- Creation of a level competitive playing field (that only credit institutions with bank license can take deposits).

EU banking directives do not relate to credit-only institutions and therefore do not directly affect or restrict micro-lending. However, some Member States limit the lending business to licensed banks. This is the case in Germany, France, Portugal and Spain. For organisations in these countries, the only way to operate micro-credit is to partner with mainstream banks.<sup>5</sup> There are two reasons for this self-imposed restriction. First credit-only institutions also use external funds from varying sources (and maybe, indirectly, these sources are savings) so the risk of on-lending these non-equity sources remains. Secondly, these countries want to avoid unfair competition among different types of financial institutions because they are regulated under different laws. If, for example, a credit company does not have to respect solvency ratios, it can offer more favourable rates to the clients. It is this type of unfair competition that the above-mentioned countries want to avoid.

Another legislative issue affecting micro-finance is the existence of a usury law. France, Germany, the Netherlands, Belgium, all Scandinavian countries and Italy have introduced a legal usury ceiling for credit which, at less than 10 per cent in France, is especially low for

<sup>5</sup> Guene, C., *Freedom to smallness? Living with the legal framework for social and micro-finance in the EU (Appendix 2)* 2000, Exemption made for ADIE in France.

small business credit. The rationale behind a usury law is to protect consumers and entrepreneurs from indebtedness and unfair practices.

#### 1.4.4 Good and improvable policies and practices in case-study countries



Good practice: Accommodate needs of micro-enterprise support organisations that build financial bridges without distorting the financial sector.

##### France

France has a special window in the banking act for associations that lend to specific groups. ADIE (*l'Association pour le Droit à l'Initiative Economique*) is the only organisation in France that makes use of this special window. Up to July 2003, associations could only lend from their equity; they were not allowed to borrow for on-lending. ADIE was limited in its outreach by its (limited) own resources – it was able to advance itself mainly through the development of specific agreements with various banks. Since the special window, ADIE is allowed to borrow for on-lending which makes the organisation much more efficient because it does not need to pass through a bank for its operations. However, the special window has defined restrictions on the type of end clients that can be financed in order to avoid competition with the banking sector. Only recipients of minimum welfare benefits (RMI) or unemployed can benefit from a maximum loan of €6,000 and then only during the first five years after business creation. The window is designed to allow ADIE to provide the first small (hence most risky and most expensive) credit to a starting entrepreneur on the basis of risk sharing with the mainstream financial sector (70/30). This credit provision is not replacing a bank service but, on the contrary, is preparing potential clients for bank finance.

Improvable practice: To change unclear confusing, regulation that leads to uncertainty in the micro-finance sector into a clear, stable and comprehensive regulatory framework developed in consultation with stakeholders.

##### Romania

The legal framework for MFIs was previously murky. Romanian companies could lend and three internationally based MFIs had special permission from the Romanian Government to lend as well. However, it was unclear how long this special permission would last. For this reason, 14 MFIs formed a coalition to help draft proposed legislation to clarify the situation. The law has been agreed in principle but still needs to be signed by the Ministry of Justice and finalised with the Government. It is quite favourable for MFIs with light touch regulation, although it remains to be seen how it will work in practice. There is no usury rate in Romania. Due to central bank regulations, collateral requirements are very high (from 100 to 200 per cent) which inhibits banks to lend to micro-enterprise or start-ups.

##### Germany

In Germany the status of the banks is legally defined along the practice of credit allocation, so a banking license is needed to give loans. The conduct of banking business without a license leads to the risk of fine and imprisonment. The only possibility for non-banks to facilitate loans for micro-enterprises is to co-operate with banks. There are around five local partnerships of banks and MFIs but the numbers of loans is still small (< 50). Other providers are public authorities where the legal status is somehow unclear (also true in other countries where public authorities have financing functions). Some regional authorities implement loan schemes and call them 'repayable subsidies' to

overcome legal restrictions. The best schemes, situated in the limited administrative districts of the city-states Bremen and Hamburg, reach revolving status (repayment rate > 90 per cent, output > 100 loans per year). They work with market-level interest rates, a target group based on the best of the unbankable people, and outsourced decision-making and monitoring of loans.



Good practice: Implement recommendations made in study on regulation of micro-finance.

A study of the regulation of micro-finance in Europe<sup>6</sup> concludes that the decisive issue for micro lending is the extent to which the bank monopoly over certain financial services prevents micro-lending by non-banks. EU contract law does not regulate micro-lending because, unlike consumer credit, it is a credit for commercial use only.

## 1.5 FINANCIAL BRIDGE

### 1.5.1 Does micro-finance lead to inclusion in mainstream financial sector?

In this dimension, the analysis focuses on the sustained availability of financial services for self-employed people and micro-enterprises. The sub-dimensions analysed are:

- ⇒ Banking sector outreach, competition and small business lending culture
- ⇒ Bank products and partnerships for micro-lending
- ⇒ Access to banks for micro-enterprises and socially excluded groups
- ⇒ The existence of specialised institutions for micro-finance

### 1.5.2 Scoring of countries in this dimension

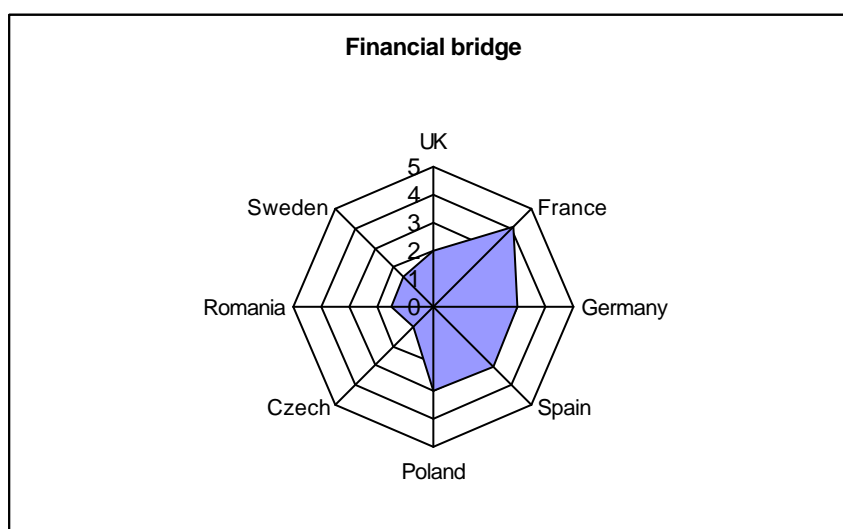


Figure 16: Financial bridge

<sup>6</sup> *Micro-finance: case for regulation*, U. Reifner, 2001.

Table 10: Scoring explained

Country	Argument
UK (2)	While there is a culture of SME lending, the banks are not interested in serving the micro-enterprise sector directly. Low number of bank branches in the country. There is no obligation and the banks are not going to do it themselves. Micro-finance is not provided through mainstream financial sector, only through a fragmented micro-lender sector with a fairly low volume of lending.
France (4)	Banks are involved in micro-enterprise finance through specialised programs. High density of bank branches. MFIs and a specialised bank exist but are not sustainable. Financial bridges are built between associations, funds and commercial banks.
Germany (3)	Poor MFI sector. Twenty-four micro-credit providers but very low volumes. High density in local bank sector. According to GEM Report 2003, the overall availability of funding for new and growing firms is average in Germany (Rank 12 out of 31). From a general perspective, the banking sector is working well for SMEs but less for micro-enterprises.
Sweden (1.5)	Banks do not focus on SMEs and do not provide micro-credit. Low density of bank branches.
Romania (1.5)	Banks are not interested in micro-finance. They cherry pick the best (high end of micro-credit). Access to banking services is difficult. Credit unions are not focused on the socially excluded. But there are 14 MFIs with 14,000 clients and a portfolio of €50 million.
Poland (3)	Banking sector and SME approach is getting better but no provision of micro-finance through the banking sector. Strong MFI sector.
Czech Rep. (1)	Very small government scheme exists but it is not clear whether the socially excluded are reached. The scheme operates through the Czech Moravian bank and has a very low volume.
Spain (3)	Savings banks are interested in micro-credit, while the commercial banks are not involved in micro-finance. High density of bank branches. Savings banks have micro-credit programmes (bridge between social system and financial system Caixa's).

Table 11: GEM-Ranking

	UK	France	Germany	Sweden	Romania	Poland	Czech Republic	Spain
<b>Availability of funding for new and growing firms'</b>	Rank <b>13</b>	Rank <b>21</b>	Rank <b>12</b>	Rank <b>22</b>	n.a.	n.a.	n.a.	Rank <b>19</b>

Source: GEM-Report 2003

### *Highest score*

#### *France*

France is well covered in terms of bank branches: a total of four branches per 10,000 inhabitants is an above-average density. Although French banks are not doing much in the field of micro-finance on their own initiative, all three providers of micro-finance in France collaborate with the banking sector.

ADIE loans are matched with bank funding in 80 per cent of the cases. For France Initiative Réseau (FIR), 85 per cent of their interest-free loans are matched with bank loans, which are on average five times the FIR loan. Fonds France Active (FFA) guarantees bank loans so all deals are based on bank loans. Apart from these partnerships, France has a public bank for small enterprises (BDPME) that offers a product for small enterprise creation (Prêt à la Création de l'Entreprise (PCE), < €45,000). PCE has to be accompanied by a bank loan, of an amount equal to the PCE with the possibility of increasing it to triple this amount. The PCE may be supplemented by a repayable EDEN

loan within the limits of the accompanying bank loan (the bank loan must be equal to the total of the two). So like PCE, EDEN contributes to the integration of micro-entrepreneurs into the mainstream financial sector.

In France the micro-finance instruments encourages collaboration between the various public and private banks and support associations involved in business creation in view of making the 'unbankable' bankable.

Many of the clients introduced through the micro-finance initiatives (FIR, FFA or ADIE) remain clients of the bank they were linked to, so the financial bridge is working! Banks say they are interested in this collaboration because of the establishment of contacts with potential future clients apart from their desire to strengthen their social image.

### *1.5.3 Most important or interesting issue*

#### ***Commercial banks' interest in micro-entrepreneurs: compassion or commerce?***

In many countries commercial banks consider micro-enterprises as grant-worthy not creditworthy or bank-worthy. Because mainstream financial institutions do not provide services to the lower segments of the market, specialised initiatives fill the credit gap. This is especially the case in countries where concentration in the banking sector is prevalent, like Sweden, England and Poland.

If special organisations or programmes take care of the lower segments of the markets, it could lead to segregation in the financial sector for specific groups. A financial bridge is built when graduation from a special programme to mainstream services can take place. This means that subsidies and programmes should include the banking sector during implementation to ensure smooth transition.

In France, the micro-lender ADIE's recent agreement with BNP-Paribas, a commercial international bank, is an interesting example of private partnerships: BNP-Paribas refinances the portfolio for XY interest rate. It takes over a share of the risk and pays part of the transaction cost through a grant of 10 per cent of the amount lent. Such a finance package encourages efficient and effective lending!

### *1.5.4 Good and improvable practices in case-study countries: Policies that provide an incentive to the financial sector to service the self-employed*

Improvable practice: Do not donate unconditioned grants but use funds to build financial bridges between microlending and mainstream banks.

#### *UK*

There is a good level of engagement between banks and MFIs in the UK but not yet at a commercial level. The banks do not co-finance the loans, but provide financial support for MFIs in the form of gifts and subsidies. Although this is a very positive point under the dimension 'funding and support for micro-finance' it means that financial bridges will not result from the partnership. As long as micro-entrepreneurs are not considered for mainstream financial products, economic inclusion will not be realised.

#### *Spain*

Banks combine social responsibility subsidies with mainstream finance for micro-enterprises based on a European Investment Guarantee Facility. In Spain, the banking

sector does not have a SME-minded policy, except for the savings banks and credit co-operatives. These are, together with traditional banks, the most important credit institutions. Given their foundational nature, savings banks do not pay dividends, but rather donate a significant percentage of their profits (on average 25 per cent) to community welfare projects (*Obra Social*), such as micro-credit programmes (e.g. Caixa Catalunya, Caja de Granada, Caixa Galicia).

#### Sweden

In the northern part of Sweden (Västerbotten) there is a new initiative, called *Kreditgaranti förening* (Credit Guarantee Association). The idea comes from the fact that in the northern part of Sweden it is very difficult to get a loan because houses and land are not accepted as collateral. Banks exclude people from this region from credit services because the risk of worthless collateral is too high.

#### Germany

There are around five local partnerships of banks and MFIs (i.e. SPK Göttingen, SPK Offenbach, Hanseatic Bank, Deutsche Bank Herrhausen Stiftung, GLS Bank). The number of loans is still small (< 50) and these local partnerships lack the desire for mainstreaming and proving a business case. However, a new initiative led by KfW in 2004 is trying to develop good practice in such partnerships and improve the accessibility of KfW's own products, notably *Mikro-Darlehen*, to such partnerships.

Improvable practice: Prejudices within the banking sector against self-employed can decrease through awareness raising and dissemination of success stories.

#### Sweden

One of the interviewed people from the banking sector put it as follows:  
"For socially excluded it is difficult to get a loan from banks. Not only because they have no collateral but also because they have no history as an entrepreneur. This shows the prejudice and misconception that socially excluded are not trustworthy and don't have entrepreneurial experience!"

#### UK

All the major banks offer basic bank accounts for individuals but not businesses. Anecdotal evidence suggests that opening a business bank account can be difficult for micro-enterprises, and many run their business finances through an individual account. There are no structured business loans on offer for micro-enterprises. Recent criticism of the uptake of Basic Bank Accounts by minister Stephen Timms pointed out that only one million accounts had been opened and that they offered very restrictive services (*The Guardian* 3 December 2004).

#### Germany

Basic bank accounts are a growing problem for some groups (indebted, negative credit record, micro-enterprises with untypical aspects as home business, migrants, etc.). As in the UK example above, this is true in particular for the business bank account where no voluntary commitment exists as in private basic bank accounts. Structured business loans are a problem as well. Although there is a strong local banking culture in Germany, competition pressure on the small banks has risen dramatically in the past years. As a result many local banks are much more restrictive in small firms and start-ups lending. The preparation on Basel II is another argument for the bank management to be cautious.

Improvable practice: Not only support the enterprise start-up phase but assure provision of micro-finance services till the bridge to mainstream financial sector is made.

### All countries

Several experts raise the issue of micro-enterprise financing beyond start-up. Most schemes related to activation of unemployment only assist people to get the business started, while it turns out that after one year of start up many micro-enterprises encounter problems with working capital finance and their lack of assets inhibit access to bank loans. This barrier has been described earlier as the lack of smooth transition from income support to enterprise income and specialised micro-finance support to access to bank finance. In addition, it demonstrates that micro-finance in Western Europe, unlike that in the rest of the world, has taken a development path into start-up finance. In the rest of the world the picture is opposite: lending to established micro-enterprises is the norm, lending to start-ups is the exception.

## 1.6 FUNDING AND SUPPORT FOR MICRO-CREDIT PROVIDERS

### 1.6.1 Are MFIs supported through direct and sustained funding?

In this dimension, the analysis focuses on the availability of funding for micro-credit providers including organisations that support self-employment and business creation. The following sub-dimensions have been defined:

- Possibility for self-sufficiency of micro-credit providers.
- Existence of lobby organisations for micro-credit providers.
- Availability and type of donor funds for micro-credit providers.
- Is micro-credit part of the ESF programme or specified in subsidised action programs?

In this area it is particularly difficult to present good practices because we have not had a chance to evaluate the different funding and support programs. We therefore look more into the set up and potential for sustainability of the different initiatives without expressing a qualitative opinion on each program mentioned.

### 1.6.2 Scoring of countries

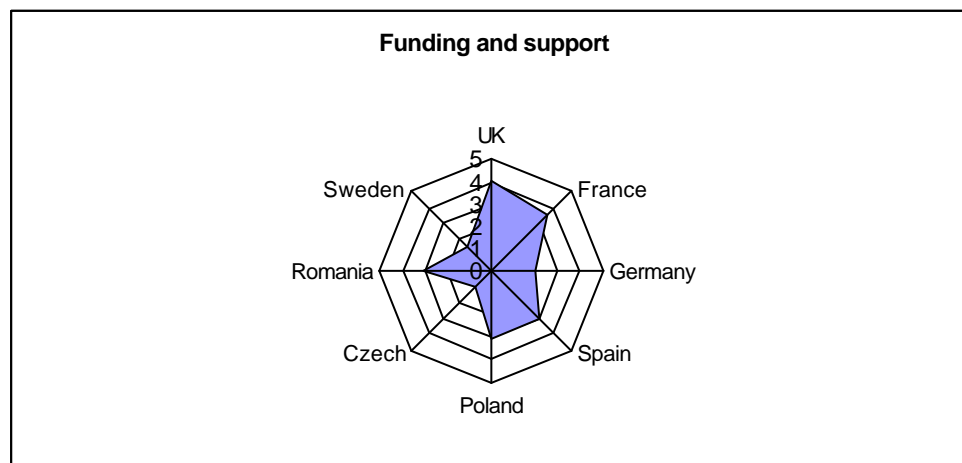


Figure 17: Funding and support

Table 12: Scoring explained

Country	Argument
UK (4)	If volumes are raised micro-lenders might be because no restriction on interest rates exists. Good donor support (government, banks but charity/CSR) Good micro-credit lobby. Charity organisation can invest and lend money for on-lending.
France (3.5)	Interest rate is restricted and does not allow for sustainability. Lobby organisations are existent and active. MFIs and micro-enterprise support programmes exist. Associative charity sector is large, but not so much for supporting self-employment and microfinance. Funds are very thinly spread out.
Germany (2)	Margins are too low for financial self-sufficiency. Donor culture is not in favour of micro-finance. A lobby organisation is emerging. EU funds are there and the amount is increasing but access is difficult due to regulations. Charity law does not allow on-lending by charity organisation.
Sweden (1.5)	No lobby organisations. No donor culture for micro-finance. EU funds mainly used for wage employment programs. No micro-finance.
Romania (3)	Financial self-sufficiency would be possible with international support and high interest rates but not through local funding. International donor culture is good. But banks do not engage as they see MFIs as potential competitors. No local embedding of micro-finance support. Lobby organisation is emerging through network 'Micro-finance Romania'.
Poland (3)	Interest rate is 7 per cent over base rate so can lead to sustainable operations. No EU funds for micro-credit. Credit unions are set up with donor funds. MFC exists as lobby organisation.
Czech Rep (1)	No micro-finance industry seems to exist and no micro-lending support exists.
Spain (3)	No lobby organisation but some organisations act as catalysts (savings banks, ICO). EU support is there (European Investment Fund, NAP). Few initiatives on micro-finance. Un Sol Mon acts as catalyst in debate.

### High score

#### UK and European Commission

The most significant supporter of micro-finance in the UK is the Phoenix Fund, which provides grants to CDFIs and enterprise support initiatives serving disadvantaged communities and deprived areas. Since its inception, the Phoenix Fund has doubled the number of CDFIs in the UK. Despite its success, the facility is due to close in 2006. It is hoped that the regional development agencies can step in to finance the budget gap.

The European Commission has developed and funded many initiatives to promote micro-credit and micro-enterprise development. Activities and instruments are diversified creating the possibility for complementarities. Interventions vary between awareness creation in Member States (studies, conferences, and papers) to financial support for the (facilitator) EMN and the creation of financial instruments that aim to build bridges between micro-credit providers and banks. EMN is currently compiling a paper on the good and improvable practices of the European Commission in the area of micro-credit support.

### 1.6.3 Most important or interesting issue

#### **What are good support programs?**



Support programs for self-employment and micro-credit consist of different instruments that should be based on different visions with regard to sustainability and target group. Over the past years donors and policy-makers worldwide have defined principles for support to enterprise development and use of subsidies. These principles are as follows:

*“Government organisations are generally least successful at being business like and should concentrate on the creation of an enabling environment for micro-enterprise development instead of getting actively involved in the delivery of services to the self employed or micro-enterprises. Micro enterprise development organisations can be important catalysts for the development of a financial and non-financial services market. They have demonstrated that they can play an important role in advocating micro-enterprise and self employed persons’ interests and to a lesser extent in providing services. Private companies like banks, sustainable micro-credit organisations, consultancy firms, accountants or advertising agencies are the normal providers of services for small and medium enterprises. However they tend to concentrate on the upper end of the market. Facilitators can play a role in bringing these providers closer to the micro-enterprise and self-employment market. The facilitation role, which is by definition temporary, can be subsidised, the provision of services should become self sufficient in the longer term.”<sup>7</sup>*

Donors and governments base the market development approach on the belief that the objective of outreach and sustainability can only be achieved in well-developed markets for services delivery, and not by direct provision of services by them. The focus of public and donor intervention should be shifted away from direct provision and subsidies at the level of the transaction between the micro-enterprise and the services provider, and towards the facilitation of a sustained increase in the demand and supply of services.

In practice this approach advocates that the support to a person who wants to become self-employed should consist of bringing this person closer to the market for financial and non-financial services. This approach matches the policy of inclusion. The aim is not to create a parallel chain of services for those at risk of poverty; the ultimate aim would be that all people have access to appropriate mainstream services and that the policy environment is conducive for their type of enterprises. Examples of the type of support that fits in this approach are:

- A facilitator provides a (subsidised) credit (or guarantee) to a person. In case of successful repayment, this person will build a track record and become bankable. The services of the facilitator will then be redundant.
- A (subsidised) business advisory organisation (facilitator) helps the potential entrepreneur in registering his/her business and in identifying an administrator (commercial) that will take care of the tax declaration. Once the business is up and running the facilitator becomes redundant and the self-employed person is able to source and pay for his/her own support services. As the business advisory

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<sup>7</sup> Committee of Donor Agencies for Small Enterprise Development, *Business Development Services for Small Enterprises: Guiding Principles for Donor Intervention*, February 2001.

organisation advocates for an enabling environment for micro-enterprises the need for its services decrease (less 'bureaucracy experts' are needed).

As long as governments or other funding organisations consider the role of the facilitator necessary, subsidies and grants will be provided. The services provided by the facilitator are temporary; therefore there is no need to seek self-sufficiency. The facilitator will be evaluated on the basis of the number of successful cases: the number of people at risk of poverty that start a business and are able to conduct their activities on a sustainable basis (i.e. without subsidised services).

This approach means that there are two types of micro-credit organisations that have different visions on sustainability:

- **Micro-credit organisations as subsidised facilitators** whose objective is to make the non-bankable people bankable and assist people to start and follow through their sustainable activity.
- **Self-sufficient providers of micro-credit services** who adhere to the vision that financial bridges cannot always be made, so sustainable availability of micro-finance services is required. This vision advocates for interest rates that cover MFI expenses.

In the European Union both type of organisations exist, although the distinction between the two and the role of subsidies and grants, and vision on sustainability and exit strategy is not yet very clear for many of them. The issues raised should be debated in order to come to a consensus on appropriate support to micro-credit organisations.

#### *1.1.4 Good and Improvable practices in case-study countries*

Improvable practice: Support for renowned facilitators should continue as long as performance criteria are met and until self-sufficiency or exit strategies guarantee sustainability of results.

#### *Sweden*

In Sweden there are many subsidies and funds available for all kind of NGOs, programmes funded by the central and local government, and the European Union. However, most of the European Social Fund (ESF) programs have a bias towards waged employment and there is no policy or debate on micro-enterprises. In addition, the total finance for social and employment programmes is decreasing and ALMI, an established governmental organisation supporting enterprise creation, fears budget cuts.

#### *European Commission*

The Micro-credit Guarantee objective is to reduce the access to financing barrier for starting entrepreneurs. The relatively higher risks the entrepreneurs represent, and their insufficient security, are compensated with a guarantee facility. As of 31 March 2004, six intermediaries from six countries make use of the facility. They are:

1. First Step Ltd (Irl)
2. The Prince's Trust and the Prince's Scottish Youth business Trust (UK)
3. Fonds de participation (B)
4. Kreditanstalt für Wiederaufbau(KfW) (D)
5. Instituto de Crédito Oficial (E)
6. Association pour le Droit à l'Initiative Economique (ADIE) France (F)

The program has no exit strategies and organisations like The Prince's Trust do not aim for sustainability so it is not known whether the beneficiary organisations continue to provide services without the guarantee fund.

### Germany

Germany can serve as both a good and a bad example. Four micro-lenders were founded with the support of public money with the objective of financing start-ups. They received large subsidies for operations; unfortunately they lacked access to the necessary loan capital with the result that few loans were given out at a high cost per loan. Later in 2004 the situation has reversed. Now there is better access to loan capital but a shortage of subsidies to cover operations. On the positive side, in 2003, one regional employment agency developed a strong success-oriented support system for start-up coaching where the organisation receives bonuses for surviving start-ups and minuses for closed start-ups.

Improvable practice: If the Government acts as credit provider it should be temporarily, and clear exit strategies should be designed to ensure sustainability.

### Poland

The Government created a loan fund called TOR#10 and granted 3,249 loans over the past seven years. The micro-finance NGOs in Poland granted 30,969 loans.<sup>8</sup> The uptake of private/NGO schemes is much higher than government schemes, because private sector schemes have to focus more on their own institutional sustainability, hence on realising outreach to a large number of people.

### The Czech Republic:

The Government of the Czech Republic has only made available very small amounts of money for micro-loans, so small as to be insignificant (103 loans in 2002).



Good practice: Diversification of funding sources and instruments and measures that encourage private sector funding for micro-credit.

### France

Although in France the major funding for micro-credit and self-employment is from public sources, the *Plan Dutreil* foresees several measures that will make it more attractive for investors to invest in small enterprises. There is an income tax reduction of 25 per cent with a maximum of €10,000 per person. If someone invests in a local enterprise and it goes bankrupt, losses can be deducted from the taxes due. The aim is to channel local savings to local enterprises and encourage financing of small enterprises. The outcome of this measure is not yet known.

### UK

Several charitable trusts and foundations have given strong grant support to MFIs. The Charity Commission has clarified the rules on charity investment, and programme-related investment is now possible. But very few charitable trusts and foundations have so far taken this up. The community investment tax relief also encourages investment from organisations and individuals.

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<sup>8</sup> Source: Mikrofinanse w Polsce, MFC Publication, 2002.

### *Germany*

The DMI, a national micro-lenders' association that started in autumn 2004, pools donor money in a central fund that will refinance MFI portfolios. With the goal to develop and standardise micro-finance in Germany over the course of two years, this centralised refinance scheme will conduct quality controls, through an appraisal and licensing scheme for micro-lenders. It is still in an early stage but such a wholesale approach is promising.

**PART 3**

**BUILDING BRIDGES**

# 1 CONCLUSIONS

## 1.1 TOWARDS AN IDEAL MICRO-FINANCE MODEL THAT CONTRIBUTES TO SOCIAL INCLUSION

This section draws on the results presented for each dimension of the matrix in Part 2. It presents a model that brings together the best of EU practice from the different Member States. Where there is inadequate good practice, policies are presented from outside the EU.

In this section we take into account that:

- There are different socio-economic models prevalent in European countries.
- The different welfare models determine the main actors in the social welfare and employment/enterprise systems.
- This sets limitations in inter-country learning of enterprising environments for social inclusion.
- Each of the models has varying forms and degrees of inactivity traps and credit gaps that need to be transformed into welfare and financial bridges.

Despite these differences we see an enormous potential for European countries to learn from each other about how to fight the inactivity trap, which harms all European welfare states, regardless of model. 'Building bridges' is therefore our approach, a genuine third way between welfare state and the free market. We see the potential for consensus on building bridges among politicians and stakeholders in all EU countries. But as the issue of social inclusion and self-employment is rather new, there is little knowledge about the bridges to be built. We analysed eight countries and did not find a country with a comprehensive approach. Instead each Member State had part of the good practice, which presents a signpost to the future. Even the good practice mentioned in previous chapters is not always perfect. But it gives a sense of the potential.

As a conclusion we would like to outline an ideal world where an enterprising environment facilitates the promotion of social inclusion. Figures 18 and 19 demonstrate the highest scores found and the ideal world.

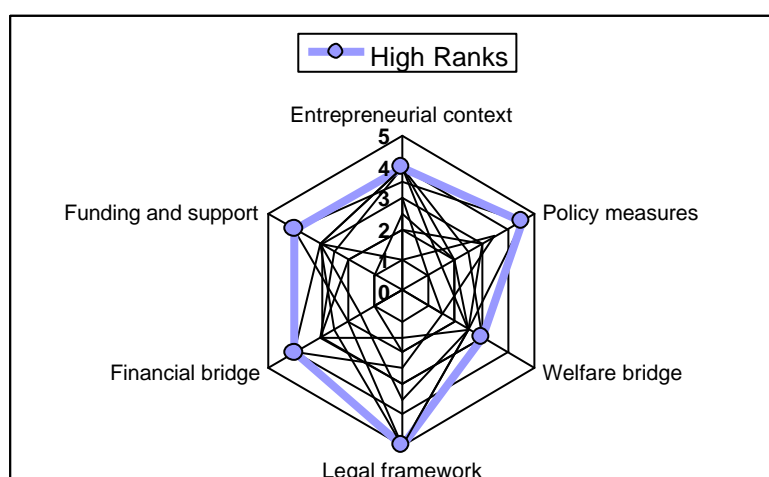


Figure 18: Scoring on each dimension and highest scores

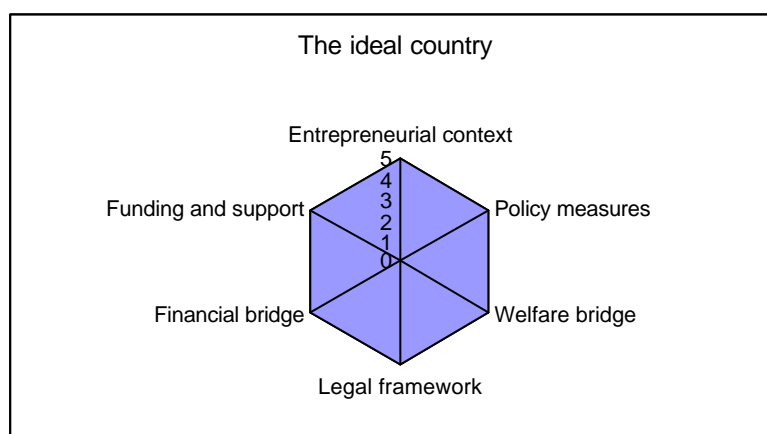


Figure 19: The ideal country

### 1.1.1 Dimension 1: The ideal entrepreneurial context

In an ideal situation entrepreneurship is an option for every individual who has the ambition to start his/her own activity, including women and men, migrants and residents, young and old alike. In an ideal world, this diversity in entrepreneurship is actively promoted and society regards entrepreneurship positively – people are proud to become entrepreneurs.

The national curriculum for school children includes business creation and the world of work. The life and success factors of a micro-entrepreneur are made transparent and people are aware that it is possible to make a living from entrepreneurship. The tides of entrepreneurship are made visible: from low- to high-level enterprise activity, from success to failure.

The size of the informal sector is small, despite being an entrepreneurial society, due to an easily accessible formal economy. Test trading, part-time entrepreneurship and home-based businesses are promoted as steps from unemployment to full time entrepreneurship. In medicine we learn to understand a healthy body through analysing illness; the illness of micro-enterprise is the informal sector and the need for non-financial business support. The studies on informal sector operators make us understand what changes need to be made in the policy framework. Therefore the approach the public authority takes towards the informal sector is to ask what can be done to make the transition easy?

There is a culture that failure does not prevent a second start. Private insolvency regulation exists. Going bankrupt is a failure but not necessarily the end of an entrepreneurial career.

#### **Some signposts for the future to improve the entrepreneurial context:**

1. In Poland, the Czech Republic, and the UK entrepreneurship training is an integral part of the school curriculum. In addition, Entrepreneurship is being promoted amongst young people through projects with 'fictitious companies'. In Poland, the lack of teachers' knowledge in that area was tackled through a project where 600 teachers were sent to university to learn about entrepreneurship development.
2. In Germany, a newly created word – the ICH AG ('Me the public shareholder business') – delivered the message to society: becoming self-employed is a viable and valuable option in your life career. As a consequence, the demand for the related support scheme was overwhelming.
3. In Poland, a loan scheme to university graduates reduces the prospects of unemployment because the option of entrepreneurship is actively promoted.

4. In France, the regional authorities tested a system with lower VAT for private construction and home and garden services to foster the transition of informal entrepreneurs into the formal economy.
5. In the UK, tax officers were seconded to the micro-finance institution Street UK to interview clients who struggled with the transition from the informal to the formal economy. Results are currently being analysed and solutions for smooth transitions will be prepared. One of the aims was to change attitudes among tax officials: people working in the informal economy are not 'benefit cheats and tax dodgers' but people who mostly use cash transactions to try to make enough money to live off.
6. Private insolvency regulation exists in most countries (e.g. the UK, Germany). However, pathways to start a new venture and recycle experience are rare.
7. In order to prevent the loss of pensions and saving reserves as a result of a business failure, a 'saving gateway system' is being piloted in the UK.

### 1.1.2 Dimension 2: The ideal policy measures

Ideally each country would have a variety of public, NGO and private sector initiatives to support the creation and development of micro-enterprises. We know what works for whom, how we can develop the market for services, and how we reach the socially excluded with micro-enterprise development initiatives.

Ideally policy would deliver the following:

- Business support clearly targeted to micros (not to the much wider group of SMEs) due to different needs and capabilities. They particularly need easy, accessible, and broad-ranging services and coaching that can be delivered on demand in their locality or at their premises. What they want is hands-on advice and an enabling policy environment that makes being self-employed less complicated.
- Access to finance regardless of loan size and bank history but filtered with criteria around motivation, capability and capacity to repay a loan.
- The development of market-oriented services for the smaller segments of the market. Subsidies are used to develop the market for financial and non-financial services for all. For access to finance clients this means taking interest rates at market level but packaging the loan with subsidised support to minimise risk for all. For the providers it means that their support operations justify some taxpayers' money but not their financial operations where interest rates should cover costs.

#### **Some signposts for the future to promote policy measures that support micro-enterprises**

1. **Targeted business support programmes:** Policy-makers should be creative in the manner in which they provide support and advice to micro-enterprises. They have different needs than SMEs. In many cases, face-to-face advice or formal business training is not critical for micro-enterprises. It can be more cost effective and easier to reach scale by decreasing the compliance requirements and administrative burden for micro start-ups. The telephone, a support instrument that seems to work for sole traders, start-ups and micro-enterprises (< 4 employees) allows tailor-made support to be given on the job, without bureaucracy and the need to make appointments. There is one national scheme in the UK ([www.bdl.org.uk](http://www.bdl.org.uk)) and one regional one in Germany ([www.firmenhilfe.org](http://www.firmenhilfe.org)).
2. **Revolving loan funds for start-ups that work efficiently:** Loan funds are more likely to be successful if specialised NGOs or banks run them. In the past, many failed to be revolving. However, a better design could make public authority intervention feasible if

no other actors are at site.<sup>1</sup> The schemes that work with market-level interest rates, a target group focusing on the best of the unbankable, and outsourced decision-making and monitoring reach a revolving status – in these cases public intervention may be worthwhile. Output (over one hundred loans per year) and repayment rate (> 90 per cent) is best so far in the schemes in Bremen and Hamburg where a revolving status might be reached.

3. **Bundled interventions from the public sector:** The Government has to highlight the importance of access to financial services and affordable credit as a means of tackling poverty and must focus on making the environment for small business more conducive. The policy measures applied in the UK that combine research, support for funds and public and private agencies that focus on self-employment and political backing at a high level are a good example. Easier than direct intervention of public authorities is a packaged intervention. In France, some local public authorities offer subsidies as 'equity of honour' to such starters who receive a loan from a micro-lender – this combination prevents market distortion.
4. **Efficient use of current regulatory environment:** The regulatory environment is not always the bottleneck; sometimes there is unused potential within existing rules and regulations. The German social welfare regulation allows welfare benefit administrators to invest in people starting self-employment – even beyond start-up phase. While the regulation is quite flexible and can be used for subsidies or loans, there is only one public authority – the city of Kassel – where this opportunity is used. The result is quite impressive: the city saves more than €1.5 million in welfare benefits – after reducing administrative costs and write-offs. Crucial for success is having one person in charge of the scheme who behaves like an investor and not a social help distributor.
5. **Provision of finance for different purposes:** In the UK, the subject access to finance is much more broadly understood than start-up finance. Through the Phoenix Fund, the Government supported and funded the development of CDFIs where different organisations focus on different target groups.
6. **Efficient and widespread use of E Government:** In all European countries initiatives to improve the *E-Government* – government services accessible through Internet – benefit the micro-entrepreneurs who are often not familiar with bureaucratic organisations and often lack time to find the right information.

### 1.1.3 Dimension 3: The ideal welfare bridge

An ideal welfare bridge will:

- Activate but not force the unemployed to become self-employed (pull rather than push).
- Offer realistic opportunities and combine them with support.
- Give people as much control as possible to determine their timing.

The general observation is that “more carrots are needed, in proportion to sticks”. Pushing people into an activity is not the only way to fight the inactivity trap – the unemployed must be offered a fair deal to make a living.

Ideal policies are those that:

- Provide financial support during a transition period.

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<sup>1</sup> A list of success factors for the design as interest rates on market level or efficient external selection have been collected in the handbook *Finance for Local Development: New Solutions for Public-Private Action*, London 2001 (Evers, J., Fisher, T., et al).

- Give access to non-financial business support services and advice during the transition process.
- Allow gradual steps in matching enterprise income with welfare benefits.
- Have the possibility of a 'nothing to lose' approach and a return into the benefit system if the enterprise venture fails.
- Filter the potential candidates to prevent 'free riders' and 'falling riders' to start a business venture without being patronising; the best monitor is based on people's own objectives.

The pathway from welfare benefits into an income generating activity is visualised in Figure 20:

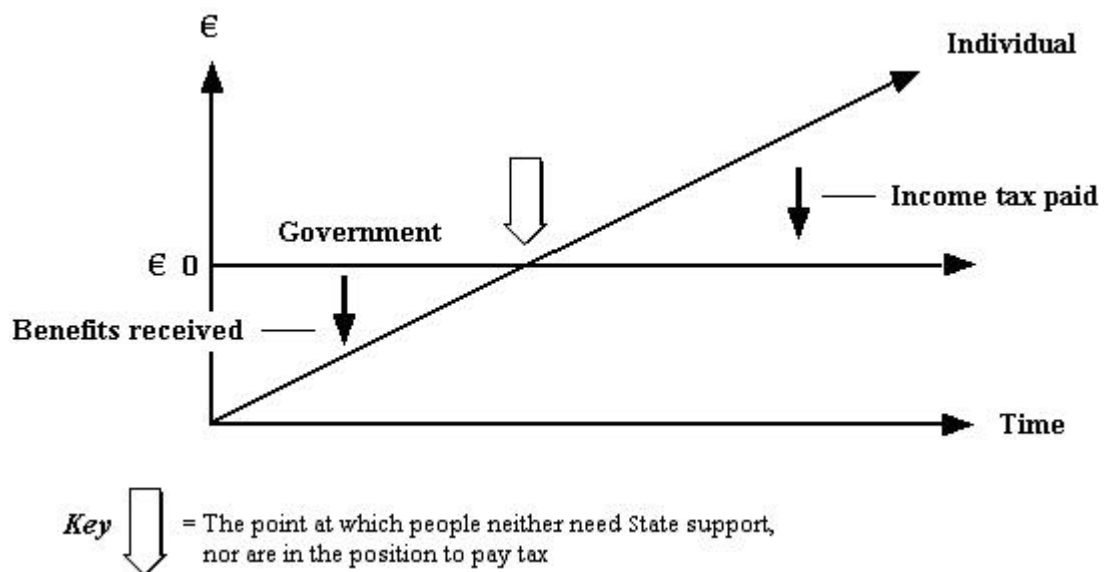


Figure 20: The smooth transition from welfare benefits to tax payment, Source: Rosalind Copisarow, *Self-employed in the Informal Economy – Cheats or Contributors?* Sheffield 2004, p.36

### Some signposts for the future to promote policy measures that build welfare bridges:

The most advanced European model is the Irish system where people get income support on a decreasing scale during a period of three to four years. There are no barriers or penalties if the person wants to return to the benefit system in case the enterprise fails. This transition period allows people to test the income earning capacity of their enterprise.

We found other, less ideal schemes:

1. The German Ich AG has its beauty in the decreasing support steps (three steps of one year each) but it lacks any kind of filter or combined non-financial support. Take-up is highest in Europe with 150,000 people added in 2004 to 180,000 in the former scheme at the same time. The design of the scheme has still to be developed to prevent free rider effects but it is a promising start for building bridges through transition periods.
2. The UK Government is trying to tackle the disincentives to leave the welfare system through tax credits and test trading periods. However, take-up is low due to poor flexibility. The test-trading period is shorter than in examples above.
3. The French ACCRE is strong in that it can be combined with a support scheme EDEN. It has been in existence for along time and is therefore widely known. The transition period where welfare benefits continue to be paid is limited to six months, and, in

exceptional circumstances, to one year. Uptake was low in 2002 (around 30,000) but is increasing with 42,000 people taking it up in 2003. In autumn 2004, national parliament passed a law called 'Borloo' to expand this period and to overcome the inactivity trap by making minimum revenue free of social contribution obligations.

#### *1.1.4 Dimension 4: The ideal legal framework for micro-credit and related services*

In an ideal world the European and national regulators consider 'Access to finance for all' a goal that is as important as 'safeguarding the savers' interests through the supervision of the financial sector'. Besides mainstream commercial banks, there are legal possibilities for alternative financial institutions whose objectives are to create access to micro-finance for low-income groups and marginalised people.

#### **Some signposts for the future to promote policy measures that create a favourable legal framework:**

1. The Polish and UK models of bank regulation are both very liberal and therefore provide no obstacles to micro-finance. However, we see the lack of usury regulation as being harmful in the light of consumer protection.
2. This model could be completed with a regulation similar to the German one: Maximum interest rates are limited by a usury law that forbids charging more than double the average interest rate in the sector (e.g. real estate, loans), or exceeding the average interest rate in the sector by 12 percentage points or more.
3. The French bank regulation has opened a special window for micro-lending. The window is designed to allow micro-lenders to provide the first small (hence most risky and most expensive) credit to a starting entrepreneur on the basis of risk sharing with the mainstream financial sector. This credit provision is not replacing a bank service; on the contrary, it is preparing potential clients for bank finance.

#### *1.1.5 Dimension 5: The ideal financial bridge*

In an ideal world we see a variety of financial institutions, each of them effective for its target group and product. The regulatory environment and public authorities' willingness to support the 'Access to finance for all' agenda, makes innovative financial institutions interested in developing products and delivery systems that contribute to social inclusion. An effective response to that is the emergence of development departments in banks, full-development banks, specialised micro-finance banks, and NGOs that operate as MFIs. Such innovators run pilots for new product delivery to new client groups – like bank accounts for the homeless, pension schemes for the poor or micro-loans for enterprise growth or migrant entrepreneurship. They create their own new markets and enlarge the potential clientele for commercial banking; they operate a laboratory for future banking.

#### **Some signpost for the future to promote policy measures that build financial bridges:**

1. The Spanish saving banks develop special units for micro-finance within the mainstream banks. Caixa la Catalunya has a special not-for-profit unit and La Caixa has specialised loan officers within general branches.
2. The UK Government identified specific ways in which enterprise in deprived areas and access to basic banking services for the socially excluded could be improved. Some of the recommendations have been implemented within mainstream operations (banks offering basic bank accounts), while others have been taken forward by the voluntary sector through the establishment of new institutions (e.g. setting up CDFIs).

3. Some UK banks disclose their start-up finance numbers in disadvantaged neighbourhoods. This makes underserved markets a little more transparent. They are motivated by Government to prevent a disclosure act as is used in the USA. Currently banks do not need to provide detailed data on individual neighbourhoods (as is the case by law in the USA).
4. In the Czech Republic the EBRD has provided support to the Raiffeisen Bank to develop a product for micro-business.
5. In France the three micro-lenders Fonds Initiative Réseau, Fonds France Active, and ADIE have built financial bridges for the self-employed starting from disadvantaged backgrounds. Banks refer clients they cannot lend to themselves to micro lenders and at the same time banks take over graduating clients that have repaid in time.
6. In Finland, the micro-lending operation of the public body Finnvera finances micro clients but hands them over to banks if they have repaid and grown.
7. In Germany, some saving banks have started to co-operate with local not for profit start up support centres to develop and disseminate micro loans. KfW currently develops a good practice manual and window to refinance specific products for such co-operation.

#### *1.1.6 Dimension 6: Ideal funding and support for micro-credit providers*

Ideally the cost of micro-finance will primarily be covered from financial operations. However it must be acknowledged that this may not be realistic across all of Europe. Interest rate caps set at low levels and fragmented demand for micro-loans are just two factors that are present in certain countries and might impede micro-finance providers' ability to become self sustainable. Public sources and grants are performance-based and used to supplement specific services to specific clients on a temporary basis. The aim of subsidies is to build bridges between the person at risk of social exclusion and mainstream institutions. Once the bridge is built, the subsidy disappears.

MFIs are well known for risk management systems, which allow them to serve low income, risky clients while maintaining bad debts under 5 per cent. As a result MFIs are increasingly financing their costs from interest spread (the spread is the difference between interest paid by the MFI and interest received from clients). However, the public sector, such as the European Commission, is willing to cover another share of the transaction cost on a performance basis: an example is that for each excluded person integrated into the financial sector they pay a lump sum. The degree of exclusion is measured through a rating system and lump sums are adjusted. Therefore a competitive industry develops: different lending and support methodologies compete for inclusion effectiveness. The trend possibly goes to large economies of scale in inter organisational back office operations (Apex banks) and small units who do the marketing and monitoring locally where they have strong networks and capabilities to serve the target group.

Private donors like banks, associations and wealthy individuals invest in loan portfolios and support transaction costs and business development services for groups they want to support. They include the aspect of sustainability in all funding guidelines. They also provide seed funding for the establishment of MFIs and support national and European network structures, because they help to foster best practice exchange, develop standards and provide technical assistance for MFIs.

**Some signpost for the future to promote policy measures that encourage funding and support to MFIs:**

1. Fundusz Mikro (FM), the Polish micro-lender with 8,000 active clients currently, started to be profitable in Year 3 and was fully sustainable in Year 4. Interest rates are around 20 per cent, default rate is under 5 per cent and a \$20 million interest-free donor investment has enabled the organisation to accumulate capital that enables FM to obtain commercial loans. The donor set clear goals but gave freedom in implementation.
2. The Northern Ireland (UK) micro-lender Aspire has a margin of around 11 per cent between loan loss rate (7 per cent) and interest rate charged (18 per cent) to cover part of the transaction costs. It competes successfully with regional subsidy schemes that provide free funding on the basis of quality service delivery.
3. In France, the micro-lender ADIE's recent agreement with Paribas, an international bank, is an interesting example of private partnerships. Paribas refinances the portfolio for XY interest rate, it takes over a share of the risk, and pays part of the transaction cost through a grant of 10 per cent of the amount of lent. Such a finance package encourages efficient and effective lending.
4. Un Sol Mon, a foundation of Caixa Catalunya – Spain's fifth largest bank, founded a micro-lending department to pilot micro-loans for self-employment and inclusion of people without guarantees. In three years the number of loans has increased steadily (2001:55, 2002:115, 2003:173, 2004:230 approx.). The interest rate of 6 per cent (annual) now covers the risk (4.6 per cent) and is starting to cover a growing share of transaction costs (75 per cent), and financial costs (51 per cent). The next step is to decentralise marketing and monitoring of the loans. This started under the title "Micro-credit express" in the summer of 2004. Un Sol Mon will become the central back office of the marketing and monitoring hubs.
5. DMI, a national micro-lenders' association in Germany started in autumn 2004 to pool donor money in a central fund that refinances MFI portfolios. The centralised refinance scheme conducts quality controls, through an appraisal and licensing scheme for the micro-lenders.

## 2 POLICY RECOMMENDATIONS

The research has identified different interest groups or stakeholders that could contribute to the design and implementation of policy measures that promote micro-credit as means to finance self-employment:

- Labour ministries and employment agencies could support policy measures that promote self-employment as an alternative for waged employment for unemployed people.
- On the basis of partnerships with micro-credit organisations banks could identify and test a new group of potential customers.
- Social welfare institutions could offer self-employment as an activation option, which is partly self-financing.
- Micro-enterprise/finance support organisations could build the bridges between the three above-mentioned stakeholders and receive funding for that.

Throughout this report policy measures and examples of good practices and policies from different countries have been presented. In this section the emerging findings from these country studies and literature on main issues and opportunities for policy reform are summarised

### 2.1 Dimension 1: Entrepreneurial Context

*Policy measures that foster entrepreneurship*

- Awareness programmes to promote self-employment and entrepreneurship as an alternative for waged employment in school, university and employment agencies.
- Reduction of legal, fiscal and administrative barriers related to self-employment: special (favourable) regulation for micro-enterprises, tax and social security holidays, easy business registration.
- One-stop, temporary assistance for creation of micro-enterprises.

### 2.2 Dimension 2: Promoting micro-enterprises

*Policy measures to promote micro-enterprise support organisations*

- Support programmes for non-financial services delivery to start-ups (mentoring, training etc.).
- Tax incentives and waivers for micro-enterprise support organisations.
- Subsidised funding or guarantees for micro-credit organisations (interest rate subsidies) enabling the institutions to cover their costs from the spread of earned interest and risk cost. In addition, operational cost subsidy as a lump-sum fee per loan is feasible till the industry is competitive and efficient.
- Creation of and support to an umbrella (training and advice centre) or trade association for micro-enterprise support organisations.

*Policy measures that strengthen links between potential self-employed people and micro-enterprise support agencies*

- Provide easily accessible single explanatory information to potential micro-entrepreneurs through appropriate channels (internet, telephone, confidant).

- Define straightforward referral systems for potential micro-entrepreneurs from social welfare, employment and micro-enterprise support organisations.
- Document and exchange know-how from micro-enterprise agencies on potentially successful client identification and appraisal methods.

### **2.3 Dimension 3: Welfare bridge and employment policies**

*Policy measures that reduce the barriers between social system and employment/enterprise system*

- Collaboration between social welfare and employment/enterprise systems to monitor closely the individual who moves from benefits to self-employment.
- Both systems should ensure smooth transition between different sources of income.
- Active labour market policy (incentives to work and penalties for the unwilling) includes and provides incentives for self-employment.
- Awareness programs and incentives for staff of employment bureaus to offer self-employment as an equal alternative for waged employment flanked with appropriate tools to identify entrepreneurial capability/potential.
- Provide financial and business literacy courses to social welfare workers.

*Policy measures that encourage unemployed to become self-employed*

- Conduct research in each Member State to understand social exclusion and the people at risk of poverty in view of their possibilities to become self-employed.
- Programs that assist people at risk of poverty should address barriers like inadequate social participation, insufficient cultural and normative integration, material deprivation and lack of social rights as precondition for self-employability.
- Income bridges should allow testing the income generating capacity of the activity.
- In-work benefits should be available for self-employment on the same basis as waged employment and self-employment should be an integral part of active labour market policies.
- Self-employment opportunities should be offered on the same basis and conditions as waged employment.

### **2.4 Dimension 4: Legal and regulatory framework for micro-finance**

- Specific legislation for micro-lending if niche is clearly defined and as long as the organisations are not in unfair competition with mainstream financial sector operators.
- Reduced capital requirements for micro-credit institutions adapted to the specific characteristics of micro-credit (by amendment to banking directive to open eyes of national regulators).
- Favourable fiscal status of micro-credit institutions serving specific purposes or groups (tax waivers or incentives).
- Ease possibility to attract (commercial) sources for micro-lending.
- Adequate protective private law to prevent indebtedness.

## 2.5 Dimension 5: Financial bridge

*Policy measures that strengthen links between micro-finance organisation and banks*

- Risk sharing loan instruments (financial bridges) whereby banks can test credit worthiness of self employed client.
- Tax incentives for investors (banks) supplying funds to micro-credit retailers.
- Outsourcing of activities related to the loan transaction (credit analysis, business plan preparation and analysis, business monitoring, etc.), to (subsidised) micro-enterprise support organisations.
- Sharing of office premises.
- Cross-selling of services.

## 2.6 Dimension 6: Funding and support for micro-finance providers

*Policy measures that promote diversified funding instruments for micro-enterprises*

- Tax waivers for investors in start-ups.
- Reduction of taxable income for people that provide business support services to start-ups.
- Conducive tax regime for donations to activation programs or CDFIs and MFIs targeting people at risk of poverty.
- Promotion of risk capital instruments for micro-enterprises.

*Policy measures that strengthen partnerships between micro-enterprise support organisations*

- Conduct research to come to recommendations on how governments can best assist micro-enterprise support organisations to strengthen efficiency and effectiveness.
- Information exchange between agencies on potential self employed people and micro entrepreneurs.
- Facilitate links between micro-enterprise support institutions and social welfare institutions for client referral.

# PART 4

## COUNTRY CASES

