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ERENET Summer Message July 2020

Distinguished Readers and Friends,

As the proverb says, even the good priest is learning until his death. In 2020, the mankind is experiencing in four different attitudes:

- We have been learning a new expression: COVID-19;
- The way life slowed down;
- Innovative new digital technologies are implemented in education - teaching and learning;
- Relations – between wife and husband, between parents and

children – became more intimate.

As far as the economic activity is concerned we are experiencing an unprecedented decline caused by the corona virus. It is a sudden and dramatic change for MSMEs because they are more vulnerable and exposed to the liquidity squeeze. The COVID-19 outbreak is causing a global health emergency & devastating effects on businesses and workers. Trade, investment, growth, and employment are all affected and the crisis will have an impact on the UN Sustainable Development Goals.

Massive wave of migrants are at the gate of Turkey ready to invade Europe while Brussels is clumsy considering the national borders as an obstacle which has to be demolished. The former colonists are chattering about the human right who do not practice what they preach. The Coronavirus unhindered are penetrating in Europe and freely circulates on the Soros's open ended society. While thousand people in Europe lost their job, the liberal management of the European Commission intends to bring up to strength workforce and fill in the employment with illiterate migrants. The EU was not able to handle this pandemic. National Governments have been introduced measures to treat this epidemic.

There is a critical need for Governments to offer financial support for vulnerable individuals and businesses. One of the tools help SMEs to overcome the coronavirus pandemic is using microfinance. This special issue of the ERENET PROFILE highlights the major achievement in this field.

Microfinance is a financial service to low-income individuals or to persons who are excluded from formal banking services. There is a lack of consistent and commonly used definition of microfinance. The European Commission defined microcredit as a loan under EUR 25,000 to support selfemployment and microenterprises. (EC 2007:12). According to an EC report (2004) 30% of microloans backed by guarantees below EUR 5,000 and 40% between EUR 5,000 to 10,000.

While the EC initiative “JEREMIE” combines contributions from the operational programme of the European Regional Development Fund and the European Social Fund, the “JASMINE” initiative launched in 2007 aimed at supporting the development of non-bank microfinance institutions in the Member States. The new Employment and Social Innovation (EaSI) programme promotes sustainable employment, support social protection, combats social exclusion and poverty and improve working condition. It brings three EU programmes managed separately between 2007 and 2013: these are the PROGRESS, EURES and Progress Microfinance.

Dr. Antal Szabó
Scientific Director of ERENET

THOUGHTS ON MICROCREDIT

(Preface)

Microcredit is a special area that is becoming more and more widespread in the field of business financing. It basically means lending money to people who want to make a living from their own income-generating activity but are unable to obtain small loans from commercial banks – that is the main players of the financial market – to finance their activities. There are those who bless it and there are those who curse it, but the majority of people completely misunderstand the essence of this activity. A lot of microfinance institutions operate around the world with different methods and results. Due to its expected positive social impact, more and more public money is allocated for microcredit activities by the individual member states and the European Union itself. The authors of this publication would like to bring this activity and the underlying “professional secrets” closer to the readers.

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PAPERS

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MICROFINANCE IMPACT ASSESSMENT AND MANAGEMENT

ABSTRACT

In this day and age the importance of impact has risen and grown, and an increasing number of stakeholders at different levels are interested in its measurement and management. An extensive literature is to be found when studying this topic from a donor or international cooperation agency perspective; however, tackling the problem from Microfinance Institutions (MFIs) perspective is not developed as much as other fields are.

Being aware of the necessity for Financial Institutions (FIs) to prove their actions and accountability towards donors as well as clients, Microfinanza proposes an impact assessment to be included into FIs daily work. Thanks to its longstanding and worldwide experience in technical assistance, Microfinanza has decided to undergo the impact assessment and management also considering the triple bottom line, i.e. the economic, social and environmental dimensions, to fully analyse the topic.

A simple methodology and data collection are presented in order to guide practitioners to set the Monitoring Information System (MIS) in order to make the impact assessment a daily and automatic work. A special focus is given to communication and reporting, which are crucial to best communicate accountability towards external and internal stakeholders.

Main conclusion concerns the necessity of sustainability at all three levels identified by the triple bottom line, as growing importance will be put by European Institutions coherently with the Green Deal as a way of example. In fact, impact measurement, its analysis and management, will become a key component in reporting comparable and reliable non-financial information. Furthermore, a sufficiently structured scheme may be essential to face complexity and avoid unnecessary costs related to reporting non-financial information.

Keywords: impact analysis, microfinance, non-financial disclosure, sustainability, triple bottom line

JEL Classification: O19; O20; P46; Q01; Q56

1. WHAT ARE IMPACT AND IMPACT ASSESSMENT? A BRIEF OVERVIEW OF THEORY AND DEFINITIONS

Impact is defined as “a powerful effect that something, especially something new, has on a situation or person” (Cambridge Dictionary, 2019). Since 2000s, its measurement has become a priority for both public and private organizations, independently from their vision and mission statements. The word ‘*impact*’ has come to

different means and *nuances*: private investors talk about ‘impact investing’, whereas social actors refer to ‘social impact’ and ‘social change’. Moreover, the urgent need of finding solutions to climate change has pushed the international community to focus on the environmental dimension widely defined as environmental sustainability. So impact measurement, independently from the different significances we do give to this word, being able to quantify and measure medium and long term impact of our interventions, is a top priority.

The power of impact is important as it has consequences, both positive and negative, on a certain person, a community or situation, even environmentally. To study the impact, we do distinguish two types of evaluation:

1. Impact **analysis** &
2. Impact **assessment**

According to OECD (OECD Directorate for Science, Technology and Innovation, 2014), impact analysis is “*part of the needs analysis and planning activity of the policy cycle*”, involving the perspective of what the impact of an intervention could have or be, and it is used to inform the policymakers. Therefore, this analysis is an *ex-ante* evaluation. On the other side, impact assessment is “*part of the evaluation and management activity of the policy cycle*”, and is done *ex post*. However, we do underline that many international development organizations have given a definition of what impact is and they do apply it to their field of intervention.

To sum up, we can say that the main difference between analysis and assessment is the different time perspective: the first is *prospective*, meaning that it is done in the first phases of project or programme planning looking forward the interventions to be executed, whereas assessment is *retrospective* and *ongoing* as it focuses on the effect of the interventions.

1.1 Impact assessment and the Theory of Change

Impact assessment can be also linked to the **Theory of Change** (ToC). According to the Center for the Theory of Change (Center for Theory of Change, s.d.), it is “*essentially a comprehensive description and illustration of how and why a desired change is expected to happen in a particular context. [...] It does this by first identifying the desired long-term goals and then works back from these to identify all the conditions (outcomes) that must be in place (and how these related to one another casually) for the goals to occur*”. Following the definition, an Outcome Framework needs to be identified and it provides the basis for the finding the leading activity or intervention, so that a clear view from the start to the end of the chain is to be seen (from activity to impact). A ToC also helps to identify the underlying assumptions and risks that will be vital to understand and revisit throughout the process to ensure the approach will contribute to the desired change. Nowadays, ToC has the gained attention of international agencies, organisations and aid workers as it goes a step further than the well-established LogFrame. However, we as this chapter is not dedicated to different project evaluations in international development context, we do not go deeper into the topic, but we will give a brief glimpse of it. In brief, the theory of change starts from the desired change (impact) and looks for the activities/intervention that lead to it.

Briefly, here as follow the main parts of the theory of change (or *results chain*):

- i) **Input**. The first element necessary to set up activities and interventions;
- ii) **Activities or interventions**. They are actions undertaken to carry out a task;
- iii) **Outputs**. They are the results of the activities and can be improved capacities, capabilities, skills, systems, policies; they can also be tangible elements such as something built, created or repaired;
- iv) **Outcomes**. They are a further level of result and can be the effect resulting after a short/medium period. It can be hardly controlled differently from outputs.
- v) **Impact**. It is the ultimate level of result, and the effect of intervention cannot be seen in short or medium term, but we need to wait for years to see the effective improvement of a certain conditions. Both outcome and impact concern a change in behavior or in performance

What is the relationship between theory of change and impact assessment? We can say it is mutual:

- As theory of change looks for social change, impact assessment is a useful tool to identify data which are necessary to be collected/gathered and for finding out indicators for output, outcome and impact in a short/medium and long term perspective.
- ToC focuses on the long-term impact, studies the “*long chain of cause-effect relations*” and acknowledges the complexity of development and change processes (Gerard & Saskia, 2015). All these elements can be reconducted to the impact assessment which aims at describing and measuring the changes occurred along the chain

To sum up, impact assessment is based on indicators used to monitor progresses in the ToC.

1.2 Impact assessment and microfinance

As mentioned above, impact assessment has become a crucial topic for many stakeholders who wish to study the consequences of their actions and interventions, especially in international cooperation programs implying ToC.

When dealing with microfinance and microcredit, we mainly refer to developing countries, where microcredit was conceived and has found breeding ground for developing. In fact, microfinance allows ‘*unbankable*’ people to get access to finance and get them a second chance to get out of poverty trap. However, following the economic and financial crisis which has affected also Western countries, microfinance in general has gained attention and has become a trend topic even in Europe, not being confined at developing countries anymore.

1.3 Impact assessment and stakeholders at European level

European Commission states that “*the impact assessment process is about gathering and analysing evidence to support policymaking. It verifies the existence of a problem, identifies its underlying causes, assesses whether EU action is needed, and analyses the advantages and disadvantages of available solutions*” (Commission, European, 2019). In fact, following international trends, since 2002 European Commission has started talking and approaching the theme of ‘impact assessment’, and in 2006 it has established an Impact Assessment Board (IAB). It is an independent entity whose role and scope are to better the quality of impact analysis and assessment of EU interventions. Moreover, it examines all EC impact assessments, issues opinions asking for improvements, and its opinion is required for a proposal at EC level. It is composed of nine high-level officials chosen because of their personal capacities, especially their expert knowledge on the three bottom-line, i.e. economic, social and environmental pillars. The Board is chaired by Deputy Secretary General for Smart Regulation. However, IAB has been replaced by the Regulatory Scrutiny Board (RSB), introducing wider responsibilities, such as implementing the Better Regulation Agenda. In fact, both institutions are part of a broader European programme and strategy called “Better Regulation”, whose scope is to open up policy and law-making, listening to individuals. More into detail, the Agenda aims at ensuring:

- An open and transparent decision-making process;
- A contribution throughout policy and law-making processes by citizens and stakeholders;
- Evidence and understanding of the impact of EU actions;
- A minimum regulatory burdens on businesses, citizens and public administrations.

Nowadays, RSB is composed of three high-level commission officials, and three experts recruited from outside the EC.

1.4 Why has impact assessment become so important?

According to Hearn and Buffet (Hearn & Buffard, 2016), there are many economic and political factors which have led to the growing interest for the topic of impact assessment in the last twenty years. They state that a possible explanation is the reduction of financial resources available for international development programs, given by donors and agencies – and consequently the need for justifying the use of those financial resources; another reason might be the fact that in international development projects and programmes, ‘*welfarism*’ has

clearly failed to alleviate poverty, and social and financial exclusion; therefore, there has been a growing need of being able to state and clarify how money was spent.

Another possible reason could be the need for overcoming the mere assessment of interventions from the economic point of view. In fact, a vast and broad literature was produced in the last years to state that there other dimensions to take into consideration, such as the social and the environmental one.

Before continuing, it is important to underscore the link between impact assessment and microfinance. In fact, if considering other dimensions, microfinance may have a positive social *impact* or may generate positive externalities, but we need to learn how to measure and capture it. Moreover, in the last year, an ongoing study and research was conducted by Microfinanza Srl (Microfinanza Srl, 2019), in order to stimulate debate inside and outside microfinance world. The pioneering and ambitious study was focused on the link between impact and indicators, being the latest referred to Social Development Goals (SDGs) as well. SDGs can be defined as “*urgent call for action [...] in a global partnership*” (United Nations, s.d.) and has gained worldwide attention at different levels. The over-mentioned 17 goals aim at “*eradicating poverty in all its forms and dimensions, including extreme poverty*” (United Nations, 2015), being committed in achieving sustainable development in three dimensions – economic, social and environmental. The Agenda 2030 is based on principles and purposes of the Charter of the United Nations, including full respect for international laws, on Universal Declaration of Human Rights, on Millenium Declaration and on 2005 World Summit Outcome. It is important to underscore the fact that none of the three dimensions can be separated to the others in order to reach a sustainable development: we strongly believe that economic development cannot ignore anymore the **scarcity** of natural resources, especially water, and the **necessity** of starting acting responsibly towards nature.

The underling reasons that have led to this Agenda are above others the extreme poverty of which billions of people suffer from, and the lasting inequalities, including gender ones. Therefore, Microfinanza has decided to adopt the SDGs as reference scheme for the indicators to be used for conducting an impact assessment study: in fact, poverty is a multidimensional concept, referring not only to material poverty, but also to lack of health, education and dignitous living standards (Oxford Poverty & Human Development Initiative, 2019). Therefore, the link between SDGs, impact assessment and microfinance is clear: the latest is one tool through which deprived individuals can try to drop out from the poverty trap, being financially and socially included. However, the microfinance sector is strongly in need to demonstrate benefits of financial and social inclusion and whether access to finance may improve incomes, capacities, empowerment, well-being and opportunities of clients served by the different financial institutions (Microfinanza Srl, 2019). The broad nature of financial inclusion asks for adopting a holistic approach by considering several dimensions related to the social, economic and environmental capital, and that is the reason why the methodology suggested by Microfinanza focuses on these three dimensions responding to the triple bottom line. Moreover, we have been investigating the meaning and importance of financial and non-financial services through the analysis of the above-presented dimensions and capitals, and by focusing on five key categories of stakeholders such as clients, microfinance providers, investors, public institutions and donors and intervention community.

In fact, a set of indicators must be established in order to monitor and analyse the loan portfolio and credit history of the client. The proposed set of indicators should be consequently embedded in the MFI data collection procedures and become standardized for being able to produce reports, for internal and external use.

2 HOW TO MEASURE IMPACT?

As stated in the previous section, impact assessment is crucial to demonstrate the effectiveness and efficacy of an intervention, both financial and non financial. However, for the sake of the book, we will focus on microcredit/microfinance interventions at European level. In the last years, Microfinanza has developed a methodology which involves three dimensions (i.e. economic, social and environmental) and on a set of indicators retrieved from different sources and from own elaboration, based on the long international experience in different contexts.

It is important to notice that impact assessment is very precise and differs from evaluation: in fact, this latter answers to many questions and focuses on broader aspects of intervention. Being very narrowed down on specific topics, impact assessment needs a restricted framework, answering to:

- **What** impact we want to investigate;
- **Whom** the impact concerns;
- **How** the impact is;
- **When** impact materializes.

The following sections present the method used by Microfinanza in order to answer the questions.

2.1 Methodology

WHAT

To limit the impact, we do consider three different **dimensions**, i.e. economic, social and environmental.

Firstly, the **economic** dimension represents the capacity to satisfy essential needs for individuals and groups of individuals through the creation of economic added value. It is the easiest dimension to study and to deepen as it is composed of figures and numbers. Secondly, the **social** dimension concerns values, norms, roles and rules, and influences the human behavior. Sustainable social dimension can be related to the concept of quality of life of individuals, groups and communities which does not necessarily correspond to a high level of economic status. It is also characterized by the presence of positive, neutral and negative externalities caused by human action. At last, the **environmental** dimension represents all those elements such as activities, products and services which interact with the environment in an ecological sense. It deals with fragility of ecological and biophysical systems and their interactions. It is characterized by the presence of negative externalities which have a negative impact on the environment in the ecological sense. We do not consider environment as external context but only as natural sphere.

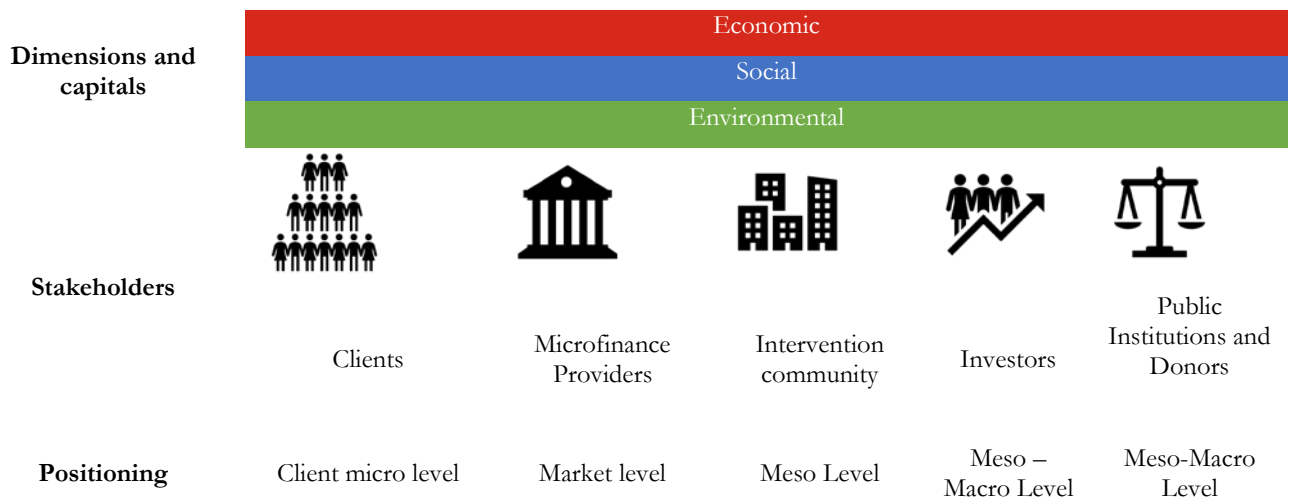
WHO

Once the dimensions are identified, we need to clearly define the **stakeholders**, who have a twofold dimension of 'interest', meaning that they are interested because of the results of the impact assessment, but also interested because they are affected by it. As part of impact assessment in microcredit program, we do identify five stakeholders:

- i)* **Client**
- ii)* **Microcredit provider**
- iii)* **Intervention community**
- iv)* **Investors**
- v)* **Public institutions and donors**

level, we talk about microcredit provider, and not microfinance institutions, and they are all banking and non banking institutions providing microloans up to EUR 25,000 to entrepreneurs (i.e. small enterprises), to social economy enterprises, to individuals wishing to become self-employed, or to unemployed (Kraemer-Eis & Conforti, 2009).

Here as follow a summary of stakeholders and their positioning is presented:



HOW

As previously mentioned, to measure the impact, Microfinanza has developed a set of indicators having the following characteristics:

1. **Stable**, as a good indicator should be useful and used for a long time (we should stick to the same indicator throughout the whole analysis, not changing it on the way);
2. **Comparable**, as a good indicator should be useful to compare data of homogenous institutions, projects, programs and situations;
3. **Operative, specific and measurable**, as a good indicator should be feasible (in terms of financial means and timing) to collect these data.

The indicators are related to the three dimensions and refer also to the SDGs. They are both quantitative and qualitative, and refer primarily to an index (*synthetic index*) which is then associated to an outcome.

In the European and microcredit framework, impact assessment follows this path:

- Identifying the target and goals to be achieved, analyzing vision, mission and values of the MCP;
- Selecting and developing indicators;
- Updating or adjusting Monitoring Information System (MIS);
- Organizing data collection as embedded procedure;
- Analysing data and working out the reporting.

The hierarchy of analysis is as follow:

- Outcome theme defines the macro area (*What is the expected outcome?*)
- Index defines the desired change (*Which kind of change is the stakeholder looking for?*)
- Indicator stands for the measure of the change
- Source represents where the information is retrieved

Microfinanza strongly believes that **MIS** and its use should have a **central role** when studying and analyzing microfinance impact. In this day and age, the technology available at most financial institutions would allow to support data collection and entry into MIS which could be further analysed according to the selected set of indicators and desirable changes that stakeholders would like to follow through a systematic tracking of changes

To conclude, we do underline that the hereby proposed methodology can be used as complementary to other assessments.

3 IMPACT ASSESSMENT FROM AN MFI PERSPECTIVE

The current study presents an example of indicators that can be used to measure medium and long term impact inside MFIs, taking into account different perceptions. To sum up, we as follow present the step-by-step approach for an effective impact assessment. We do underline that it should be **an embedded procedure** in Monitoring Information System (MIS) and that indicators should be **adapted** to different stakeholders, more specifically to vision and mission.

3.1 Who is your target? Which goals would you like to achieve?

The stakeholder looking for changes, i.e. outcome and impact measurement, should clearly **identify** its target and goals to be achieved and to required and desired kind of changes according to the three suggested dimensions: the economic, the social and the environmental ones. These latter should be further interrelated and linked in order to promote progressive and positive changes at different levels. In fact, a positive change at the economic level should be capable to produce positive effects also at social level without having a negative impact (or by expressing it in economic terms, without having a *negative externality*) on the environment. According to the approach suggested by Microfinanza, it is not enough to measure ‘the number of jobs created, or the economic activities supported’ as the other two dimensions, social and environmental, should be explored as well. Few questions we could ask are whether these jobs and economic activities are positively contributing to changes at household level or at community level, whether the social cohesion has improved, whether the economic activities are environmentally sustainable in terms of use of natural resources and waste reduction. Once the target is clearly known and goals identified, an appropriate set of indicators should be identified and worked out according to changes to be measured in the short, medium- and long-term timeframe.

3.2 Select or develop indicator

Microcredit Providers, donors, investors and public institutions have their own set of indicators to measure changes across programmes and projects they support or to simply monitor if funds are efficiently used.

Financial institutions are more and more focused on their financial and social performances according to international best practices and procedures. However, even with a huge amount of potentially interesting data, indicators used are very few and it is difficult to grasp the signs of change; it is not always clear what to measure and whether the measurement of processes is useful and how can be used internally or externally for analysing results of ongoing activities and guiding decision making processes, as well as reporting or communication and visibility purposes.

So, the suggested methodology should be used to identify a set of stable, comparable, operable, specific and measurable indicators (about 10 to 15), covering the three dimensions; starting from the systematized ones provided by different authoritative source and by those suggested, indicators should be identified according to stakeholders’ own measurement purposes. Selected indicators should be furtherly linked also to SDGs and their monitoring framework.

Finally, selected indicators should be used to constantly capture and monitor changes against the progression of time; a data collection plan should be embedded in the MFI working procedures and the MIS should be used as a data collection tool.

3.3 Update or adjust your MIS

Each Microcredit Provider has a specific MIS to manage account systems, portfolio and to track mainly financial performance through a set of financial indicators. An increasing number of financial institutions is chasing also social indicators according to internationally recognized social performance best practices and

procedures endorsed by the microfinance industry¹. At MIS level, inputs (data) and outputs (reports) are to be linked, too. To measure the selected set of outcomes, input must be the most adequate to measure expected changes. The work must be based on an adequate collection of data at the source to ensure that the same data can then feed the analysis of the outcomes according to the selected indicators.

The MIS is the ‘core’ of data management and is used for different reporting purposes at MCP level, for regulators, donors, partners and stakeholders. In our experience we can say that MIS and data stored are often underused and given the huge amount of data collected at field level by the staff and the technology, available outcomes measurement can be improvable. Few refining might be needed at software level.

3.4 Organize data collection as an embedded procedure

The work must be based on an adequate collection of data at the source to ensure that the good and right data can then feed the analysis of the outcomes according to the selected indicators. An internal data collection plan and related procedures should be defined and known by the staff that should follow the process. The data must be collected constantly and entered into the MIS for subsequent processing. It is key to have data looked-for obtaining the selected indicators.

3.5 Analyze data

Collected data according to a work plan and constantly imputed in the MIS will feed the outcomes analysis according to a previously selected set of indicators. Data analysis according to impact measurement objective should be an embedded practice allowing to have a clear understanding on outcomes related to the three dimensions: the economic, the social and the environmental. According to data analysis it will be possible to have a critical thinking on results achieved and analysing data more in detail. Data will feed the set of indicators and by guiding the outcomes analysis will serve to guide the operations of the institution according to its mission and vision. The constant availability of data with respect of its work objectives will facilitate the decision-making process by the BoD, the external communication - towards partner and donors – and will improve visibility with respect to community.

3.6 Work out reporting

The outcome assessment should be used to constantly guide and systematically analyse changes incurred at client and community level in the three dimensions (economic, social and environmental). Reports can be a time-consuming exercise, if data are not constantly collected and managed, but certainly reports are relevant to every stakeholder and for internal decision-making process. Reporting can be used as way to present MFI to external stakeholders as well as to internal communication.

4. CONCLUSIONS

4.1 Why has impact assessment become so important?

According to Hearn and Buffet (Hearn & Buffard, 2016; Authors, 2018), there are many economic and political factors which have led to the growing interest for the topic of impact assessment in the last twenty years. They state that a possible explanation is the reduction of financial resources available for international development programs, given by donors and agencies – and consequently the need for justifying the use of those financial resources; another reason might be the fact that in international development projects and programs, “welfarism” has somehow failed to alleviate poverty, and social and financial exclusion; therefore, there has been a growing need of being able to state and clarify how money was spent.

Another possible reason could be the need for overcoming the mere assessment of interventions from the economic point of view. In fact, a vast and broad literature was produced in the last years to state that there are other dimensions to take into consideration, such as the social and the environmental one. In this sense, evaluating those external determinants which are not counted into the market, become a key element.

¹ Social Performance Task Force, Cerise, Smart Campaign

4.2 Impact and sustainability

Impact assessment is a transversal topic which can be related to many others such as sustainability. In fact, as stated in the comprehensive work “Sustainability: A Comprehensive Foundation” (Theis & Tomkin, 2015), “sustainability indicators are needed to improve our understanding of the nature of human demands on ecosystems and the extent to which these can be modified”. So, impact assessment can be also fruitful to make this understanding easier and more comprehensive.

Furthermore, impact assessment can be helpful for those stakeholders which need to give evidence and transparency of their actions and performances, not necessarily economic, but environmental, social and governance. For instance, at European level, in 2016 a High-Level Technical Expert Group on sustainable finance was created with the specific aim to elaborate a common European strategy on sustainable and green finance. One of the objectives of this HLTEG is to better transparency concerning societal communication: in fact, private entities are not required only to communicate financial information, but non-financial as well. So, it is clear the importance that impact assessment and its communication towards internal and external stakeholders require.

In this sense, impact assessment may become one of the major and key topics in the following years. As Ursula von der Leyen, President at the European Commission states, even in times of crisis (i.e. COVID-19), “the political necessity is as strong as it was before the crisis, because climate change and global warming did not stop – they will keep on going. So, to fight it is in our own interest if we do not want to pay heavily for the costs of non-action”. It is clearly necessary to “kick-start our economies and drive our recovery towards a more resilient, green and digital Europe”. For this reason, we need to promote a new paradigm, in which productivity, environment, stability and social rights are ensured, interlinked and disseminated. In the following years we will witness a transition through a new idea of sustainable finance, with capitals addressed to sustainable investments, sustainability integrated in the internal risk management system, and a promotion of the transparency and compliance, together with a long-term vision and strategy.

In all likelihood, private actors and entities will be prompted to become more and more familiar with non-financial information on their social and environmental impact disclosures (also considering the legal requirements and outlooks related to the EU Directive 2014/95).

Impact measurement, its analysis and management, will become a key component in reporting comparable and reliable non-financial information. Moreover, a sufficiently structured scheme may be essential to face complexity and avoid unnecessary costs related to reporting non-financial information.

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Tibor Szekfü

Engineer-Economist

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Abstract

"Microcredit is special area that is becoming more and more widespread in the field of business financing. It basically means lending money to people who want to make a living from their own income-generating activity but are unable to obtain small loans from commercial banks – that is the main players of the financial market – to finance their activities. There are those who bless it and there are those who curse it, but the majority of people completely misunderstand the essence of this activity. A lot of microfinance institutions operate around the world with different methods and results. Due to its expected positive social impact, more and more public money is allocated for microcredit activities by the individual member states and the European Union itself. The author of this publication would like to bring this activity and the underlying "professional secrets" closer to the readers.

Tibor Szekfü, Engineer-Economist, President of the Hungarian Microfinance Network, university lecturer has more than 25 years of experience in the field of microcredit. His experience provides a comprehensive picture and helps to understand the operation and characteristics of microcredit, which he introduces based on the curriculum of the "Microfinance" module of the Master's course of the University of Cádiz, where he also teaches.

In his article, he moves from the general presentation of microcredit, through the definition of its social need, to the definition of the most important factors of publicly funded microcredit programmes. This knowledge may be useful both for those working in the field of microcredit and for professionals working with public funds, especially those working in decision-making positions."

Keywords: microcredit, microfinance, publicly funded microcredit, social need of microcredit, utilization of public money in microfinance, principles of microcredit, enterprise development

JEL Classification: G21, I28, O16, L31, Q1,

UTILIZATION OF PUBLIC MONEY IN MICROFINANCE - teaching principles and practical issues in the international training of experts –

As microcredit – in which the European Union itself invests substantial amounts – is becoming an increasingly widespread activity carried out by tens of thousands of organizations around the world, there is a growing demand for training professionals at higher level. In response to these needs, the University of Cádiz in Spain and Fejér Enterprise Agency, which has decades of professional experience and is recognized internationally, have developed a fully online postgraduate programme, upon the completion of which one can obtain a MASTER's degree accredited in Spain.

One of the main modules of the Master's course launched under the title of MICROFINANCE, HUMAN RIGHTS AND DEVELOPMENT COOPERATION is "Microfinance".

By completing the module independently, students will receive an international microfinance expert certificate. The extensive curriculum introduces the various types of microcredit, its microeconomic background and the practical issues related to the implementation of the specific microcredit programmes.

The issue of establishing and operating publicly funded microcredit programmes is given special attention during the course. This is particularly important because in case of publicly funded programmes it is essential that the programme should have positive social impact and focus on achieving this positive social goal.

This knowledge could be useful for people working in the field of microcredit and for professionals working with public money, especially for those working in decision-making positions.

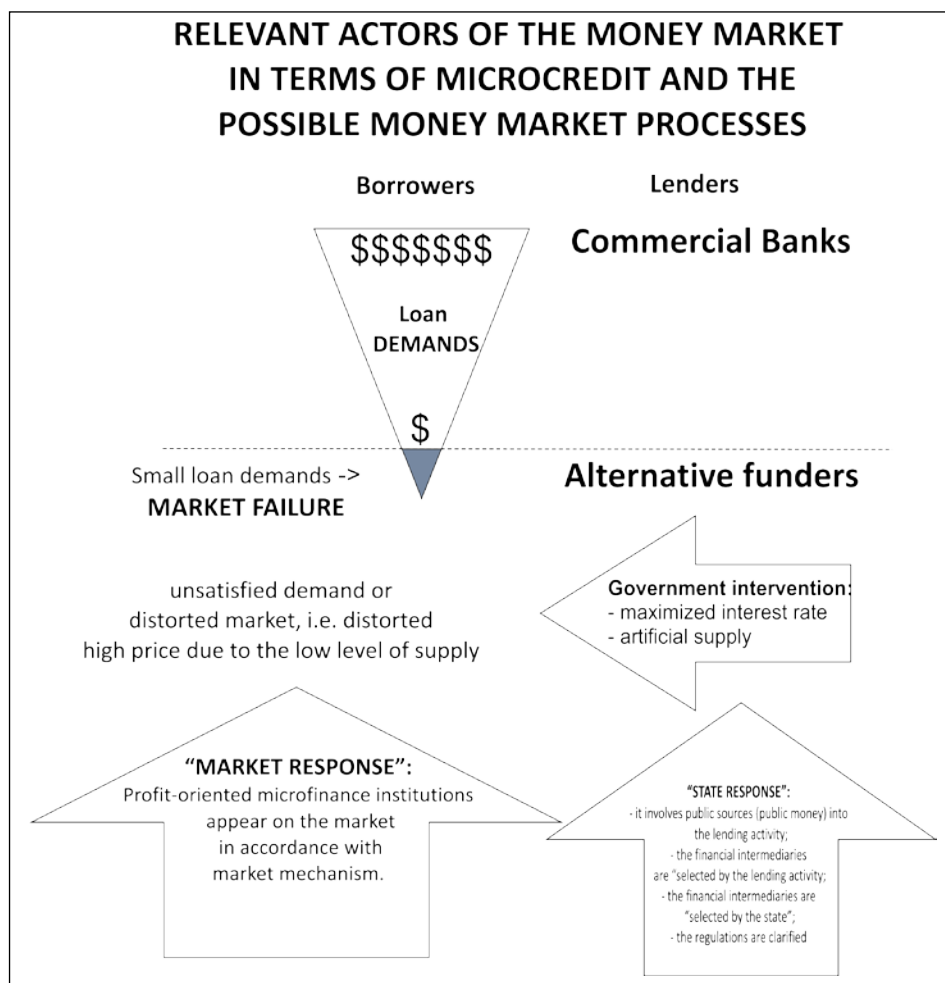
In my article I will present some important principles concerning microcredit based on the curriculum of this course.

MICROCREDIT IN GENERAL

The phenomenon described as the **crisis of the microfinance sector** is well-known in many countries of the world. In certain countries, the majority of microcredit clients viewed microcredit as a tool that contributed to their insolvency instead of improving their material well-being. That is why a lot of clients committed suicide. Also, a lot of protests were organized against microcredit, and coalitions were set up demanding the ban of microcredit.

The above-mentioned detrimental social phenomenon **cannot be explained with the crisis of the sector** due to the fact that **there is no uniform microfinance sector**.

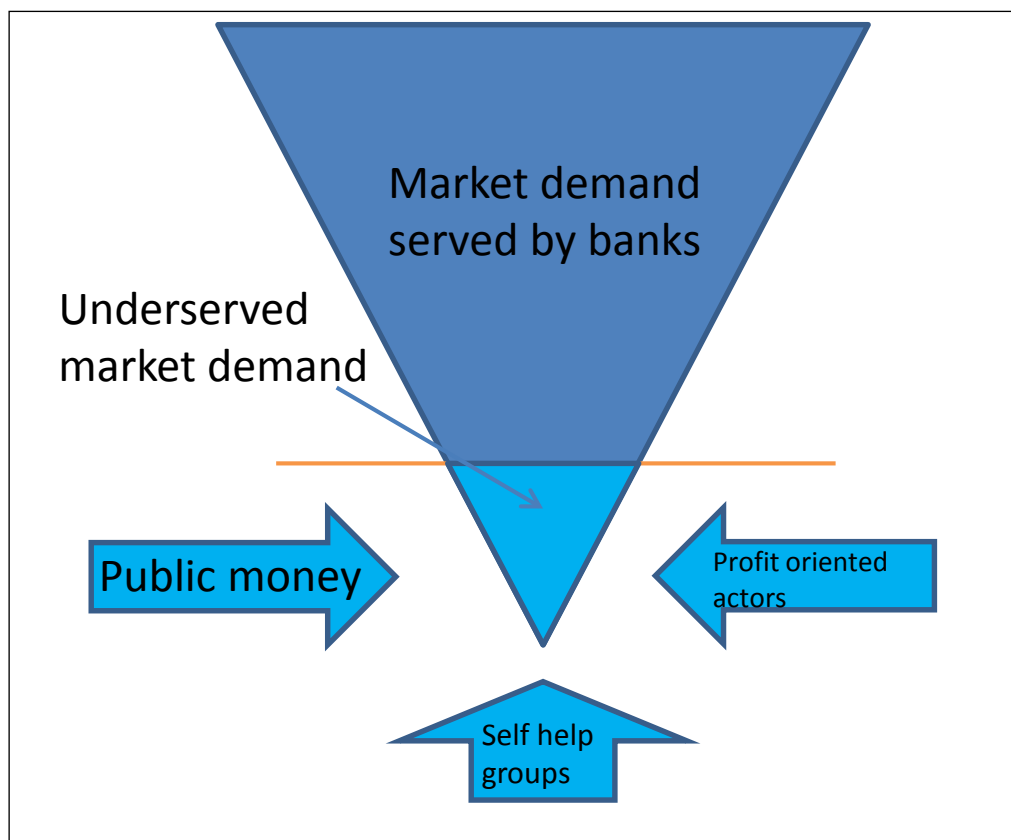
This phenomenon is a **consequence** of a natural market process called **market mechanism**. Putting it simply, the point is that in markets where there is a lot of disposable income continuously, supply is likely to appear, which entails price equalization. If supply fails to appear and no price equalization takes place, it is **classified as market failure**.



As illustrated in the figure, the majority of borrowing requirements appearing on the financial market are satisfied by the Commercial Banks. At the same time a great part of the small loan requirements having relatively high costs and risk remain unsatisfied, and **market failure** occurs. According to **market mechanism**, a supply appears on the side of the alternative profit-oriented microfinance institutions, but due to its limited nature the demand-supply equilibrium described earlier is not fully achieved. As a result, there is a high level of **unsatisfied demand** and **distorted high price**. In a best-case scenario, the state intervenes in accordance with the concept of sustainable society. On the one hand, it limits the maximum interest rates with **administrative and legal means**, and regulates the operation of microfinance institutions. On the other hand, **it creates artificial supply** with the **involvement** of public funds (**public money**). It sets up revolving social microcredit funds from public sources, from which (ideally non-profit) microfinance institutions selected thereby perform microcredit activities.

Examining the phenomenon further, we can state that the extremely diverse microcredit activity that is present in the world can be basically classified as follows based on the type of socio-market response given to the mentioned market failure:

- the appearance of alternative profit-oriented market players (speculators, or “ethical” social businesses) to exploit the market gap with the hope of achieving high profit;
- the setting up of self-help microcredit groups;
- governmental intervention with financing (and regulating) tools.



It is absolutely obvious that we have to differentiate among the three operating-financing types, and in particular between non-profit microcredit schemes (e.g. programmes funded from public money or donations) which aim to achieve social objectives and programmes serving the interest of investors (speculators). At the same time we must point out that the non-profit and for-profit financing fields operate according to

completely different principles, operational goals and standards as well as social expectations , therefore **no uniform standards may be applied for their operation.**

The curriculum of the aforementioned University of Cádiz mainly describes the operation and features of the self-help groups organized on the basis of the model of Muhammad Yunus (Nobel Peace Prize Laureate, economist), which is presented by Jaime Duran Navarro, Honorary President of the Spanish Microfinance Network, former Vice-President of the European Microfinance Network, and university lecturer. I present the necessity of governmental intervention, its basic principles, professional background and characteristics as well as the practical issues related to the creation of programmes with my colleague, Péter Vonnák.

SOCIAL NEED

Where public money and community resources are used to satisfy a social need or to tackle a social problem, it is always advisable to follow the logical steps below:

- identifying the social problem or need,
- determining whether the problem or need requires central government intervention due to its scale, and whether the situation can be improved through such an intervention,
- where the intervention of the government is justified, examining what tools are suitable to tackle the problem,
- selecting the tools with which the identified social need or problem can be tackled efficiently or with the help of which social impact can be maximized,
- when reviewing the applicable tools, determining the resource need of the set of tools to be applied (expected costs and when they are incurred),
- determining the mechanism by which the social need – social problem is tackled with the help of the resources and the selected set of tools,
- starting the intervention in addition to informing the stakeholders.

In our case the social problem is that certain social groups do not have or have only limited access to loans granted by commercial banks, from which they could finance the launch or development of an independent economic activity supporting their and their family's subsistence.

This reduced creditworthiness could be attributed to:

- the small borrowing requirement of the clients (due to the high costs it is not worth dealing with such small amounts);
- the inadequate collaterals offered by the clients (owing to the lack of collaterals there is no adequate cover for the loan if the client becomes unable to repay the loan from his activity or becomes insolvent),
- the fact that they are start-ups and as a result they have no entrepreneurial past that could be evaluated, therefore the risk involved in lending money to them cannot be accepted by the banks.

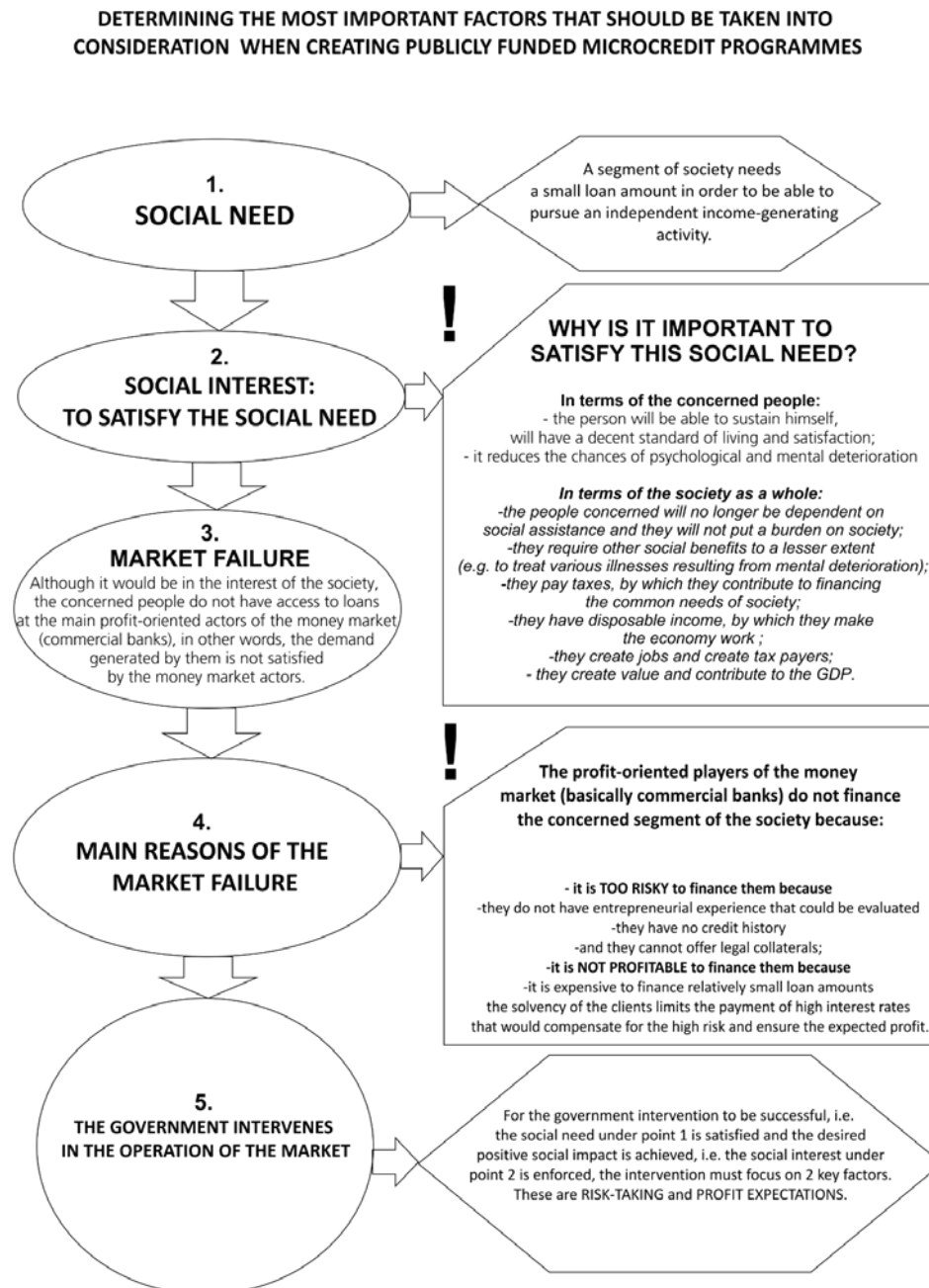
It must be noted that in addition to the economic constraints such high-risk lending may also have legal constraints, since the banking laws of certain states may severely limit how much risk banks may take in order to protect the depositors since the banks mainly grant the depositors' sources in the form of loans.

Although the scale of this social problem (social need) varies from country to country, it can also be detected in the developed industrialized countries continuously.

PUBLIC MONEY AND MICROCREDIT

It is a fundamental requirement that public money should be used in the interest of the society and not in the interest of private individuals.

Where public money is used to solve a social problem, it is inevitable that this social goal is given priority. Therefore, it is important to bear in mind that the development of microfinance from public money is only a tool used for solving a social problem and not the goal itself. The need for microcredit as a social need and the importance of meeting such need are illustrated in the figure below.



The main reason for MARKET FAILURE (no supply appears to the demand that would balance the prices, no equilibrium price is achieved) is that the high **CREDIT RISK IS NOT ASSUMED** by the main players of the financial market (e.g. commercial banks). Also, the solvency of the affected customers does not allow for the compensation of the expected high **CREDIT LOSSES**, and the expected revenues do not fully cover the **OPERATING COSTS**. (As mentioned earlier, they cannot satisfy the PROFIT EXPECTATIONS of the shareholders of the banks either – under normal operation –, and in most countries the banking act does not allow such risky funding in order to protect the interests of the depositors and shareholders.)

Accordingly, to achieve the desired positive social impact the **high risk associated with lending must be assumed** by the state, in other words, clients not having an entrepreneurial past that can be evaluated, or not having adequate legal collaterals should also be able to access the sources. As a result, it must also be accepted that **the revenues coming from the lending activity will probably not cover the credit losses and the operating costs fully**.

When setting up a new publicly funded microcredit scheme, in terms of the achievement of the positive social goal it is crucial **WHO BEARS THE RISK OF LENDING** (*how credit risks are accounted for and financed*), and **WHO AND FROM WHAT SOURCES COVERS THE OPERATING COSTS**.

Funding the socially important target group of microcredit poses very high credit risk. Therefore, **every circumstance that forces the key actors of the microcredit scheme to AVOID THIS HIGH RISK prevents the programme from channelling the sources to the target group**.

In case of publicly funded microcredit schemes **the return on the funds made available must be achieved on a wider social level and not on the level of sources made available, in accordance with the criteria set for sustainable society**.

According to the Declaration issued by the World Academy of Sciences: ‘*Sustainability is the satisfaction of current human needs through preserving the environment and natural resources for future generations*’. The most important criteria and the essential requirements of a sustainable society are:

- ***social justice***, the basis of which is ensuring equality regarding access to opportunities, and sharing social burdens;
- ***continuous efforts to improve quality of life; the sustainable use of natural resources***, the implementation of which requires the environmentally conscious and environmentally ethical attitude of the society;
- ***preservation of the environmental quality***.

The quality of life includes health – the complete physical, mental and social well-being – and in connection therewith material well-being, healthy environmental conditions, democratic rights, safety and education accessible to all.

The objective for ensuring decent living conditions, suitable quality of life and well-being applies to everybody, to the future generations as well.

A systemic approach and governance are inevitable for the implementation.

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MICROCREDIT IN THE EUROPEAN UNION: A FEASIBLE MEANS FOR BUSINESS GROWTH, FAIR ACCESS TO CREDIT AND SOCIAL INCLUSION**ABSTRACT**

Microfinance in Europe has been consolidated as an essential tool of social policy, for the promotion of self-employment, microenterprise support and the fight against unemployment, social and financial exclusion. The European Commission renovated this tool in the framework of the Programme for EaSI for the years of 2014-2020.

The aim of this article is to analyse the role played by the European Union in supporting microcredit in the member states and to assess the importance of microfinance in Europe. The structure is the following. Chapter 2 illustrates the main initiatives adopted by the EU in the area of microcredit; chapter 3 describes the main features of the market; chapters 4 analyses the benefits of microcredit and the final section concludes with some comments and proposals.

Keywords: microfinance, EC programme for Employment and Social Innovation (EaSI), Jeremie, Jasmin, European Progress Microcredit Facility, microfinance institutions (MFI)

JEL Classification: G20, G21, F35, O16

1. INTRODUCTION

Microfinance in Europe is slowly and gradually being consolidated as an essential tool of social policy, for the promotion of self-employment, microenterprise support and the fight against social and financial exclusion. This is demonstrated by the renovation of the initiatives in support for the sector by the European Commission (EC) in the framework of the Programme for Employment and Social Innovation (EaSI) 2014-2020.

Microfinance is a general term to describe financial services to low-income individuals or to those who do not have access to typical banking services. Microfinance offers people excluded from formal financial services the opportunity to obtain microloans in order to generate income and engage in productive activities, often by creating or expanding their small businesses (Armendariz and Morduch 2010). Microcredit programmes extend small loans to very poor people for self-employment projects that generate income, allowing them to care for themselves and their families.

Microfinance has proved to be an efficient and resilient tool for leveraging the potential of economically poor but innovative people (Bauer, Chytilová and Morduch 2012; Braun and Woller 2004; Khandker 2005), even if doubts on his impact persist (Banerjee, Karlan and Zinman 2015; Hermes and Lensink 2011; Imai, Gaiha, Thapa and Annim 2012; Karlan and Zinman 2011). Microfinance in the developing countries fulfils many functions: provide capital for small businesses, boost self-employment, empower citizens, reduce the negative impact of shocks and develop financial intermediation.

The geographical remit of this article is limited to the European Union (EU). The transfer of the technology of microcredit from low-income to high income countries took place since the 1990s (Morduch 1999; Yunus 2004). The factors leading to exclusion from access to bank lending for the poor people are similar to those limiting access to bank lending for small and medium enterprises (SMEs). Nevertheless

microfinance plays a slightly different role in developed countries with a large number of businesses and a dense network of financial intermediaries (Canale 2010). There are different constraints that impede or limit the development of microfinance: higher costs of delivery, due to personnel and administrative costs; the ceilings on interest rates limiting the possibility of supplying small collateral-free loans achieving financial sustainability; the strict legal and regulatory requirements for the banking sector and financial intermediaries. As a consequence of a different environment, the main instrument that has been used in Europe is the credit guarantee scheme (Di Maio and Landoni 2015).

The definition of “microcredit” by the EC is broad and twofold:

- a business microloan is a loan under EUR 25,000 to support the development of self-employment and microenterprises;
- a personal microloan is a loan under EUR 25,000 for covering clients’ personal consumption necessities such as rent, personal emergencies, education.

The lack of a consistent and commonly used definition of microfinance for banks’ internal reporting impedes the collection of information about the activity. In many countries small loans to micro-enterprises are not classified as microcredit. This creates difficulties in gathering and comparing data at the EU level. According to the EC (2014), 30% of microloans backed by guarantees are below EUR 5000 and 40% are between EUR 5000 and 10000. These data refer to loans under the guarantee of the Microfinance Facility.

The European Union is a keen supporter of microcredit as a means for jobs creation and social inclusion. Especially after the 2007-8 crisis, microfinance has become a high priority across the EU’s internal, regional, enterprise and employment policies and a tool for addressing a market gap in the credit sector. Microfinance is particularly relevant to support microenterprises as well as low income and other disadvantaged people who have been excluded from access to traditional banking and related services. According to Bendig, Unterberg and Sarpong (2014), in 24 EU countries nearly 390,000 microcredits were disbursed worth EUR 1.53 billion in 2013 (+45% in two years). This shows the growing potential for the use of microcredit.

2. HISTORY OF EU SUPPORT FOR MICROFINANCE

Microfinance has long been recognised by EU policy-makers as an instrument to support entrepreneurship, competitiveness and social inclusion. The EU has promoted a series of initiatives and programmes for promoting microfinance and microcredit.

In December 2007, with the EC Communication “A European initiative for the development of micro-credit in support of growth and employment”, the EC acknowledged that Europe had lacked the necessary intermediaries, capital and environment to unlock the potential of micro-credit in the EU. According to estimates based on Eurostat data, potential demand for micro-credit in the EU could amount to over 700,000 new loans, worth approximately EUR 6296 million in the short term. This demand was however not met (EC 2007).

The situation has been worsened by the 2007-8 crisis. Micro finance institutions struggling in finding external resources of funding and a new demand driven by customers who were not served by banks anymore put further pressure on non-commercial micro finance institutions. Moreover, the banking sector considered lending to the microcredit target groups as risky and cost intensive. The lack of an adequate track record and lack of sufficient collateral translate into a higher risk profile of these clients for the banks, with a concomitant risk of higher default rates, lower recovery rates and ultimately higher net losses. Banks consequently further reduced their loans to this segment of the market.

The EC defines microcredit as “the extension of very small loans (micro-loans) to entrepreneurs, to social economy enterprises, to employees who wish to become self-employed, to people working in the informal economy and to the unemployed and others living in poverty who are not considered bankable. It stands at the crossroads between economic and social preoccupations. It contributes to economic initiative

and entrepreneurship, job creation and self-employment, the development of skills and active inclusion for people suffering disadvantages” (EC 2007: 12). Microloans do not exceed Euro 25,000.

In 2007, the EC called for removing the obstacles in the way of developing micro-credit by ensuring that national legislation would facilitate the provision of microfinance. The proposed initiative had four different strands:

1. Improving the legal and institutional environment in the member states;
2. Further changing the climate in favour of entrepreneurship;
3. Promoting the spread of best practices, including training;
4. Providing additional financial capital for micro-credit institutions.

In order to achieve those goals, the EU set up three main initiatives at EU level aiming at promoting micro-credit: the Competitiveness and Innovation Framework Programme, Jeremie and Jasmine.

The main instrument available for financing establishment and growth of small businesses was the Competitiveness and Innovation Framework Programme (CIP). The programme’s SME guarantee facility for micro-loans provided loan guarantees which would make it possible for banks and non-bank microfinance institutions, such as the Spanish MicroBank and the French ADIE organisation, to make more debt finance available to microenterprises by reducing their exposure to risk.

The second initiative “Jeremie” allowed for combining contributions from operational programmes of the European Regional Development Fund (ERDF) and the European Social Fund (ESF) with loan capital and other sources of finance to support the creation and expansion of micro, small and medium-sized enterprises. The decision to implement Jeremie rested with the managing authorities of the member states and regions.

Finally, the Commission launched in 2007 “Jasmine” a new European-level facility which aimed at supporting the development of non-bank micro finance institutions in member states. Financial support came from the existing technical assistance budget of the Structural Funds which the EC manages. The facility was managed within the European Investment Fund (EIF), which was already a partner of the Commission in the field of micro-credit through Jeremie. The technical assistance part was financed in 95% by the Commission (technical assistance budget of the ERDF) and in 5% by the EIF. Technical assistance comprised among others: mentoring as well as technical and financial advice to MFIs/micro-credit providers; evaluation and rating of MFIs/micro-credit providers; promotion of good practices and dissemination of know-how.

As a response to the 2007-8 crisis and to address the structural problems disadvantaged groups have when financing the setting-up or development of a business, the EU set up a microfinance facility for employment to offer a new chance to the unemployed and open the road to entrepreneurship for the disadvantaged groups, including the young. The European Progress Microfinance Facility (Progress Microfinance) was launched in 2010 and managed by EIF in the 2007-2013 programming period and funded by the EC and the European Investment Bank (EIB). The financial contribution from the EU budget to the programme added up to EUR 103 million for the period 1 January 2010 to 31 December 2013. It aimed at supporting eligible intermediaries to enhance their capacity to provide micro-credits and guarantees on micro-credits to micro-entrepreneurs by:

- issuing guarantees, thereby sharing the providers' potential risk of loss;
- providing funding to increase microcredit lending.

The target groups were persons who wanted to start or develop further their own microenterprise and who:

- have lost or at risk of losing their job;
- have difficulties re-entering the labour market;
- are facing the threat of social exclusion;

- are vulnerable persons in a disadvantaged position with regard to access to the conventional credit market.

Its financial resources have been fully deployed through selected financial intermediaries across the EU, which have provided micro-loans to micro-entrepreneurs. A microfinance institution (MFI) is an organisation that provides microfinance services. The microcredit providers may be private or public banks, non-bank microfinance institutions and not-for-profit microcredit providers. MFIs in EU member states could apply to the EIF in order to become intermediaries under Progress Microfinance. The conditions for microloans to entrepreneurs – amount, duration, interest rates and fees, timeframe to get a loan – depend on the particular microcredit provider. The bottom line was that financing cannot be used to cover credit lines such as overdrafts or short-term revolving facilities. It was meant to create new businesses and promote social inclusion. By September 2013, microcredit providers had disbursed a total of 13 252 microloans with an overall value of EUR 116.1 million.

This facility is now included in the new 2014-2020 programme for EaSI, which is a European-level financing instrument managed directly by the European Commission to support employment, social policy and labour mobility across the EU. The concept of social innovation is at the heart of EaSI. The budget is allocated in three broad projects:

- PROGRESS (Programme for Employment and Social Solidarity): Around 550 million Euro (61% of the total budget) will support activities with a strong Europe-wide dimension such as comparable analysis, mutual learning and exchanges of practices in the field of employment and social policies
- EURES: Around 160 million Euro (18% of the budget) will be dedicated to the EURES network that provides information and advice to job seekers wishing to work in another EU country. EaSI will finance core activities at EU level, while the national activities can receive funding from the ESF.
- Progress Microfinance: Around 200 million Euro (21% of the budget) will extend the support given to microcredit providers and institutions in order to make more loans available, and will help to develop the social investment market and access to financing for social enterprises.

EIF is managing the EaSI Guarantee Financial Instrument which is specifically dedicated to microfinance and social entrepreneurship finance. This instrument has two main objectives:

- increase the availability and accessibility of microfinance for vulnerable groups and micro-enterprises;
- increase access to finance for social enterprises.

EIF does not provide any type of finance to micro-entrepreneurs or social enterprises directly. Through the EaSI Guarantee Financial Instrument, EIF offers guarantees and counter-guarantees to financial intermediaries selected by EIF. Thanks to the risk-sharing mechanism between the financial intermediaries and the EC, the EaSI Guarantee enables selected microcredit providers and social enterprises investors to expand the range of enterprises they can finance, facilitating access to finance for target groups who might be having difficulties in accessing the conventional credit market.

European Union's micro-credit aims at creating jobs and boosting the economy but also at increasing social and financial inclusion. This is clear from the targets of this initiative. Only micro borrowers and social enterprises with specific characteristics may apply for these funds through national financial intermediaries (see Table 1).

The European Union will provide EUR 96 million guarantee for the period 2014-2020 which is expected to mobilise over EUR 500 million in loans in order to promote jobs and growth in Europe. The programme targets individuals who wish to start or further develop their own social and micro-enterprises, in particular, people who have difficulties in entering the job market or in accessing finance. This programme shows the continuing commitment of the EU in supporting microcredit.

Table 1

Microfinance	Social Entrepreneurship
Portfolios of micro-loans up to EUR 25,000 for:	Portfolios of debt financing products (including loans, mezzanine loans, subordinated debts, leases and profit-sharing loans) up to EUR 500,000 for:
<p>Micro-borrowers</p> <p>Vulnerable persons who have lost or are at risk of losing their job, or have difficulty in entering or re-entering the labour market, or are at risk of social exclusion, or are socially excluded, and are in a disadvantaged position with regard to access to the conventional credit market and who wish to start up or develop their own micro-enterprises.</p> <p>Micro-enterprises</p> <p>Micro-enterprises in both start-up and development phase, especially micro-enterprises which employ persons as referred to in the above mentioned definition of micro-borrowers.</p>	<p>Social Enterprises</p> <p>Enterprises with either an annual turnover not exceeding EUR 30 million, or an annual balance sheet total not exceeding EUR 30 million which are not themselves a collective investment undertaking.</p>

3. MICROFINANCE MARKET ENVIRONMENT

The EU microcredit market is young and fragmented. One reason of this fragmentation is the diversity of regulatory frameworks at the national level (Thomson Reuters Foundation 2011). This explains also the broad variety of institutional forms and business models for microfinance lending in Europe.

In this section, I will describe the main characteristics of the market. In Europe, microfinance is a tool for economic growth and social cohesion. Many small businesses and families lack access to financial services in spite of the existence of a dense banking network. Financial exclusion is due to poverty and social marginalisation in the case of individuals, and to lack of collaterals and strict banking regulation in the case of small businesses. The issue and the challenge are significant because micro, small and medium enterprises (MSMEs) form the core of the Western European economic system. According to Eurostat (2015), the overwhelming majority (99.8 %) of enterprises active within the E-28's non-financial business in 2012 were SMEs (employing fewer than 250 persons) - some 22.3 million, among which 92% were micro-enterprises (fewer than 10 employees). More than two thirds (67.1 %) of the EU-28's non-financial business economy workforce was active in an SME in 2012, some 89.7 million persons. Across the whole of the EU-28's non-financial business economy, SMEs accounted for 57.3 % of the EUR 6.18 billion of value added generated in 2012. Consequently, the ability of the banking system to reach and serve MSMEs is crucial to the achievement of general socio-economic improvement. Exclusion from banking services often constitutes a major obstacle to the launch of new business activities. The development of microcredit services can fill this gap.

The EMN Overview survey report (Bendig, Unterberg and Sarpong 2014), covering the period 2012 to 2013, shows that both the overall total volume and the number of microloans show growth over previous years. MFIs from the 24 European countries surveyed disbursed 387,812 microloans with a total volume of 1.53 billion EUR in 2013 (2012: 324,406 microloans with a volume of 1.30 billion EUR). The overall allocation between microloans for business and personal purpose has slightly shifted towards loans for business purpose among the participating MFIs. In 2013, the average loan size reached 8,606 EUR (2011: 5,135 EUR) and 79% of the total microloan value was issued for business purposes, while the remaining 21% for personal consumption (2011 benchmarks: 74% for business, 26% for personal consumption). The survey estimates that a minimum of 121,270 microenterprises and start-ups were supported by the surveyed MFIs

with financial and non-financial services. Organisations from Western European countries reported 59% of the total volume of microloans disbursed (55% in 2012). Eastern European countries accounted for 64% of the total number of microloans disbursed, but only 41% of the total value of microloans reported. The survey showed a remarkable growth of the micro-lending activities in Europe since 2009. The number of loans disbursed has increased by more than 400% and the total loan volume has more than doubled since 2009.

The demand for microfinance comes from the final recipients: the unemployed, women, students, the disadvantaged people, migrants, and microenterprises. In the EU, microfinance is mainly based on microcredit, which are loans of up to EUR 25 000. The ISF funds the financial intermediaries which make loans to the final recipients. The products offered to the financial intermediaries by the EU initiatives are very sophisticated and related to the characteristics of this market: senior loans, subordinated loans, portfolio risk sharing loans, equity and quasi-equity participations and portfolio guarantees (direct and counter-guarantees). A guarantee for microcredit protects investors from a borrower's failure to repay a debt. Guarantee schemes support access to finance by assuming risks that financial institutions are not able or willing to take on.

The money is channelled through financial intermediaries which can be either banks including commercial banks, cooperative banks, and saving banks, or non-bank intermediaries such as NGOs, foundations, social equity funds, specialised microfinance intermediaries, and government bodies (Cozarenco 2015). Non-bank MFIs do not have access to deposits as a source of funding. Many intermediaries provide also business development services which could include technical support, training activities, professional assistance and financial education. These services are vital for the set-up and the sustainability of the borrower's business. Institutional diversity characterises the sector as far as MFIs are concerned. To a large extent, this diversity is related to differences in the national legal environment for loan provision, differences in the established financial systems, and the characteristics of the business sector. According to Bendig, Unterberg and Sarpong (2014) non-banking financial institutions (29%) and NGOs or foundations (23%) are still the most represented institutional types. Credit unions and coo-operatives represent a 10%, while commercial banks 5%. In terms of business model and client targeting, the types of financial intermediaries can be summarised as in Table 2.

More than 46% of the surveyed institutions' main focus is (over 75% of their turnover) on micro-lending operations. Additionally, more than 57% of the MFIs surveyed earn more than 50% of their turnover with micro-lending. The most pressing problem for the microfinance providers is the lack of access to long-term funding.

The availability of data for employment impact, client outreach and social performance is still limited among European MFIs. However, the survey demonstrates that outreach to women and ethnic minorities has increased, at least for the organisations that provided data on target groups.

Regarding profitability, the surveyed MFIs managed to achieve a positive return on assets (2012: 6.7%, 2013: 5.6%). The surveyed institutions also managed to decrease their expenses compared to 2011, as the operating expense ratio was reduced to 18% in 2013. In combination with the positive evolution of credit at risk, this illustrates an ongoing trend of lower impairment losses and operating expenses, which might lead to an improvement of financial sustainability in the microfinance sector.

Table 2.

Type	Role of microfinance in business model	Target client	Main products
Small/ Mid-sized MFIs	Main (only) part of business model, possibly complemented by SME lending (i.e. up-scaling)	Profitable micro-enterprises, with no or limited alternative access to funding	Commercially priced micro-loans
Mainstream Banks/Bank MFIs	Small (non-core) part of business model, either (i) as part of its social responsibility programme, or (ii) as an extension of its commercial SME lending (i.e. downscaling)	Depending on business model, either (i) individuals and micro-enterprises with certain socioeconomic attributes, may or may not be profitable micro-enterprises; or (ii) profitable microenterprises, with no or limited access to funding	Depending on business model, either (i) soft priced micro-loans; or (ii) commercially priced micro-loans
Public entities	Varies	Depending on mandate, usually as above (Mainstream Banks)	Soft-priced micro-loans
Start-up MFIs or MFIs with little or no track record, sponsored by private individuals or other investors	Main (only) part of business model	Varies	Commercially/soft priced micro-loans
Funds or vehicles, often set up for a limited period of time, that invest in (usually Small/Midsized) MFIs or provide micro loans directly.	Main (only) part of business model	Allows to access intermediaries and hence final beneficiaries, which otherwise could not be included in the fund	Varies, depending on business model of intermediaries pooled in the Indirect Investment

Source: Bruhn-Leon, Eriksson and Kraemer-Eis (2012)

4. RATIONAL OF PUBLIC INTERVENTION AND BENEFITS OF MICROCREDIT

What is the rationale for intervening in this market? A market failure in the area of finance access to SMEs is mainly based on asymmetric information between the two parties, the lender and the borrower (Ghatak and Guinnane 1999). Information asymmetry can be reduced via three ways: a firm's ability to signal its credit worthiness (rating by an independent agency and the provision of collateral), a strong relationship between lender and borrower, and through due diligence/lenders' examination (screening). This means that higher transaction costs would affect small companies and start-up that have no track record, limited collateral and no long standing relationship with lenders.

The reluctance to lend on the part of mainstream banking sector has exacerbated after the 2008-9 crisis and creates an opportunity for microfinance but also underlines the paramount importance of credit risk

management. The target group for microfinance, namely the financially excluded but economically active, might be faced with tightening credit supply by mainstream banks due to their higher risk aversion and increasing need to de-leverage their balance sheets. The main challenge for MFIs is the sustainability of their business as a result of the balance between the income and the costs, which in turn are a function of the pricing policy (interest and fees), cost management (operational and financial costs and provisions), economies of scale and level of available public and private funding. The impact of the crisis further increases the market failure – also driven by increased risk aversion on the supply side of microfinance - and underlines the need for public support for this emerging sector in Europe.

The second justification for public intervention is the pursuit of positive externalities (Cornes and Sandler 1986). Social and financial inclusion generate economic and social returns by reducing unemployment, empowering citizens and alleviating the pressure on welfare subsidies. The EU stance is to make public intervention conditional upon “additionality”, i.e. adding EU money to private, regional and states funds in order to create a sustainable market in the long run. Further public intervention at the EU level is in line with the principle of subsidiarity. Microcredit is regarded as a positive tool for creating growth and employment and it is embedded in the Europe 2020 strategy. According to Bruhn-Leon, Eriksson and Kraemer-Eis (2012), Progress Microfinance has many features that justify the EU involvement. It has brought critical mass to a fragmented sector; complements the national, regional and private funds; allows for a degree of risk diversification and allows to multiply limited EU budget resources; increases efficiency by using market-based instruments and practices; diffuses best practices and increases financial intermediary sophistication.

Explaining the rationale of public intervention leads to discuss the benefits of microcredit. There is a kind of bias on social investment. Investments with positive social impact are expected to have negative financial returns while investment creating financial value would not take the social dimension into consideration (Emerson 2000). Microfinance instruments may offer power possibilities for addressing this imbalance and the lack of flexibility in the traditional banking system. In fact traditional banks are generally reluctant to lend small amounts without much higher interest rates, due to the fixed costs of managing loans coupled with a higher credit risk for these loans.

Balancing social purpose and financial sustainability is the great challenge of microfinance. In general, microfinance involves a higher proportion of management costs and higher risk so interest rates are higher. If we exclude commercial banks, the majority of the intermediaries share the following features: social purpose as main goal; provide credit at the local level; have capacity to offer adaptable financial services, and have qualified expertise for providing non-financial services like advice and training. Non-bank intermediaries generally operate more in markets with low financial service penetration and limited public or third party support (Bruhn-Leon, Eriksson and Kraemer-Eis 2012).

Microcredit may affect different public policies that are at the centre of the public debate in our societies:

1. Social cohesion, since it offers more opportunities for employment, and it contributes to the social and financial inclusion of individuals.
2. Economic development, via job and wealth creation and small business financing.
3. Public Finances, by encouraging the unemployed to start a business can save money and it also generates additional revenue for the public authorities.

I will briefly examine some of these benefits. Microfinance can complement the labour policies. Microcredit targets people who are often unemployed or unable to access the traditional banking system and who wish nevertheless to start their own business. They play an important role in boosting self-esteem. While other labour instruments aim to give a temporary income or funds for acquiring new skills, microcredit contributes directly to self-employment and job creation. Difficulty in accessing finance still represents one of the main barriers for aspiring entrepreneurs. Microcredit may reduce the burden on public finance by investing public funds on instruments that create income and long term gains for people and the local

community. The EU has recognised the role of microcredit in this area by including it in the EU EaSI. According to the European Commission Report “Implementation of the European Progress Microfinance Facility — 2013” (EC 2014), more than 20,000 entrepreneurs have already benefited from loans and guarantees worth a total of €182 million. In particular, the report finds that Progress Microfinance has significantly contributed to job creation by enabling credit for unemployed or inactive people, who often struggle to borrow money from financial institutions. The report indicates that 60% of final users were unemployed or inactive when they applied.

The EMN (Bendig, Unterberg and Sarpong 2014) shows a substantial impact on employment generated by the activities of the microfinance actors in Europe. According to the survey, in 2013, a minimum of 121,270 micro enterprises and start-ups were supported by the surveyed organizations, resulting in an approximate impact of at least 250,000 jobs throughout Europe. This result mirrors the commitment of the sector towards the reduction of unemployment rates. In fact, according to the survey, 85% of the surveyed MFIs consider supporting and creating employment as part of their dedicated mission.

Microfinance is addressing also financial exclusion, which is the inability to access financial services in an appropriate form. Microcredit can facilitate the access to credit to the “credit excluded” and to those who rely on loan sharks at unaffordable rates. Lack of access to credits may impact negatively on standard of living and may stigmatise people.

Social inclusion is affected by the capacity to access financial services at affordable rates. Social exclusion defines the processes which push people to the edge of society, which limit their access to resources and opportunities. Poverty is a direct consequence of social exclusion. To this respect, microfinance is a development tool allowing the poor to improve their living conditions by facilitating access to basic financial services such as loans, savings, money transfer services or micro insurance. In the long run, microfinance can reduce vulnerability and empower citizens. The idea of empowerment is pivotal in today debate on welfare state, workfare state and their transformation under globalization and budget constraints (Esping Andersen 2002; Hills 2015).

Progress Microfinance had a clear positive impact on the access of microcredit providers to financial resources for their microfinance operations. This also confirmed by Bendig, Unterberg and Sarpong (2014) who point to the high relevance of public and in particular EU funds for financing microcredits. Overall, half of the interviewed intermediaries were of the opinion that they could not have found similar debt financing elsewhere. In particular the MFIs that are non-banks would have had difficulties finding alternative financing, whereas bank institutions would have secured such through their access to the financial markets. Some of the intermediaries stated that had it not been for Progress Microfinance, they would have had to downscale their lending activities in terms of number of credits (Mikrofond, FAER) and the size of loans offered (Siauliu Bankas, ADIE).

Despite the existence of a wide range of benefits, according to Gloukoviezoff (2016), it is impossible to discuss the impact of microfinance at a general level considering that this impact is highly dependent on many factors, including the client profile, the profile of the service provider (i.e. type of services provided, services’ features, profit/not-for-profit, etc.), and the institutional context where microfinance services are provided (i.e. credit market, labour market, welfare state, etc.). The same service will have a different impact with different clients or in different institutional contexts. Odell (2010: 6) argues that “given this extreme heterogeneity, one of the greatest errors researchers and practitioners can make is to over-interpret the empirical results that are available to us, since each study necessarily applies only to a very specific context. Rather, keeping both the general and the specific questions in mind, each impact study must be interpreted as a small piece of a growing body of knowledge about how microfinance, in all its forms, functions in the world and how it affects the lives of the poor”.

Further, we can say that no impact evaluation methods can claim to be the ‘gold standard’ and each of them comes with their own strengths and weaknesses. Evaluators should keep in mind that it is impossible to obtain a bias free impact evaluation of microfinance due to the limitations of the evaluation strategies available (Duvendack *et al.*, 2011) and that none of these strategies are able to deliver all the outcomes expected from

an impact evaluation. Nevertheless I think that impact studies are welcomed and needed for evaluating the impact of microcredit and assessing the proper use of public funds.

5. CONCLUSION

In sum, microfinance can create many benefits in the short and long run:

- Empower citizens and give them the finance instruments for coping with the market economy.
- Reduce unemployment and create economic returns in the local economic context.
- Attract co-investment by sharing the risk.
- Help local financial intermediaries in extending the amount of money they can loan.
- Integrate public support for social inclusion.
- Reduce public spending for social services by providing finance to disadvantaged groups.

The European Union fulfils an important role in sustaining MFIs in the member states by providing guarantees and extending the amount of money they can loan to vulnerable sectors of the economy and the society. In theory, the activities of public and private providers should be complementary and mutually enhancing, with public support targeted at non-bankable borrowers to ensure that needier sections of the population, who would not otherwise obtain financial services, are served. The MFI have to ensure that their financing supports and helps to create enterprises that will be successful in the longer run. This article shows that there is a trend towards efficiency, professionalization, and self-sustainability. However, without the access to stable funding, the perspectives of the sector with regard to growth and self-sufficiency are limited, and therefore its impact on society will be limited. I conclude with some comments and proposals.

The main concern in the microfinance market is a trajectory where primarily commercially driven investment and lending models takes place on the back of the borrowers to whom high interest rates are charged and selection of borrowers takes place under a purely financial perspective whilst losing the social mission out of sight. The level of interest rates charged by microfinance lenders in Europe varies widely from country to country, due to varying business models, differences in refinancing costs, and different national laws regarding usury and consumer protection. Currently, 14 EU member states had either some form of an absolute ceiling (Greece, Ireland, Malta) or a relative ceiling based on a reference rate (Belgium, Estonia, France, Germany, Italy, the Netherlands, Poland, Portugal, Slovakia, Spain, Slovenia). The cost structure of micro-lending is usually high, because of small loan amounts, often very short maturities and high monitoring costs related to lending without collateral.

MFIs can reinvest the profit in the business and thereby grow to an institutional scale that is capable of being financially sustainable in the long term for the purpose of pursuing the desired social impact. This involves achieving a minimum portfolio size to reach a diversification that in turn reduces risks, and to achieve efficiencies through scale effects and expertise (Bruhn-Leon, Eriksson and Kraemer-Eis 2012).

Microfinance institutions have to earn the credit risk, refinancing cost, servicing, transaction, monitoring and administration costs related to the micro-loans. High operational costs for MFI linked to the limited exploitation of scale economies may compromise the self-sustainability of the sector, which is depending on external funds. Some MFIs heavily depend on public grants of limited duration, and are not able to sustain their activities when these funds end (Lagoa 2014). Technology (front end and back-office related) and standardisation are key factors to improve quality of processes and systems and enhance product offering and outreach. Financial education and mentoring of final beneficiaries and entrepreneurs especially in their start-up phase is also key for reducing default rates for MFIs. Such business services are offered by intermediaries or in cooperation with dedicated service providers.

The separation between small loans that can be supplied by a bank to bankable borrowers, and those cases that should indeed be handled by a MFI or a non-commercial bank shall be clear. The threshold of 25,000 euros cannot be the sole indicator. The definition of microcredit should be based on the type of client targeted (underserved population by the financial institutions), on the type of institution offering it (social purpose organisations characterised by their transparency, client protection and ability to report on their social

performance results), and on the type of services offered, especially considering that the provision of non-financial services is a key component of microfinance. The EU instruments lack a specific measure dedicated to funding microfinance institutions in order to support the accompanying activities (non-financial services like training, coaching, mentoring, monitoring of beneficiaries during repayment, and financial education), closely linked to the loan and required for vulnerable clients of MFIs. These services are pivotal in order to make the most of the loan and ensure the long run sustainability of the new business. At the same time, it should be recognised that in some markets banks are providing, or supporting, microfinance services to the non-bankable sector as well. They do that because they are motivated by their CSR or financial inclusion objectives, and/or by the benefits of collaborating with public bodies. In the longer run, one of the goals of microcredit is allowing some borrowers to migrate from the non-bankable to the bankable.

Targeted customer groups will need more tailored services. For example, migrant communities (composing a significant percentage of the microfinance clients in Western Europe) require a specific approach combining financial and non-financial services that increase their opportunities for self-employment and entrepreneurship. Many migrants have found profitable to get a small loan to launch their own business. In a more general way, they can regain self-confidence and feel empowered, and moreover small economic activity could generate some additional income and help people to achieve a more respected member of society. This is a great opportunity for implementing a suitable instrument for integrating immigrants and refugees in the local economies and communities.

MFIs often follow a transformation process: they start as NGOs and finance their business via donations and/or public money; over time they “grow” towards formal financial institutions and regulated entities. Social performance assessments and ratings are also developing, reflecting the growing need for accountability of institutions in this field. MFIs shall apply sound and transparent lending practices. The EIF is particularly sensitive to potential reputational risk resulting from engaging with intermediaries that would not apply good standards of quality. Both the EU and EIF shall be monitoring financial intermediaries and checking that their practices reflect standards and transparency.

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

In conclusion, microfinance offers a possible tool to make a significant difference in the lives of many people. Microfinance in Europe is under a process of consolidation and it is a means for promoting self-employment, supporting small businesses and combatting social and financial exclusion. There is a lot of potential that the European Union and other stakeholders might develop to increase the capability and the sustainability of MFIs.

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Microloans create new and direct connection between economic players and classes

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HAS MICROFINANCE LOST ITS MORAL COMPASS? ²**ABSTRACT**

This paper argues that microfinance in south Asia, like mainstream finance in North America and Europe, “has lost its moral compass”. Microfinance institutions have increasingly focused on financial performance and have neglected their declared social mission of poverty reduction and empowerment. Loan officers in the field are under enormous pressure to achieve individual financial targets and now routinely mistreat clients, especially poor women. The values of neo-liberal mainstream finance in the rich world have spread to microcredit in the villages of Bangladesh and India. This situation is hidden from western publics who are fed the lie of “the magic of microfinance” by their media, guided by the needs and interests of mainstream finance seeking to provide some “good news” about the financial sector as scandal after scandal unfold. Urgent action is needed, particularly from the leaders of the microfinance industry, to refocus their organisations and workforce on achieving both financial and social performance targets.

Keywords: microfinance. MFIs, loans to poor people, neoliberal microfinance, microfinance in Bangladesh

JEL Classification: G21, G23, L31

On his first day in office in April 2014 the incoming chief executive officer (CEO) of the UK’s newly-established Financial Conduct Authority reported that “finance has lost its moral compass”. He was reporting from one of the world’s financial capitals, London, following years of scandals in which banks and finance houses have misold products, overcharged clients and rigged markets. These scandals range from forcing clients to buy unnecessary payment protection insurance (PPI), misselling endowment mortgages, to rigging the London Interbank Offered Rate (LIBOR) and foreign ex-change rates so as to swindle money out of the finance system and, ultimately, their clients. Recently the now infamous Wonga payday lender had to write off around 3,30,000 customer loans because the firm failed to properly assess the repayment capacity of customers. Repetitive public scandals led the UK’s Parliamentary Commission on Banking (2013: 85) to report that “...for years failure has followed failure in banking, and scandal has followed scandal”. One can see a similar moral malaise in the US as people suffer from house repossessions, engineered by the sale of sub-prime mortgages, and banks are still recovering from the bank-induced financial crisis of 2008 that helped to bring the global finance system to the edge of total collapse. No wonder the Occupy movement tried to seize the streets in Manhattan and London.

² This publication is the second edition. The first edition see in Economic & Political Weekly, 29 November 2014, VOL XLIX

In this paper we take up this theme, but ask whether it is not just mainstream finance that has lost its moral compass; we ask, has microfinance also lost its moral compass? Have the amoral and immoral attitudes and practices of mainstream finance in its global centres (particularly New York and London) contaminated the activities and behaviours of microfinance institutions (MFIs)¹ in developing countries? Should the Occupy movement be trying to seize the streets in Delhi and Dhaka, Hyderabad and Chittagong, to protest at what microfinance institutions are doing to their clients? Do micro-finance firms lend money responsibly?

Readers in the rich world would be surprised at our concerns. In North America, Europe and Japan the media routinely presents microfinance as a great success. Indeed, journalists treat the provision of small loans to poor people as virtually synonymous with poverty reduction. Lauding microfinance was particularly common in the western media in the mid-2000s. A classic example in the *New York Times* (NYT) of 12 April 2004 reported that one of the US's "most successful venture capitalists" was so impressed with microfinance in Andhra Pradesh that he was going to put his time and expertise into supporting the microfinance industry. A list of successful US financiers and hi-tech entrepreneurs were identified as wanting to transform poor, unproductive, disempowered and isolated women into dynamic businesspeople through microfinance. The anecdote of Sivamma, a woman who used a \$45 loan to create assets worth \$5,000 in four years, was presented as evidence of what microfinance could achieve (NYT 2004). The NYT and other broadsheets spread a simple message: microfinance is a "proven development strategy, expected to benefit 100 million of the world's poorest families" (NYT 2003). The sector has regularly been presented as a remarkable opportunity for leading US entrepreneurs to play a role in as "...even philanthropy aimed at alleviating poverty can be profitable" (*Forbes* 2007; also see *Forbes* 2011 and NYT 2010).

This narrative in the western media continues despite the 2009-10 crisis in Indian microfinance (Hulme and Arun 2011), microcredit "bubbles" in Nicaragua, Bosnia-Herzegovina and Morocco (Chen et al 2010) and the scandal of the privatisation of Compartamos Banco in Mexico (which has placed high returns to shareholders above the interests of low-income clients). As Taylor (2012: 601) points out, with the recent concept of "financial inclusion", promoting microfinance has been presented as a "global moral imperative". In December 2012 the *Guardian* – usually seen as the UK's only "left-wing" broadsheet newspaper – devoted a full page to "the magic of microfinance", lauding what microfinance was achieving and building the case for its expansion through commercialisation (*The Guardian* 2012). In contrast to these positive accounts in the western media, in countries where most microfinance is implemented, such as Bangladesh and India, the media coverage is much more mixed and, quite commonly, very negative.

In this article we argue that microfinance is not "magic". Indeed, the empirical evidence indicates that the provision of loans to poor people is far from being associated with increased incomes that prompt reduction in poverty and improvements in well-being. Just like mainstream finance – indeed by moving closer to the moral norms of mainstream finance and focusing almost exclusively on short-term financial performance – microfinance has lost its moral compass. The staff of many MFIs (and certainly all the large MFIs in Bangladesh) has personal financial performance targets to achieve: the impact of loans on client welfare has become a secondary issue. However, the severe social performance challenges that face MFIs in south Asia are hidden from western publics by the continued peddling of the myth of microfinance by the western media. The tarnished reputation of mainstream finance means it energetically promotes the generation of "good news" about what finance does for society in the commercial media industry (that it is financing). Peddling a false account of the "magic of microfinance" in developing countries, and the enthusiasm and good intentions of western banks and billionaires to support this magic, is a key component of the public relations strategy of mainstream finance.

The Mainstream Finance Story

One should clearly not see capitalist finance through rosetinted glasses. But it is possible to go back only a few decades – the 1970s and early 1980s – and, in the UK and US, recall an era in which bank managers and employees were respected members of the local community and when loans for housing were assessed not merely to ensure short-term bank profitability but also to protect borrowers from getting themselves into trouble. But all that changed in the 1980s with the neo- liberalisation of finance, prompted by Reagan and Thatcher. In London the “big bang” of 1986 opened up the UK’s financial markets in ways that transformed their quantity (they expanded rapidly) and their quality. Greed was declared a good thing, as it was believed to make markets efficient. This was apparently good for “everyone”, and short-term profitability became the driver of market behaviour. In the UK the mutually-owned building societies were privatised and by the early 1990s they were competing with the private banks to fool clients into taking out endowment mortgages. This created big profits for banks, and large bonuses for their staff, but ultimately turned out to be a misselling scandal. Over the 1990s and 2000s retail banking and investment finance in Europe and North America pursued a strategy of short-term profit maximisation and *caveat emptor* (buyer beware). If the client is stupid enough to buy a product – confused by the exaggerated claims of product performance and the systematic hiding of fees and commissions – then s/he deserves to take the consequences (having to reduce their living standards or be indebted for life). Often the people who are the most vulnerable to this are on low incomes, the ones who needed money the most. 2

We do not go into detail here but what Nobel-prize winner Joseph Stiglitz (2003) calls the “Roaring Nineties” saw the mainstream finance sector lose almost any sense of moral responsibility. This has continued through to today. The old moral arguments about the social role of finance – mobilising investment, promoting widespread prosperity, creating jobs, helping people plan for their future needs – have become rhetorical. Mainstream finance is about making vast amounts of money very quickly and “getting out” at the right time. The millions who lost homes in the sub-prime mortgage scam, the near meltdown of the global financial system of 2008-09, the collapse of banks across Europe and the US were not a problem for those who had made millions (for some billions) through such activity.

The Microfinance ‘Magic’

Our research on MFIs and personal interactions with MFI leaders since the mid-1980s leave us in no doubt that most of the path-breaking MFIs, particularly in south Asia, did not merely have a moral compass – they had a social mission. The founders of these organisations were genuinely seeking to help poor and low-income people improve their economic and social prospects. Over time, however, organisational goals (being bigger, having higher rates of repayment and higher levels of profitability, winning international awards) and closer links with mainstream finance have displaced this social mission. As the leaders of MFIs have become international figures 3 they have increasingly become part of the simplified narrative of the western media that presents MFIs as being the leading lights in tackling extreme poverty in south Asia, Africa and Latin America.

This narrative claims that by making small loans (\$20 to \$500) to poor women a set of innovative MFIs have allowed them to develop micro-enterprises – small shops, petty trading, raising chickens, rearing milk cows, opening beauty parlours – that have greatly improved the women’s incomes and the quality of life of their families (education, nutrition, and female empowerment amongst other things). MFIs and their staff are presented as heroic, dedicated to working in remote rural areas and filthy slums to take services to the poor and poorest, relentlessly going where mainstream banks cannot and fighting against poverty. Borrowers repay their loans with interest and their repayments are ensured by the “social capital” of women being in groups that support each other and ensure financial discipline. This means that the MFIs are sus- tainable, even

profitable, in fact so much so that some have integrated themselves into mainstream finance and borrow capital for microlending from Wall Street and London.⁴

Muhammad Yunus, the Nobel-prize winner who founded Bangladesh's Grameen Bank, has been the leading figurehead for this narrative supported by annual global Microcredit Summits. Many of his, and microfinance's, advocates and supporters in the western world have finance, banking and business backgrounds. They find that supporting or working in the microfinance sector helps them reconcile with their moral values – to devote themselves to doing something that has “a bigger and positive impact on the world” as the president and CEO of Women's World Banking reported to *Forbes* (2011). The director of the Global Philanthropy Group, who implemented the United Nation's Year of Microcredit initiative in 2005, claimed that microfinance is providing poor people “the same financial tools we have so that they can help themselves” and that these people “are perfectly capable of creating their own success even though they were not born into the same circumstances” (*Forbes* 2012b). Such speeches are intrinsically moralistic and punctuated by altruistic statements about the transformative change that philanthropy and social investment in microfinance achieves: “You can literally change someone's life” (*Forbes* 2012a).

Unfortunately, the compelling narrative of the success of microfinance – of millions of heroic and entrepreneurial women lifting themselves and their children out of poverty (and into relative affluence) through small loans and self-employment – is not supported by serious evaluations of microfinance. Systematic long-term studies indicate that the impact on incomes is limited and at times may be negative (Hulme and Mosley 1996; Morduch 1999a; Roodman 2011; Banerjee et al 2013). However, the exaggerated messages of “magic”, “miracles” and “success” in the western media make it difficult for the public of the rich world to understand the crucial distinction between delivering microcredit to the poor and tackling poverty.

The Hollowing Out

Excessive claims about what microcredit can achieve for poverty reduction were corroborated by the strong leadership of few well-meaning pioneers who believed in commercialisation as a financial means to achieve social goals, at scale. The microfinance “formula” was passed on, often irresponsibly we think, to more narrowly commercial-minded firms (in Mexico and India especially). At the last Microcredit Summit Yunus mulled over the transformations that reshaped the industry, expressed his surprise about the profit-driven aspirations of some aggressive commercial firms entering the industry and recognising the shortfalls of commercially-driven microfinance (Next Billion 2014). This follows on from events in southern India in 2009 and 2010 when reports of MFI borrower suicides hit the headlines (Kinetz 2012; Kumar 2012) and a number of MFIs went bust under the strain of overly rapid and aggressive expansion supported by mainstream finance (Hulme and Arun 2011).

This led to concerns in south Asia about whether MFIs were good for poor people. The Governments of India and Bangladesh began to regulate the sector more closely and introduced caps on interest rates so that clients could not be charged “excessive” rates. While newspapers in south Asia reported these problems, as well as broader issues of MFI staff abusing and mistreating vulnerable clients, the media narrative in the rich world (from the US to Luxembourg, to the UK and on to Japan) has remained largely positive. The belief and vested interests in the microfinance narrative in the rich world are so strong that microfinance can avoid the growing evidence of its “dark side” (Hulme 2000) being relayed to western publics. Could it be that the idea of profitable microfinance, supported by social investors and mainstream banks, alleviating poverty is manufactured to meet the needs of big banks and wealthy people?

From microcredit to microfinance, the evolution of the types of financial product available to poor people over the last 35 years across the world has dramatically improved. The rural poor in Bangladesh, for example, have an almost “routine access” to microfinance services supplied by MFIs more than they have access to

basic public services – health, security, education, electricity, water, roads, information and so on (Rutherford 2009). Microcredit, lending small amounts of money to the poor has been transformed into a wide range of financial products and services – microfinance. Some MFIs choose to add a strong savings component (compulsory or voluntary) or a training component (on livelihood asset management or financial education, for example); some collect re- payments monthly and others weekly; and, some prefer to lend to individuals (men or women) and others to groups of clients. The choice of lending strategies of MFIs has strong implications for their financial performance and for their social performance and achievement.

Below we examine recent empirical evidence from Bangla- desh – the heartland of the microfinance industry – demonstrating that microfinance has lost its moral compass. 5 Along- side this we cite other detailed studies into the grass-roots practice of microfinance (Uddin 2013; Sandberg 2012; Cons and Paprocki 2010; Hussain 2010; Hudon 2009). Powerful figures in the western world such as the Bills (Clinton and Gates) and mainstream bankers may conveniently agree that microfinance is the solution for poverty eradication but the practices of MFI credit officers on the ground are driven overwhelmingly by the need for short-term financial performance. 6 We explore the morally repulsive practices that a purely commercial approach to microfinance have and are triggering in MFIs and look at how these affect clients.

Our examination indicates that most commercially-driven MFIs in the villages of south Asia⁷ have experienced a moral drift in the same direction as mainstream finance firms in the skyscrapers of Manhattan and Canary Wharf. They have focused on financial performance and take little responsibility for the social consequences of their engagement with clients. The view that you can engage with extremely poor and vulnerable people’s lives through rigid loan-based products without encouraging them into extreme trade-offs that may damage their well-being is erroneous. As stated earlier, the micro- finance sector in Bangladesh and India (and globally) is heterogeneous with institutions offering different ranges of products to clients. Our criticisms here are about MFIs focused on microcredit and especially those with rigid repayment schedules. We recognise that other products (especially savings products and some insurance services) are not associated with the moral drift examined in this paper. It is also true that microcredit has had positive effects on particular types of households in Bangladesh. Households with low dependency ratios, relatively stable earnings, a degree of financial education, access to informal credit markets and information can often use their loans for productive purposes and draw economic and social benefits from such loans. However, when banks (mainstream or microfinance) lend aggressively there are real dangers for clients. What happened (and continues to happen) to victims of aggressive banking in the West was (is) awful but debt is much worse if you are extremely poor as it jeopardises your shelter, daily food consumption and medication, social networks, dignity and self-worth.

Neo-liberal Microfinance in Practice 8: The Community Level

The life of a credit officer in rural Bangladesh revolves around daily, weekly and monthly financial targets set by regional and head offices. This creates an incentive structure for them to make as many loans to clients as possible, to continually push for clients to increase the size of loans and making clients repay on time. Like Khandker et al (2014) we argue that overindebtedness, through formal or informal loan-taking, is the result of a two-party decision (the borrower and the lender). In this paper, however, we argue that MFIs should be held accountable for monitoring levels of indebtedness to protect their clients.

While most large-scale MFIs have a manual of procedures, how financial targets are achieved is left to credit officers guided by branch managers – it is not a concern for the head office. In some cases, when borrowers have a steady income and no problems, it is easy for field staff to follow the official manual. But, as revealed later in this article, wenn clients face difficulties in making repayments they are induced to repay by “whatever means”. 9 Such clients should not take loans, but it is difficult for an extremely poor person to

refuse a loan when offered, or induced to take one. Taking the loan will solve a whole set of immediate problems – not having any food for tonight; buying urgently needed medicine; paying off a moneylender who is taking too much interest in your daughter – and the consequences are away in the future. The credit officers' interest (shaped by financial performance targets) lies in maintaining or increasing portfolio size (by recruiting more clients or increasing loan size), regardless of whether or not households can manage credit and/or can generate income from a loan.

The main argument made here is that the lending practices of MFIs at the community level have drifted away from their declared poverty reduction mission (or even “do no harm” to clients' standards) because of a pure focus on the short-term financial performance of credit officers. Data collected during fieldwork from both current MFI-clients and former MFI-clients reported numerous forms of malpractice employed by credit officers to achieve targets set by head offices. Subsequently, these malpractices were confirmed in interviews with the credit officers themselves (Maitrot 2013). The malpractices related to both the recruitment of new clients and encouraging existing clients to take new and larger loans that entailed higher weekly repayments. Such problems were originally reported in Bangladesh by Montgomery (1996) while recent studies (Cons and Paprocki 2010; Hussain 2010) confirm how credit officers' informal practices force clients to compromise on their well-being to meet MFI financial goals. At times the pressures on clients become extreme. Maitrot (2013) and Cons and Paprocki (2010) report loan officers requesting clients with repayment problems to postpone burying their husband; take children out of school; and take loans from other MFIs (to repay the loans officer's MFI). Both studies report “unauthorised, though tacitly accepted, asset confiscations” (of roofing iron and basic cooking equipment) (Cons and Paprocki 2010), arguing with clients' family members in public, advising clients to stop their medication and telling clients to sell basic assets in order to repay on time. In one leading MFI, 47% of loan officers reported using threatening language and public humiliation to maintain high repayment rates (Maitrot 2013).

Regardless of their repayment capacity, poor and vulnerable women are commonly persuaded to take small loans that often grow into larger debts taking an increasing share of household income. Once the loan papers are signed then, after a grace period of around two weeks, borrowers are required to make weekly *kisti* (repayments). Two particular problems make paying *kisti* difficult for many women. First, a high proportion of rural households in Bangladesh do not have a regular income, it varies with time of year, demand for casual labour, the weather and a set of factors outside of household control. Second, households have high levels of exposure to shocks and hazards which affect their repayment capacity. Clients commonly report that on receipt of a loan they use the cash to solve pressing needs (food for the next week, urgent medical care, house repairs or a daughter's dowry). Addressing these needs usually has an immediate positive effect on household wellbeing, but it can seriously compromise long term well-being. Not uncommonly, for poor households a small loan from an MFI is the beginning of a long and winding road of increasing debt and, for some, over-indebtedness (a debt burden that cannot be serviced from household income). A majority of poor MFI clients reported through interviews and focus group discussions extreme livelihood compromises – sending children out to work, reducing quantity and quality of food and distress sales of essential productive assets. For some households weekly repayments to multiple MFIs had reached up to \$50 a week, a staggeringly high figure for people on rural wage rates in Bangladesh (Maitrot 2013).

Notwithstanding the western media's claims about women's empowerment through microfinance, a large body of research conducted in rural Bangladesh has found that women have little control over their loans (Balasubramanian 2013; Maitrot 2013; Uddin 2013; Bhusal 2010; Hossain et al 2009; Karim 2008). Sometimes loan officers meet with husbands to persuade them to use their wives to access loans. Several women reported that they were violently reprimanded by their husbands when they refused to apply for loans. In three focus group discussions (out of six) women clients reported that their credit officers had suggested to their

husbands to use violence. The case of one woman was particularly distressing (Maitrot 2013). This woman reported that her husband, who does not work, forced her to borrow money from four different MFIs. He controls the money, using it mainly for drinking and betting, does not leave her with enough money to feed her children and beats her if she complains. When she spoke to fellow MFI group members they refused to lend her money for kisti because of worries about their group's solvency and fear that her husband would simply squander such support. When the distressed woman talked to her credit officer, showing him bruised arms and legs and begging him to reject any future loan applications her husband forced her to make, the credit officer informed her husband and advised him to physically reprimand her. The woman cannot imagine escaping this trap and dreads the day that she will be excluded from her community or reduced to starvation or submitted to the social humiliation of being abandoned by her violent husband.

Neo-liberal Microfinance in Practice in Bangladesh

The microfinance sector in Bangladesh has benefited hundreds of thousands of households that have the capacity to meet rigid/inflexible loan repayment requirements: households with stable and reliable incomes, with good access to informal borrowing sources and with good health. After three decades of operation one might expect that these institutions would have learned how to screen financially vulnerable households (those with irregular earnings, facing health problems or with relationship problems) out of their loans programmes. But, in practice, the pursuit of organisational goals (a growing loans portfolio with more clients, increasing rates of profit or surplus, the reporting of a high repayment rate, international awards and reputation) through management systems and incentives based purely on individual and branch financial performance means that client experience is a marginal issue. In high poverty contexts, where there are large numbers of desperately poor people around who need money, this is a dangerous situation. A purely commercial approach to microfinance has fostered the neglect of the declared social mission of MFIs (for some MFIs in south Asia “abandonment” might be more accurate) and of disaligning mission and practice (Copestake et al 2005), a danger spotted long ago (Rogaly 1996). If the incentives to frontline staff are to focus purely on financial performance indicators, then, with repayment rates often above 95%, why should senior managers, directors and even well-intentioned social investors worry about the actual practices that achieve such repayment levels? Dismissing reports of the abuse of clients as isolated incidents by a few rogue credit officers is usually sufficient, as clients have no access to regulators or the media. Reports gathered in villages from women showed that sexual harassment, violent threat, coercion by neighbours and MFI group members, public humiliation, verbal abuse, as well as seizure of assets are common strategies used by loans officers (Maitrot 2013). The high repayment rates achieved by MFIs are not simply a product of their clients' ability to (always) be successful entrepreneurs or of “social capital” but also coercion and threat. When weekly kisti cannot be paid, women fear loan officer visits and sometimes hide under their beds or away from home. Villagers report that some defaulters migrate to escape their MFI debts. Why is it like this? Delay in repayment is never allowed. Loan officers push defaulting clients to borrow from another MFI to repay their current loan. Sometimes loan officers make a personal advance to their clients to ensure that the officer achieves their repayment target for that day. This “favour” may be called in at some future time when the loan officer will force the client to borrow again, perhaps a larger amount this time. Loan officers are not concerned about whether clients are investing in productive assets, they do not have time for this, and they have no incentive to care about it. For most MFIs, loan officers are not development workers but moneylenders to the poor: no more no less.

What Is It Like Being a Loan Officer?

One of the under-reported benefits of Bangladesh's microfinance industry is that it has created more than 1,00,000 formal jobs for credit officers – university graduates who obtain a lower middle class income in an

increasingly saturated graduate employment market. However, loan officers have to work hard for their money and bear the pressures of achieving daily financial performance targets. This is particularly stressful when significant numbers of clients find it difficult to repay. Maitrot (2013) explains how the systems, structures and cultures of MFIs (limited staff training, zero-delay and zero-default policy and demanding branch managers focused purely on financial performance) build chains of pressures not only on clients but also on staff. During fieldwork many MFI staff members expressed anguish about the “inhuman” behaviour they adopt to meet financial targets, develop their career prospects and avoid sanctions. Many of the loan officers interviewed reported being ashamed of, or even depressed by, the ways in which they treat clients. They explained their behaviour in terms of fear of their branch managers: 10

The worst part is that in every position the subordinates suffer mental harassment from superiors. The rules in this MFI and the psychological pressures faced by the employees are the worst part of this job (Maitrot 2013).

Some 47% of loan officers interviewed by Maitrot (2013) agreed with the statement (from a list of positive and negative statements put in front of them) that “people get angry very often in the organisation” and 71% reported fearing punishment from their branch manager. As mentioned, to avoid censure from their superiors credit officers sometimes make personal advances to clients: by doing this they achieve their daily financial target and keep their manager happy. One loan officer explained that if he fails to collect a kisti the branch manager “comes with all the staff and [they] stay in the client’s house until twelve or one at night”. In the MFI studied over 70% of credit officers reported finishing repayment collection after 8 pm, and just below 50% of those reported working up to or after 10 pm (although the official office time ends by 6 pm). As another credit officer explained:

When I do not get an instalment [...] and explain that there is a problem in this house and they cannot repay today [...] my boss orders me to sit in that house until the client gives the money: ‘If you have to sit there throughout the night you will but do not come back without the instalment’ he says. So if I leave without the kisti I face this kind of mental harassment and physical exhaustion... I feel like quitting the job.

Some poor clients are aware of the pressures credit officers are under and even feel sympathetic to their credit officers’ situation:

It is not the officer’s fault, when you are working you are simply following orders of the top officials. I heard that if instalments are not collected then money is taken from their personal salary. They are scolded at work. [...] The managers say very bad things to them the words they use are so terrible, I feel bad for them when I go there [the MFI offices] and hear such things.

In one instance a woman reported that her pregnant credit officer chose to spend the night in the client’s insalubrious home because the officer was too frightened to return to the MFI branch office without the expected amount. That night her waters broke and the client struggled to arrange for her to be taken to hospital. (The credit officer’s colleagues later independently confirmed this account.)

Is Microfinance Working?

Does microfinance work in Bangladesh or south Asia? Answering this question depends on the criteria used. If it is “can microfinance cover its costs and/or be profitable” then the answer is increasingly moving towards “yes”. But, if it is “does microfinance achieve its declared social mission (usually expressed as poverty reduction)” then the growing evidence from fieldwork with poor clients (in contrast to the public relations text turned out at MFI head offices) indicates the answer is “probably not”. This conclusion is supported by recent rigorous quantitative analyses of the economic and social impacts of microfinance (Roodman 2011; Banerjee et al 2013).

The microfinance industry may have successfully extended financial services to the rural poor – indeed the rural poor in Bangladesh have almost routine access to microfinance services, more than they have access to basic public services such as health, security, and education (Rutherford 2009). But, for a high proportion of clients this is as a lender of last resort and/or a successful “hard sell” by highly pressured credit officers, not as a poverty reducing or empowerment promoting strategy. MFIs have focused so much on achieving financial targets that their social mission (reducing poverty, empowering women and others) has become marginal.

Why has there been such a strong divergence between the actual social performance of MFIs in Bangladesh, and south Asia, and the goals these organisations declare and are assumed to be achieving by the western media? There are no doubt several reasons but this paper has highlighted the significance of MFIs increasingly focusing purely on financial performance in their management systems. In effect, many MFIs have “neo-liberalised” themselves since the late 1990s. Their activity is programmed almost entirely by market-based forces and they have abandoned their moral compass. Two specific factors can be identified as supporting this neo-liberalisation: the fostering of links between mainstream finance and microfinance and the promotion of organisational norms that focus only on financial performance.

The expansion of the microfinance industry since 2000 has been heavily dependent on commercial banks and mainstream finance (Roy 2010). Access to finance is crucial for the microfinance market to develop. For mainstream banks a new, relatively untapped market experiencing 15 years of uninterrupted expansion is appealing (Cull et al 2009; Karnani 2007). Despite the global financial crisis, public expenditure austerity and low economic growth rates in developed countries, private investors remain enthusiastic to support microfinance. A recent Consultative Group to Assist the Poor (CGAP) study found that wholesale investors in microfinance funded \$25 billion in 2011 and that overall microfinance funding continues to grow in absolute terms (Lahaye et al 2012) despite consecutive crises and scandals emerging in the industry (Mohan et al 2013; Singh 2010). In theory, the microfinance industry could expand until it reaches an estimated one billion unbanked poor households, as the biggest potential markets still have relatively low microfinance penetration rates – 13% in Bangladesh, 3% in India, and 2% in Brazil and Nigeria (Dewan and Alamgir 2009).

While some mainstream banks are directly providing micro finance products (Citibank, Deutsche Bank and ICICI Bank) others have sought to fund MFIs or refinance MFI portfolios (Dieckman 2007). Most mainstream financial contributions fund the refinancing of loan portfolios of MFIs (77% of total funding) through debt instruments (55% of total commitments).

By contrast, strengthening MFI capacity or supporting market infrastructure and regulatory environments receive only 15% and 4%, respectively (Lahaye et al 2012). In order to attract investors and secure mainstream finance, MFIs have concentrated on achieving “good ratios” in terms of orthodox financial indicators (client number, portfolio growth, on time repayment, portfolio at risk, interest rate spread) used by purely commercial financial institutions (Bateman 2010, 2012; Fernando 2004). Not surprisingly, this has led to the prioritisation of financial performance by MFIs and the increasing neglect of social performance (Maitrot 2013). This is not to suggest that financial performance is not important for MFIs but, for organisations claiming the reduction of poverty as their main goal, assuming that financial ratios are evidence of goal achievement is clearly inappropriate.

The second factor is the promotion of financial indicators as the only measures relevant to MFI performance. This approach dominated the industry advising CGAP in its early years with its promotion of “sustainable banking” as the goal for microfinance – based on the assumption that any financial institution making small loans that was financially sustainable was automatically helping poor people. But, it was reinforced by the introduction of international awards for MFIs in the 2000s. *Forbes* (2007) led the way with its identification of “the world’s top 50 microfinance institutions”. It declared, “microfinance has become a

buzzword of the decade, raising the provocative notion that even philanthropy aimed at alleviating poverty can be profitable” (*Forbes* 2007). However, *Forbes* used only two measures of performance: costs per borrower as a percentage of gross national income (GNI) and return on MFI assets. Social performance was not assessed in any way! Subsequently awards for microfinance have proliferated globally (e.g., the C5 Global Microfinance Achievement Award and the Fondazione Giordano Dell’Amore Award), regionally (e.g., the Microfinance Africa Awards and the Citi-CMFA Caribbean Microfinance Award) and nationally (e.g., the Microfinance India Award and the Paeng Microfinance Awards in the Philippines). While efforts have been made to make these awards more focused on social impact the awards process has been developed, and largely financed, by mainstream banking.

What Does Mainstream Finance Get Out of Microfinance?

So mainstream finance – Barclays, Citibank, Deutsche Bank, ICICI, bond markets in London and New York and many more – seem happy to put money into commercially successful microfinance even when the “numbers” on its social achievements (Banerjee and Duflo 2011; Morduch 1999a; Roodman 2011) are not impressive. Could there be other benefits for mainstream finance?

The answer has to be a resounding “yes”. One part of the answer is that, when done effectively, taking on a microfinance portfolio can contribute to group profits. But, it has to be recognised that this is a minor contribution from the perspective of mainstream finance. Far more important is that by taking on the narrative of working with the microfinance industry that helps poor people (especially poor women) and reduces poverty, mainstream finance can generate a positive message about its philanthropic and commercial contribution to society. Is this too cynical? We think not. At a lavish breakfast in the House of Lords in 2012 to launch the Banking on Change programme – a Barclays Bank grant of GBP 10 million with CARE and Plan UK for village banking groups in Africa – Department for International Development’s Chief Economist, Stefan Dercon, felt it appropriate to ask the CEO of Barclays, Antony Jenkins, how this small grant related to the hundreds of millions that Barclays had acquired by rigging the LIBOR interest rate over many years.¹¹ Mainstream finance finds microfinance very useful: it provides copy in the western media to counterbalance reports about its constant misdemeanours; it can be highlighted in annual reports and on websites; and if you are not too concerned about the social impact it may even provide a financial return. The media groups with a vested interest in keeping the good news about microfinance pumped out to the public – *Forbes*, the *New York Times*, the *Financial Times* and others – are useful allies.

CONCLUSIONS

And so we return to our opening question – has microfinance lost its moral compass? The recent evidence from ethnographic fieldwork in Bangladesh, supported by recent and rigorous quantitative studies of impact and alongside the meltdown of south Indian MFIs and lots of their clients indicates that microfinance in south Asia, like mainstream finance in north America and western Europe, has certainly experienced a moral drift and that parts of the sector have lost their moral compass. Many of the non-governmental organisations (NGO) that have shifted to becoming MFIs started their operations as deeply committed attempts to support poor people. As they have focused more and more on microfinance and massively expanded they have increasingly begun to compete with each other and have professionalised in financial terms (better accounting systems, better monitoring of unit costs and profit centres, individualised performance indicators for staff), adopting standards and approaches from the mainstream finance community. As MFIs have moved upstream to access funds from global financial markets, financial performance (size of portfolio, PAR, return on assets, repayment rate, profit/ surplus) has shaped staff behaviour in ways that contradict the social missions MFIs proclaim. The neo-liberalisation of the mainstream finance sector that began in the London and New York in the 1980s has now contaminated microfinance in rural Bangladesh and India.

What should be done? One response would be to try to close formal microfinance down – as some south Asian politicians have argued. This would be unwise for two reasons: (i) well-designed microfinance, that is pursuing client needs and sustainability, is beneficial for many poor and low-income people (Collins et al 2009), and (ii) the informal moneylenders that would recolonise the formal market may do no better, may do worse, than the MFIs. A second option is more effective regulation of microfinance. This is very desirable but in most countries it is very difficult to achieve. Central banks, when asked to improve MFI regulation focus on administratively intensive reporting by MFIs (which raises their costs) and/or arbitrary interest rate caps, which may reduce MFI capacity to meet client needs. But, central banks could be much more influential in pushing MFIs to be transparent (e.g. simple loan terms written in Hindi or Bangla in loan books that are read out at group meetings) in transmitting a message of “buyer beware” and asking MFIs about how they screen vulnerable people out of their lending programmes.

The third option is to challenge the founders and directors of leading MFIs – Md Shafiqul Haque Chowdhury, of ASA; Sir Fazle Abed and Shameran Abed of BRAC; Zakir Hossain, of BURO Bangladesh; Abu Nasser Muhammad Abdus Zaher, Chairman, Islami Bank Bangladesh Ltd; and others – to re-examine their microcredit operations and ensure that social performance is at the heart of their monitoring systems and shapes the behaviour of branch managers and frontline staff. We encourage these charismatic leaders to rebalance the channels of influence and become pioneers in promoting social performance management and enforcement at the branch level. Although initiatives and systems for monitoring social performance have improved greatly over the last decade – see M-CRIL’s “social rating” methodologies and ImpAct’s framework (M-CRIL 2012; Copestake et al 2005; Copestake 2007; Sinha 2008) – MFIs need leaders to genuinely demonstrate that social performance is as important as financial performance. They need to be visiting branches and clients unannounced, convening open meetings with clients and ex-clients, discussing the problems that credit officers face without their managers being present. Organisational cultural change will be needed to reorient staff to a world with two bottom lines – financial and social.

These leaders could be more ambitious. Ideas from what used to be called “developing countries” are now having an impact on global thinking, most obviously in the post-2015 UN Sustainable Development Goals which have moved beyond the G7/OECD focus only on extreme poverty. Sustainability, reducing inequality and “leave no one behind” are now on the international agenda thanks to “Southern” voices. Could the leaders of the microfinance industry in the South put their voices to demands that their counterparts in mainstream finance – the CEOs and directors of HSBC (presently threatening to resign if the UK government makes directors criminally responsible for financial malfeasance), Barclays, Lloyds, Citibank – return to pursuing the common good (make a good profit while contributing to productivity growth and job creation) rather than short-term profitability at any price? We know that globally finance has lost its moral compass (see the reports of Global Financial Integrity at www.gfi-integrity.org to understand how ripping poorer countries off has become routine behaviour for companies and financial institutions). Microfinance does not have to follow this drift towards short-term financial performance is all that counts. It could take on a leadership role promoting an alternative vision by ensuring it achieves its social mission and pressurising mainstream finance to move from its predatory practices to being a member of society again.

The leaders of mainstream finance in North America and western Europe have clearly let their institutions lose their moral compass – would either of us trust our banks in the UK or France to treat us fairly? “how stupid do you think we are?” The leaders of microfinance in south Asia have a choice – will they follow the lead of mainstream finance in the West and drift into amorality and immorality? Or will they chart a different path – in which social performance is a genuine pursuit and not a public relations exercise?

NOTES

1 In this paper we use the term microfinance institutions (MFIs) but many of the institutions we are examining are more accurately described as microcredit institutions as they focus primarily on making small loans.

2 This continues to the present day in the UK. At the time of writing, the UK government's Advertising Standards Authority has banned three adverts by "payday lenders" for misinforming potential customers about their products (Reed 2014).

3 To understand just how "international" the leaders of big MFIs are, visit their offices. Amongst the photos on the wall will be handshakes with Bill Clinton, Bill Gates and Bono, It could take on a leadership role promoting an alternative vision by ensuring it achieves its social mission and pressurising mainstream finance to move from its predatory practices to being a member of

society again, but can you spot Nelson Mandela, Angelina Jolie or Queen Elizabeth II?

4 BRAC International raised more than \$75 million in 2010 from bond markets to finance its programmes in Africa.

5 This paper draws extensively on Maitrot (2013), including quotations from MFI borrowers and staff members. Maitrot investigated the social performance of MFIs in rural Bangladesh over 10 months of intensive fieldwork in a rural location with a high density of MFIs (ASA, BRAC, BURO, Grameen Bank and many others). It included a survey of 490 households, detailed ethnographic studies of four communities and institutional ethnographies of two MFIs. Maitrot's thesis can be downloaded from URL: www.manchester.ac.uk/bwpi.

6 Debates about microfinance's morality commonly focus on the high interest rates some MFIs charge clients. This is not our focus in this article.

7 And probably more widely, but this paper focuses on Bangladesh and India.

8 In general we dislike the term "neo-liberal" as it is commonly used by left-of-centre analysts as a blanket term to describe any activity that is partially market-based. However, we find it an appropriate term for summarising the mission drift in many south Asian MFIs from the pursuit of a social mission, through partially market-based activities, to becoming organisations driven purely by short-term financial performance indicators.

9 A common sentiment expressed by MFI credit officers and microfinance clients and former clients (Maitrot 2013).

10 Note that in Bangladeshi organisational culture a manager commonly behaves like a dictator. The job of subordinates is to do exactly what they are told and be obedient.

11 In fairness to Barclays Bank they were not alone in It could take on a leadership role promoting an alternative vision by ensuring it achieves its social mission and pressurising mainstream finance to move from its predatory practices to being a member of society again. The leaders of mainstream finance in North America and western Europe have clearly let their institutions lose their moral compass – would either of us trust our banks in the UK or France to treat us fairly? "how stupid do you think we are?" The leaders of microfinance in south Asia have a choice – will they follow the lead of mainstream finance in the West and drift into amorality and immorality? Or will they chart a different path – in which social performance is a genuine pursuit and not a public relations exercise?

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Balaton Panorama from Badacsony

Photo © by Dr. Antal Szabó

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MICROFINANCE in ROMANIA, EVOLUTION and IMPACT**ABSTRACT**

The Romanian Microfinance sector is among the largest in Europe and one of the main beneficiaries of the European Union Microfinance Programs: Progress, JASMINE and EaSI. Its recent evolution presented in the article was supported by the technical assistance and the two European Microfinance Networks: EMN and MFC and through the access to the European funded Financial instruments administrated by European Investment Fund.

Partnerships with the Romanian SMEs banks contributed to the improved financial offer and positive impact on the targeted beneficiaries. Within the last years, 2017-2019 the main Romanian Microfinance Institutions were evaluated and certified as compliant with the European Code of Conduct for Microcredit provision, a quality measure of the sector's sustainable performance, internal processes and relations with the customers.

Key words: microfinance, operational sustainability, impact of the microfinance activity.

JEL Classification: G21, G23, O16

1. DEFINITION OF MICROFINANCE:

Within the current legal framework that governs the microfinance activities in Romania there is no specific definition of microcredit or microfinance, therefore the EU definition is generally accepted by the sector and its stakeholders:

'Microfinance' includes guarantees, microcredit, equity and quasi-equity, coupled with accompanying business development services such as in the form of individual counselling, training and mentoring, extended to persons and micro-enterprises that experience difficulties accessing credit for the purpose of professional and/or revenue-generating activities³.

Previously, microcredits were limited to loans up to EUR 25,000, but a new definition has been proposed within European Social Fund Plus (ESF+) that removes the maximum loan amount. However, the loan amount up to 150% GNI/ capita of the country is generally considered as microcredit with impact in the social and financial inclusion of the beneficiaries.

Two main types of microcredit can be distinguished: personal microcredit, which intends to improve the employability of the borrower, i.e. for education, improvement of the housing conditions, access to medical services, etc., and business microcredit, which finances an income-generating activity aimed at the creation or expansion of income-generating and job-creating activities or micro-enterprises, i.e. the financing of investment in productive assets and/or working capital.

³Proposal for the REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the European Social Fund Plus (ESF+) May 2018 (page 26)
https://ec.europa.eu/commission/sites/beta-political/files/budget-may2018-european-social-fund-plus-regulation_en.pdf

2. ROMANIAN MF SECTOR EVOLUTION, TRENDS, DEVELOPMENT STRATEGIES

Microfinance activities in Romania started more than twenty-five years ago (1992-1995), when the first International Microfinance Institutions (IMFIs⁴) launched their programmes aimed at supporting the development of the private sector through financing the establishment and further development of farms and micro & small enterprises in Romania.

The Romanian Microfinance sector evolved rapidly and became more efficient and productive in achieving its mission of providing financial products and business development services to the underserved farmers and entrepreneurs.

Fifteen of the main Romanian MF providers included in the current benchmarking report are the funding members of the Romanian MicroFinance Association (MFA), registered in November 2019 with assistance and support from Microfinance Centre's project "EU-level NGOs networks active in the promotion of social inclusion and poverty reduction or microfinance and social enterprise finance".

The main objectives of the association are to represent the common interests of the Romanian Microfinance Institutions in relation to the sector's key stakeholders, i.e. control and supervision authorities at local, regional, national, but also at international level (especially EU institutions), to support the development of the microfinance services provided by its members and promote their financial and social inclusion impact, recommending best practices and the highest standards of professional behaviour and ethics, and to contribute to the education and development of the business community and the public in the field of microfinance.

Mobilising Microfinance funds of Eur230m⁵ for the targeted beneficiaries of the financial and business development services, the Romanian microcredit providers, MFIs and SMEs Banks, are among the main beneficiaries of the EU-funded financial and technical assistance programmes: JASMINE, Progress and EaSI, EFSI, COSME⁶, and represent 34% of all European MFIs certified as compliant with the European Code of Good Conduct for Microcredit Provision⁷.

3. THE LEGAL FRAMEWORK FOR MICROFINANCE ACTIVITIES IN ROMANIA

During 2002-2006, the regulatory framework for the non-bank financial companies followed the fast pace of changes experienced by the sector mainly due to the successful lobby efforts of the non-bank financial services providers and international aid programmes, funders and investors. Specific legal frameworks were enacted as Government Ordinances or Laws, e.g. the Government Ordinance no. 40 (2000) for the licensing of Non-Bank Credit Organizations (NBCO) to manage public funds, the Credit Unions law no. 266 (2006) that regulates the credit unions and their regional and national apex structure: CUs National Union and CUs Regional Associations (UNCAR/ UTCARs), Government ordinance no. 51/1997 for leasing operations and leasing companies and Ordinance no. 200/2002/ Law no. 300.2003 related to the mortgage credit and operations of mortgage companies and the Microfinance Law no. 240/ 2005.

In order to unify the specific legal frameworks created, the Romanian Ministry of Finance and the National Bank of Romania created a full legal environment that regulates all the non-bank financial institutions and their financial activities which accelerated the development and "commercialization" of the sector.

⁴CHF international, Opportunity Microcredit International, Swiss Gov. and HEKs/EPER organization, World Vision International.

⁵ EaSI WS: "Legislation specific to MFIs in Romania versus European Code of good conduct for Micro-credit provision; Bucharest March 2019

⁶ EU funded microfinance and SMEs development programs: JASMINE (Joint Action to Support Microfinance Institutions 2007-2013); EaSI (Employment and Social Innovation 2014-2020) , EFSI (European Plan for Strategic Investments, also known as the Juncker Plan, COSME (Competitiveness of Enterprises and SMEs)

⁷ List of awarded microfinance institutions 15 July 2019 <https://ec.europa.eu/social/main.jsp?catId=1482&langId=en>

The Non-Bank Financial Institutions Law no. 93/2009, adopted by the Romanian Parliament in May 2009, alongside with the secondary legislation issued by the Romanian National Bank constitute the current legal framework for all financial activities developed by leasing, mortgage, consumer credit, factoring and microfinance non-bank financial institutions. The National Bank of Romania is the regulatory and supervisory authority of all Non-Bank Financial Institutions (NBFIs).

The regulatory framework is mostly liberal, for instance no limitation is set on geographical expansion, foreign investment or interest caps, no deposits, transparency in setting costs, client protection, etc. and the capital requirements for non-bank financial institutions to develop micro-credit activities is only EUR 200,000.

Under the current legal environment, the competition within the financial sector increased to the benefit of the customers. The entire spectrum of financial services is offered from investment long-term to working capital short-term, credit lines, bridge loans to co-finance development projects funded through grant schemes, factoring, and business development support services, delivered traditionally or online through fin-techs.

The legal framework allows the implementation of the upscaling strategies of the MF Institutions, transferring the bankable clients to partner banks, and borrowing financial resources to finance the MFIs’ growing portfolio of start-ups, sole entrepreneurs, farmers and microenterprises, as well as the implementation of the upscaling strategies of banks, establishing and financing their own MFIs as NBFIs and referring to them the applications for microcredits submitted to the bank.

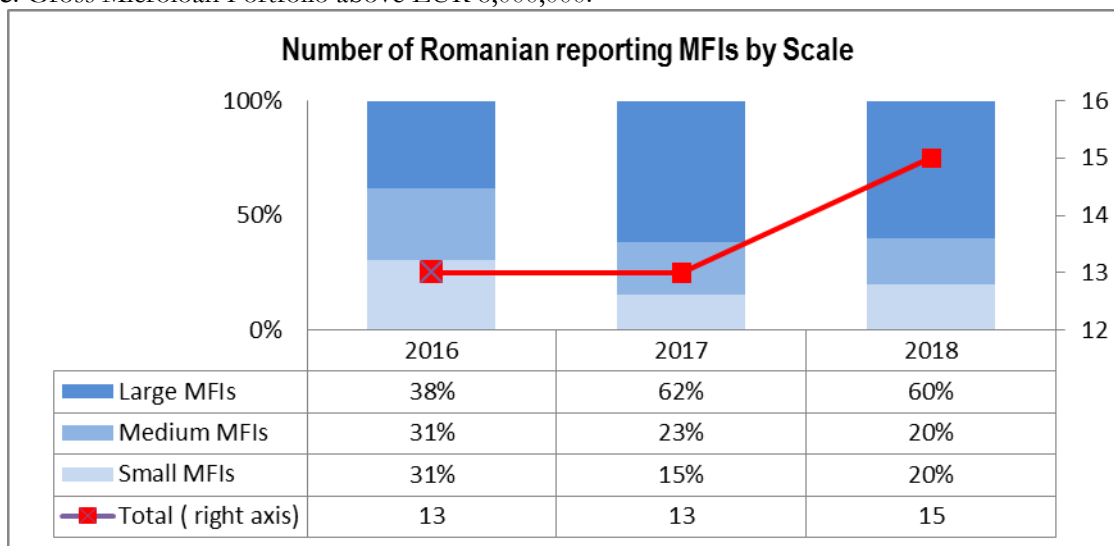
The data collected for the study were self-reported with the support of the Romanian MicroFinance Association (MFA) and processed to allow a comparison of the benchmarks of the organisations with other MFIs that have a similar size in terms of outstanding microloan portfolio.

For this purpose, the following segmentation of MFIs was adopted:

Small: Gross Microloan Portfolio below EUR 2,000,000;

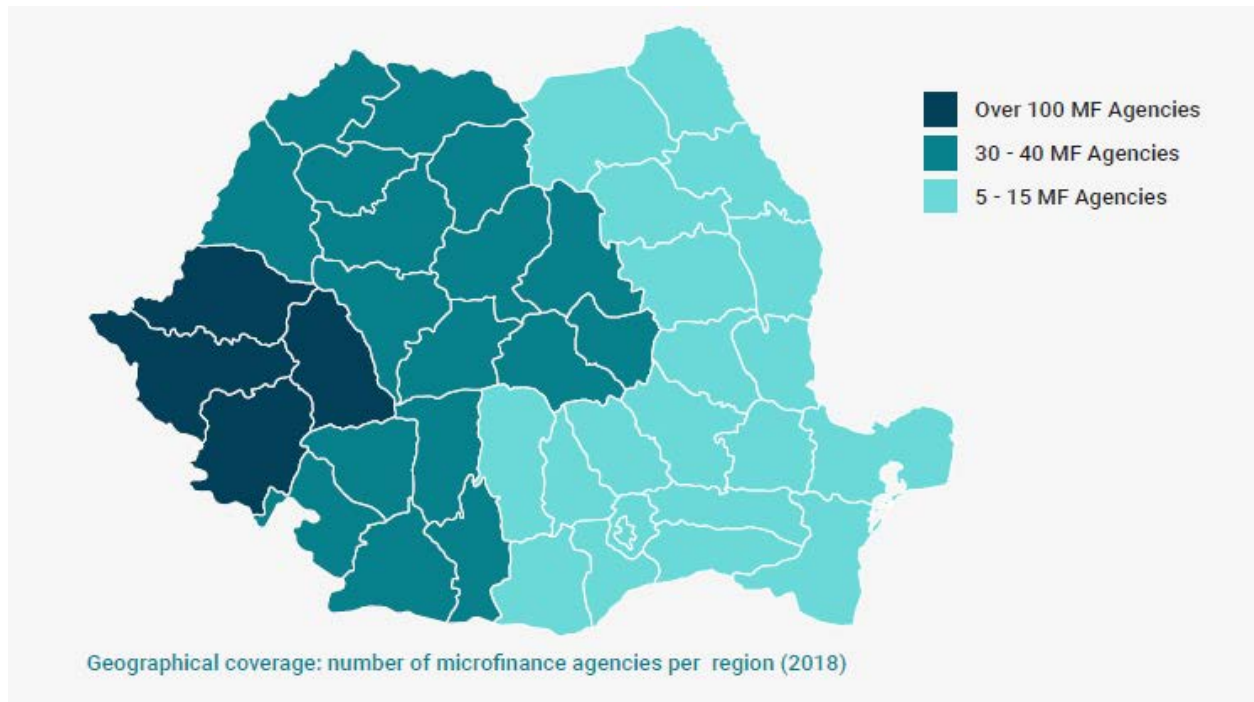
Medium: Gross Microloan Portfolio between EUR 2,000,000 and EUR 8,000,000;

Large: Gross Microloan Portfolio above EUR 8,000,000.



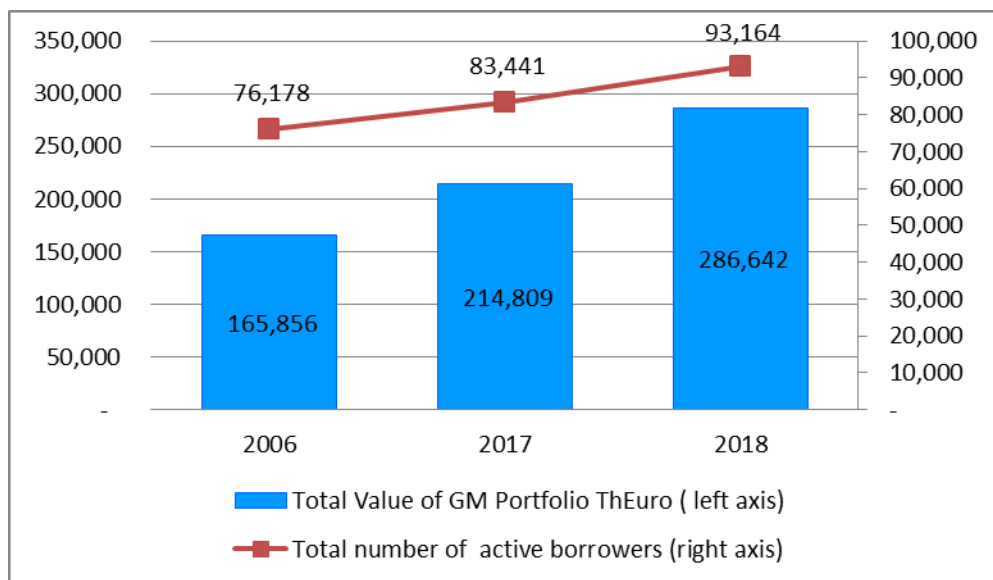
4. GEOGRAPHICAL COVERAGE

The regional coverage of MFI agencies is unequal, showing an important misbalance in the poorest and less developed South-East regions of the country.

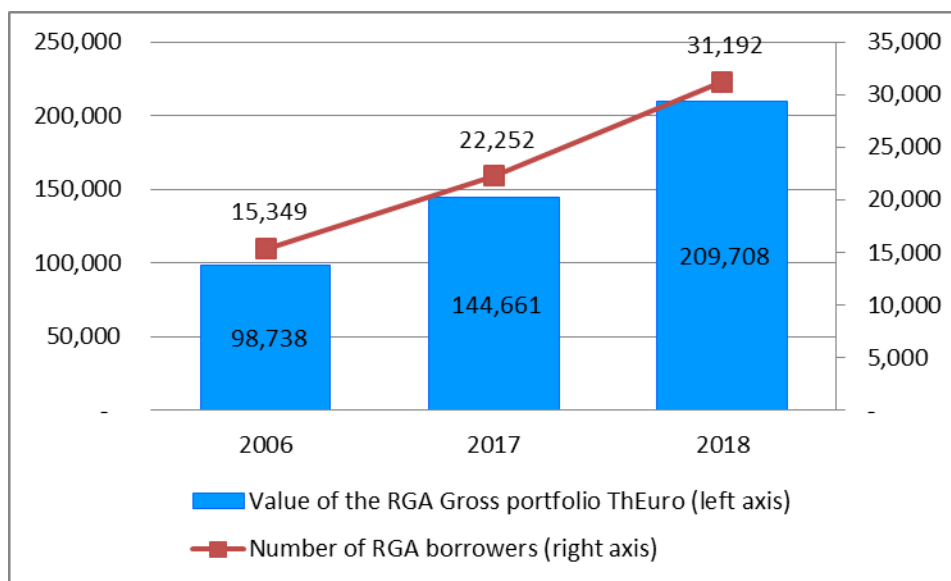


5. AVERAGE VALUE OF GROSS MICROCREDIT PORTFOLIO AND NUMBER OF ACTIVE BORROWERS PER SIZE OF THE MICROFINANCE INSTITUTION

Within the 2016 to 2018 period, the Romanian MF sector recorded a significant growth of the active portfolio by 73% as well as in the number of active clients by 22%, mainly due to the increased demand for microfinance services for revenue-generating activities and availability of financial resources and guarantees from social investors and from the EU-funded microfinance programmes: Progress Microfinance and EaSI.



At the end of 2018, the microcredit portfolio for revenue-generating activities represents 73% of the total value and 33% of the total number of active borrowers.



6. PRODUCTIVITY

Productivity indicator, calculated as number of active borrowers per number of MFIs' staff:

Indicator/ year	2016	2018	2019
Number of Active Borrowers at the end of the year	76,178	83,441	93,164
Total Number of staff (FTE)	686	721	764
Average Productivity/year	111	116	122

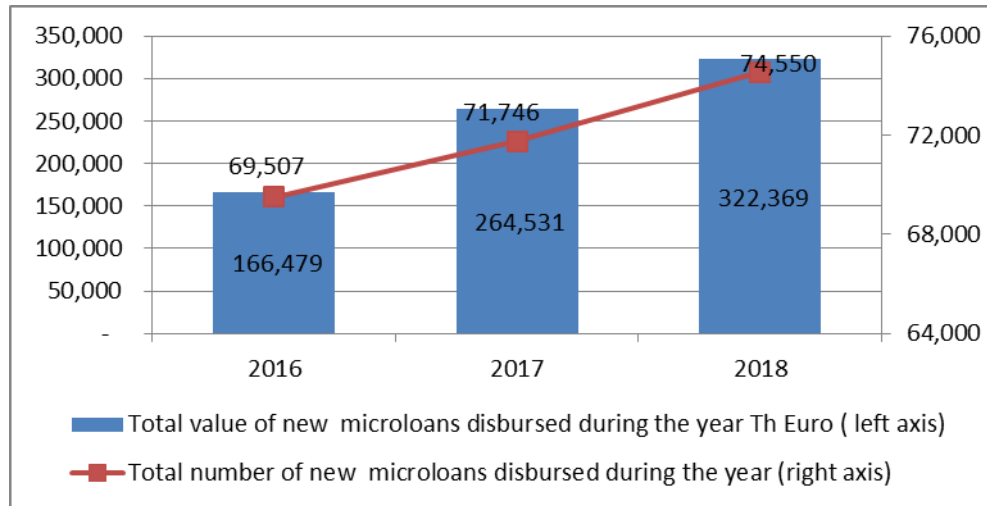
The productivity increased by 9% during the period and is expected to grow faster during the following years due to the digitalization of the financial processes implemented since 2018 and the successful establishment of Fintech MFIs.

7. VALUE AND NUMBER OF NEW LOANS DISBURSED DURING THE YEAR

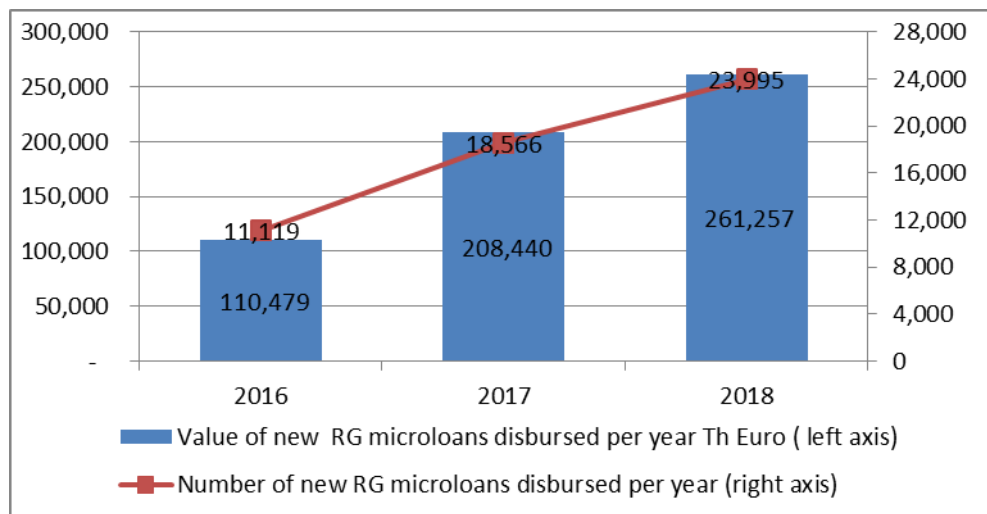
Within the 2016 to 2018 period the Romanian MF sector recorded a significant growth by 94% of the value and by 7% of the number of the microloans disbursed during the year. Important parts of the new portfolio of microcredits are short-term loans disbursed to finance the working capital needs of the customers and factoring services for revenue-generating activities.

The Total value and number of new loans disbursed during the year, grouped based on the size of MFIs

Indicator/year	2016	2017	2018
Total value of new microloans disbursed during the year Th. Euro	166,479	264,531	322,369
Small MFIs	3,416	6,916	2,196
Medium MFIs	10,909	11,957	18,502
Large MFIs	148,964	241,526	297,223
Total number of new microloans disbursed during the year	69,507	71,746	74,550
Small MFIs	355	153	406
Medium MFIs	1195	1154	426
Large MFIs	67,957	70,439	73,718



At the end of 2018, the value of new microloans disbursed during the year for revenue-generating activities represents 81% of the total value and 32% of the total number of new loans.



8. OPERATIONAL SELF-SUSTAINABILITY OF THE ROMANIAN MICROFINANCE INSTITUTIONS IN 2018.

In order to allow a comparison of the organisation’s operational self-sustainability with other MFIs that have similar years of experience in the market, the following segmentation of MFIs was adopted:

- Newly established MFIs: up to 4 years of activity in the microfinance sector;
- Young MFIs: between 5 and 8 years of activity in the microfinance sector;
- Mature MFIs: between 9 and 20 years of activity in the microfinance sector;
- Longest-Established MFIs: 20+ years of activity in the microfinance sector.

Indicator	Long established MFIs: 20+ years	Mature: 9-20 years	Young/ New: up to 4-8 years
Operational self-sustainability	130%	109%	96%

With the increased productivity and efficiency due to the digitalization of services and the good long-term relationship with the customers, the well (long)-established and mature MFIs are operationally self-sustainable. Additionally, the newly established MFIs are growing faster and are expected to break-even during the following years.

The recent entrance of the Credit Unions on the microfinance market with a diversified offer of financial products for start-ups, sole entrepreneurs and small farmers will ensure the coverage of the lowest segments of the market.

9. Social and Economic inclusion

Social and Economic inclusion indicator was calculated as average loan amount disbursed divided by Gross National Income (GNI) per capita (Romania)⁸. Previously, microcredit was limited to loans up to EUR 25,000, but a new definition has been proposed that removes the maximum loan amount. In the current practice, the value of the microcredit lower than 150% GNI/capita is considered to have a social and economic inclusion impact disbursed to underserved non-bankable customers.

The targeted clients included in the mission statement the MIFs reporting to this study are underserved individuals, farmers, sole and start-up entrepreneurs and micro-enterprises.

As within the 2016 to 2018 period the Romanian MF sector recorded a significant growth of the number and value of the microcredits disbursed during the year, an important part of the new portfolio of microcredits is disbursed to women (65% in 2018) rural clients, mainly small farmers (49% in 2008) and start-up entrepreneurs and micro-enterprises (19% in 2019).

The average loan amount increased by 87% during the analysed period, having a value of 23% of the GNI per capita, significantly below the limit of 150%, proving the fact that the MFIs reporting for this study are reaching the targeted clients included in their mission statements and the financial sustainability of the sector is well balanced by a social inclusion impact.

10. IMPACT OF THE MICROFINANCE ON TARGETED BENEFICIARIES

Within the last three years (2016-2018), the value of the microfinance portfolio and number of microcredits disbursed during the year by the main 15 MFIs from Romania doubled and the Credit Unions from Region West with the financial support of the EaSI guarantee instruments are providing financial services for revenue-generating activities serving the lowest segment of the microfinance market: start-ups, sole entrepreneurs and small farmers.

The average loan amount of microloans disbursed for revenue-generating activities represented in 2018, 58% of GNI/ capita of Romania and the professional microcredit just 6%, 65% of the loans are disbursed to

⁸ GNI per capita (constant LCU) - GNI per capita is gross national income divided by midyear population. GNI (formerly GNP) is the sum of value added by all resident producers plus any product taxes (less subsidies) not included in the valuation of output plus net receipts of primary income (compensation of employees and property income) from abroad. Data are in constant local currency.
<https://data.worldbank.org/indicator/NY.GNP.PCAP.PP.CD?locations=RO>

women, 49% to rural clients and 19% to start-up clients, proving the social and economic/financial inclusion impact of the microfinance activities provided by the main 15 Romanian MFIs participating in the study.

The development impact on the targeted beneficiaries (start-ups, sole entrepreneurs, farmers and microenterprises) is positive as well. The impact assessment study funded by USAID in Romania (2009)⁹ revealed that during and after the credit, the beneficiaries interviewed noted the following:

- 67.5% of them have had a market share increase;
- 69% of them have had a turnover increase;
- 66% of them saw an increase in the company's assets.

As consequence of the liberal legislation for the financial sector in Romania, due to the increased competition on the financial market and the diversity of financial institutions: SMEs banks, NBFIs: leasing, factoring, consumer credit, micro-credit, credit unions, cooperative banks, guarantee and counter-guarantee institutions, fin-techs, investment funds, etc., access to finance is not among the main difficulties or barriers for the development of Romanian MSMEs¹⁰.

Maria Doiciu – senior consultant, facilitator of the Romanian Microfinance Working Group and the **Eurom Consultancy and Studies team** with the assistance and support from Romanian MicroFinance Association and Microfinance Centre's project "EU-level NGOs networks active in the promotion of social inclusion and poverty reduction or microfinance and social enterprise finance".

⁹ Assessment of the Impact of USAID's Ten Years of Assistance in Micro-lending, Rural Credit, Mortgage, & Equity Investment - Romania's Unique Financial Mechanisms Assisted by USAID

¹⁰ World Bank' Doing business report 2020, <https://www.doingbusiness.org/>

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THE ROLE OF MICROFINANCE IN DEVELOPMENT OF SMEs IN REPUBLIC OF SERBIA

ABSTRACT

The importance of microfinance is in availability of funding business for those segments of the population with difficult access to conventional means of business financing from banking sector. Microfinance represents a way of funding which can create new jobs and reduce the proportion of socially vulnerable population. The existing model of microfinance in Serbia has a limiting effect on its efficient operation and satisfaction of demand for micro credits. The paper aims to point out the importance of microfinance as a support for the development of SMEs in the Republic of Serbia. A research subject is current economic development, characteristics of the SME sector, legislative framework on the microfinance, government program for supporting microfinance, major microfinance institutions in Serbia and national models of microfinance.

Keywords: SME sector in Serbia, microfinance, microfinance institutions

JEL Classification: G21, G23, O16

ECONOMIC SNAPSHOT

According to the fact that GDP is quite reliable indicator of economic development, it can be good measure of a country's economic progress, especially if it is expressed *per capita*.

Table 1: GDP in Republic of Serbia, 2016-2018.

GDP	2016.	2017.	2018.
GDP (in million)	36,758	40,291	42,954
Real GDP growth (in %)	3.3	2.0	4.4
GDP per capita in Serbia	5,208	5,739	6,152
GDP per capita in EU-28 ¹	38,304	35,731	/

- in EUR -

Source: Statistical Office of the Republic of Serbia and UNECE Statistical Division Database

Note: ¹ Value of GDP per capita is converted from \$ USD in EUR according to average exchange rate of NBS

The value of GDP in the Republic of Serbia is growing in absolute terms in the period 2016-2018. The highest growth of 4.4% was recorded in 2018. Although GDP per capita is growing, it is far below the EU-28 average. During the observed period, Serbia achieved approximately seven times lower GDP *per capita* compared to the average of EU countries.

During economic isolation in 1990s Serbia lost all international markets, started de-industrialization, implemented inadequately privatization and didn't have sufficient inflow of FDI (Eric D., et al., 2014, p. 139). For these reasons, many factories were closed, industry was destroyed and competitiveness of domestic products and services were weakened (Beraha, I., and Djuricin, S., 2011). In recent years, Serbia has recorded decline in the value of the trade deficit. The depreciation of the trade deficit is mainly the result of more

intensive FDI inflows. In the reporting period in absolute terms increases the value of both exports and imports. Exports are growing slower than imports by an average of 3.1 percentage points in the period 2017-2018.

Table 2: Exports and Imports in Republic of Serbia, 2016-2018.

Exports and Imports (in EUR million)	2016.	2017.	2018.
Exports	17,870	20,364	21,810
- growth rate in % compared to a year earlier	11.9	8.2	8.3
Imports	19,638	23,019	25,468
- growth rate in % compared to a year earlier	6.7	11.1	11.6

Source: Statistical Office of the Republic of Serbia

The inherited public debt, after the breakup of Yugoslavia, was a huge burden on the transition path. The value of public debt decreases and amounts to 67.8%, 57.9% and 53.8% of GDP, respectively in the period 2016-2018.

Table 3: RS public debt/GDP, 2016-2018.

RS public debt	2016.	2017.	2018.
RS public debt in % of GDP	67.8	57.9	53.8

- in % -

Source: Government of Republic of Serbia

The labor market in the best way reflects the economic trends. According to the definition of the Statistical Office of the Republic of Serbia (Statistical Yearbook of the Republic of Serbia, 2019):

- Employment rate is the share of employees in the total population aged 15 and over,
- Unemployment rate is the share of the unemployed in the total number of active population,
- Activity rate is the share of active population in the total population aged 15 and over,
- Inactivity rate is the share of inactive persons in the total population aged 15 and over.

The unemployment rate had a decreasing trend and recorded a value below 16% in the period 2016-2018. Reduction in the unemployment rate could be attributed to real GDP growth because in the observed period the economic growth was recorded.

Table 4: Employment / unemployment rate in Republic of Serbia, 2006-2018.

RS public debt	2016.	2017.	2018.
Employment rate	55.2	57.3	58.8
Unemployment rate	15.9	14.1	13.3
Activity rate	65.6	66.7	67.8
Inactivity rate	34.4	33.3	32.2

Source: Statistical Office of the Republic of Serbia

Highly qualified persons and persons with high and secondary professional education accounted for 44% in the total number of unemployed in Serbia. Highly skilled and skilled persons, Semi-skilled persons and persons with lower professional education accounted 23% and 3% respectively in the total number of unemployed in Serbia. Unskilled persons accounted 30% in the total number of unemployed in Serbia.

Table 5: Unemployed persons, according to the level of professional education, 2018.

Unemployed persons	2018.
Higher, high and secondary professional education	44
Highly skilled and skilled	23

- in % -

Semi-skilled and lower professional education	3
Unskilled	30
Total	100

Source: Statistical Office of the Republic of Serbia

The average net salary in Serbia in 2018 was 421 euro. The average net salary per employee increased by 8% compared to 2017. The increase in the inflation rate during the observed period annulled positive trend in increasing of net salary. Inflation is moving around 2% on average in the past six years. Analyzed by sector, above average wages are earned in sectors which largely remained unprivatized and whose holders are mostly state-owned enterprises (Eric D., et al., 2014, p. 141).

Table 6: Average net salaries by sectors, 2017-2018

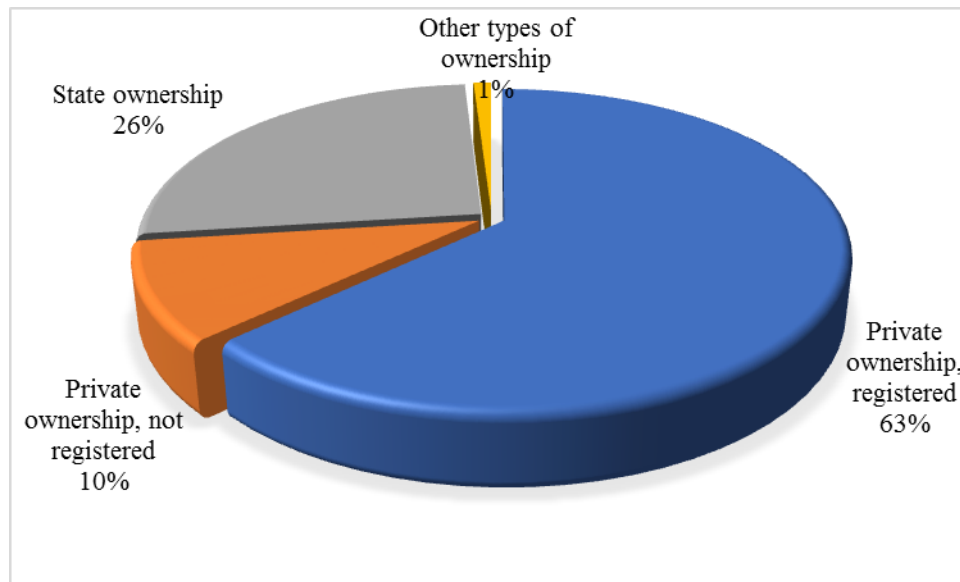
			- in EUR -
AVERAGE NET WAGES AND SALARIES	2017.	2018.	% increase / decrease
REPUBLIC OF SERBIA	389	421	8
Agriculture, forestry and fishing	342	364	6
Mining and quarrying	610	651	7
Manufacturing	374	384	3
Electricity, gas, steam and air conditioning supply	638	683	7
Water supply; sewerage, waste management and remediation activities	340	372	10
Construction	351	371	6
Wholesale and retail trade; repair of motor vehicles and motorcycles	307	354	15
Transportation and storage	399	385	-4
Accommodation and food service activities	240	268	12
Information and communications	760	705	-7
Financial and insurance activities	707	767	8
Real estate activities	440	426	-3
Professional, scientific and technical activities	600	516	-14
Administrative and support service activities	318	367	15
Public administration and defence; compulsory social security	405	493	22
Education	345	440	28
Human health and social work activities	346	417	21
Arts, entertainment and recreation	318	352	11
Other service activities	286	328	14

Source: Statistical Office of the Republic of Serbia

Note: Value of net salaries is converted from RSD in EUR according to average exchange rate of NBS

The private ownership registered companies are generating 63% of employees, while state ownership registered companies, private ownership, not registered companies and other types ownership companies, generating 26%, 10% and 1% of employed persons, respectively.

Graph 1: Employed persons by d type of ownership, 2018.

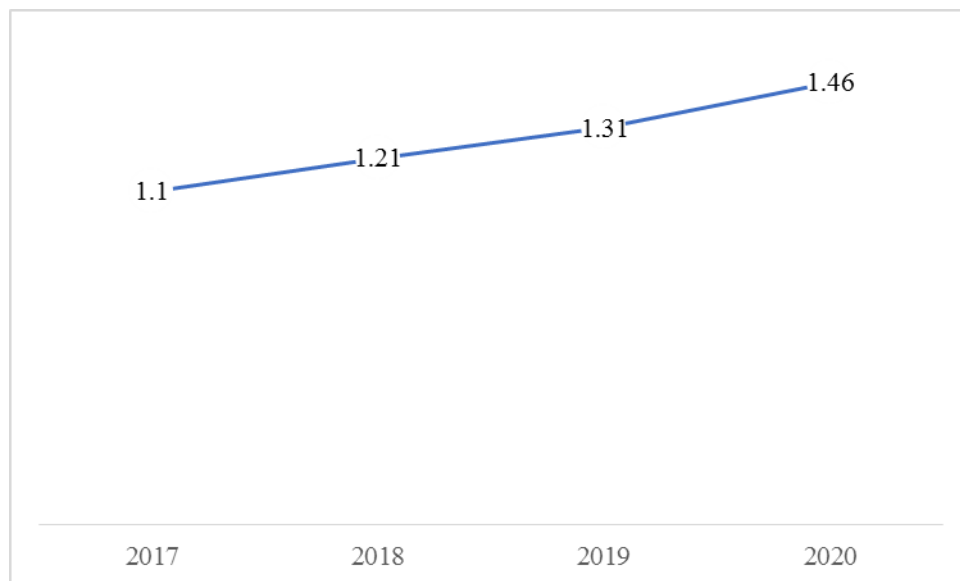


Source: Statistical Office of the Republic of Serbia

Also, the labor market characterized by slow growth amount of minimum average labor cost per hour. Minimum average labor cost per hour in 2020 compared to 2017 increased only 0.36 euro and is currently 1.46 euro.

Graph 2: Minimum average labor cost per hour-net, 2017-2020

- in EUR -



Source: The legal database, available at: <http://www.paragraf.rs/onama.html>

Note: Value of Minimum average labor cost per hour is converted from RSD in EUR according to average exchange rate of NBS

The current economic situation in Serbia is unsatisfactory primarily according to a high percentage of the population living below the poverty line. Overall macroeconomic situation has resulted in the high of the poverty rate. Based on Survey of Income and Living Conditions (SILC), 24.5% of the population in Serbia are at risk of poverty. At the same time, there is a high degree of variability in living standards within the country.

DEVELOPMENT OF THE SME SECTOR

The SME sector is a very important segment of the economy, especially in low- and middle- income countries. According to World Bank Data, Serbia is ranking as upper middle-income country, with 6,880 USD GDP per capita (WB, 2018). Even the data tell the other (better) part of the story of the development of the national economy, the discrepancy between the social welfare of different income groups is still present. One of the potential solutions for improving the social status of inhabitants is to create a perspective extern environment for the development of entrepreneurship and small and medium sized entities. Dynamic development of the SMEs sector was until 2008, when World economic crises occurred. This crisis caused numerous negative effects on all entities, but the most affected were entrepreneurs, due to the lack of financial funds for business recovery. Despite that, the flexibility and size of this sector allow him to accept the market changes easily and quickly (Erić et al., 2014).

During the last ten years, small and medium sized entities and entrepreneurship represented over 99% of all active enterprises. Also, during that period, they employed over 2/3 of employees in nonfinancial sector. In 2017, the SMEs participated with over 25% in creation of GDP in Serbia. According to the last available data, SMEs generate 65.6% of turnover, 56.7% of GVA, 39.5% of export, 54.5% of import and 66% of employed in non-financial sector in Serbia.

Table 7: Indicators of the development of the SME sector

- in % -

Indicator	Non-financial sector			
	2014	2015	2016	2017
Number of enterprises	99.8	99.8	99.9	99.9
Number of employees	64.8	65.7	65.7	66.0
Turnover	65.4	66.3	65.1	65.6
Gross Value Added	56.0	57.7	56.2	56.7
Export	44.8	44.1	40.8	39.5
Import	57.0	56.5	56.3	54.5

Source: Ministry of Economy and Statistical Office of the Republic of Serbia

Main indicators for analysis of the development of the SMEs sector are number of enterprises, number of employees, turnover, gross value added, export and import. The share of employees in this sector increased for 1.8 percentage points from 2014 till 2017 which is significant indicator of business attractiveness, especially in the domain of entrepreneurship in the non-financial sector. Even the highest share of turnover was in 2015 as well as the share of GVA (66.3% and 57.7%, respectively), the SMEs also reduce the share in total export for 11% points and the share in total import for 4% points. The decline was higher in export than in import.

Indicators given in the table above can be compared with those presented in previous research conducted for the period 2005 till 2012, by Erić et al. (2014). The main changes are noticed in the export and import shares. Both values were higher in 2012 than in 2014 (51.5% and 60.2%, respectively). Compared to the latest data, the share decreased for 20% in export and for points and for 10% points in import.

If we observe enterprises by company size, there were no significant changes compared to the official available data. The number of entrepreneurs increased for 5% in 2017 compared to 2016. In the same year, the number of micro enterprises increased for 3%. According to the last available data, entrepreneurs accounted for 72.0% and micro-entities 24.3% of the total number of enterprises in the SMEs sector. The following number leading to conclusion that people in Serbia prefer to create their own business ideas and start new business. The turnover also increased in micro, small and medium sized enterprises in 2017 compared to 2016. The detailed results are given in the table below.

Table 8: Business indicators the SME sector by size

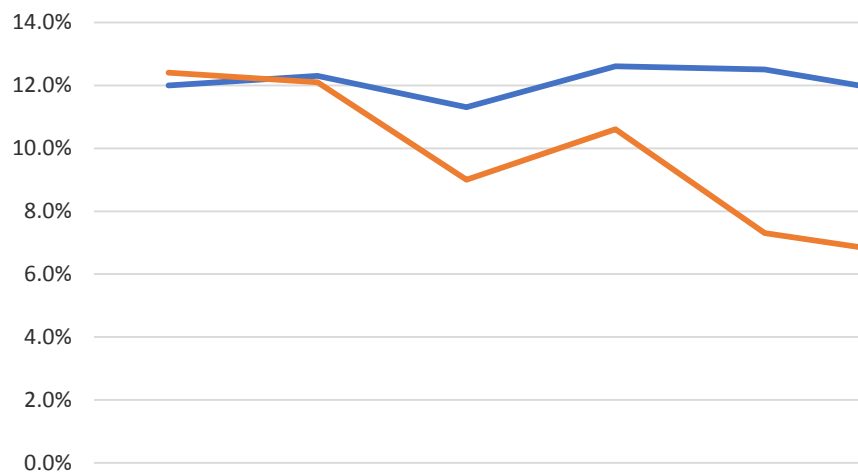
	2016				2017			
	Entrepreneurs	Micro	Small	Medium	Entrepreneurs	Micro	Small	Medium
Number of enterprises	243,590	84,105	10,154	2,263	257,267	87,012	10,583	2,372
Number of employees	247,775	154,073	203,681	232,003	257,872	157,890	213,380	244,320
Turnover*	1,116,068	1,476,356	1,952,475	2,064,981	1,215,327	1,515,631	2,133,418	2,299,722
Gross Value Added*	284,154	188,521	328,364	411,480	314,434	200,126	359,489	451,679
Export*	16,400	137,432	183,997	331,430	17,846	140,763	195,364	362,672
Import*	15,109	249,021	409,609	506,525	16,720	255,551	450,030	534,084

Note: * in thousands

Source: Ministry of Economy and Statistical Office of the Republic of Serbia

Business demography indicate the development of the SMEs sector though several additional indicators such as rate of establishing or rate of closing entities. In 2017, the rate of establishing was the highest in 2015, while the rate of closing was the lowest in 2017. The detailed review of business demography indicators is given in the following chart.

Chart 3: The rate of establishment and closing in SMEs sector



Source: Ministry of Economy and Statistical Office of the Republic of Serbia

In 2017, the rate of establishment is higher than the rate of closing indicating that business environment in Serbia is improved and with much more possibilities for success and business development. More dynamic was entrepreneurial sector because inhabitants are more likely to start their own business, but at the same time the rate of closing is significantly lower than in previous years (the ration between those rates was less favourable).

According to official data about the number of new entities opened in period 2010-2017 it can be concluded that in average over 60% of them survive first two years and that enterprises are more likely to have business success and higher survival rate compared with entrepreneurs (Ministry of Economy, 2018). Higher survival rates for all entities can be reached with adequate financial support. Better access to different sources of financial support (banks as well as national institutions) and simple administrative procedure will ensure more financial funds for the SME sector.

Table 9. Business demography by selected sectors

Sector	Established	Closed	Net effect	Survivor rate (2015/2017)
Agriculture, forestry, and fisheries	681	374	307	79.6%
Manufacturing Industry	6,553	4,144	2,409	97.6%
Construction	4,174	2,163	2,011	74.5%
Trade	8,310	6,596	1,714	73.0%

Source: Ministry of Economy

LEGISLATIVE FRAMEWORK ON MICROFINANCE

Small and medium-sized enterprises in Serbia are faced with the poor compliance range of banks and financial needs of this category of enterprises. There are no laws on microfinance in Serbia. The development of microfinance in Serbia is slow and difficult. Non-banking financial institutions are unable to provide loans. To provide loans, non-bank financial institutions use an intermediary. An intermediary is a bank that takes high guarantee deposits for its service. This creates a "partnership" between the existing microfinance institutions and commercial banks. Although there are advantages of this type of business, any internal changes in the partner's bank leads to a re-negotiation and creating new conditions for cooperation between the two organizations (Eric D., et al., 2014, p. 150). Instead to facilitate obtaining loan, the existing legislation required from client necessary documentation in limited time and resources (Ibid).

The process of granting micro credits in Serbia is carried out in several steps (Eric D., et al., 2012, p. 141; Eric D., et al., 2014, p. 153):

- Contacting to microcredit organization and getting information about the conditions for granting a loan,
- Creating of business plan and fill out the questionnaire with the assistance of a MFIs expert - a preliminary assessment of viability and creditworthiness of the customer,
- Apply for a loan,
- Loan approval and his payout by the intermediary commercial bank and
- Monitoring and consulting of microfinance institutions.

Removing administrative barriers and improving the legal framework are part of the "Strategy for the development of entrepreneurship, SME sector and competitiveness in the period 2014 to 2020". In accordance with the strategy, the estimated effects of establishing adequate and effective legislative framework for microfinance in Serbia would be as follows:

- Poverty reduction (65% of users will be out of the poverty),
- Self-employment and job creation for the poorest,
- Reduce dependency of social welfare,
- Increase in government revenue due to the development of the SME sector,
- Promotion of Regional Development.

Establishing an adequate legal framework will regulate micro finance activity and allow them to operate like other MFIs in Europe. Development of legal framework for MFIs will contribute to the development of entrepreneurship, SME sector and overall economic progress.

NATIONAL PROGRAMS FOR SUPPORTING THE DEVELOPMENT OF SMEs

Because small and medium enterprises are considered as essential part of economic growth and achieving regional equalities, Zubović and Jovanović (2019.) showed that financial support is identified as a common barrier of successful business in several South-eastern Europe countries classified as low- and middle- income. Especially in agriculture, importance of institutional support is crucial for their development on the domestic but on the foreign market, as well (Jovanović, 2016.). Entities cannot achieve the competitiveness level without appropriate funds for investment in the production.

Commercial banks often prepare a wide number of conditions that enterprises must fulfil if they want to obtain the loan. Those conditions are considered to be very unfavourable for many of them, so owners often do not want to take part in such procedures because the chance for getting the loan is very small compared to bigger companies. In line with that, the Government of the Republic of Serbia decided to prepare adequate institutional framework to support entrepreneurship and the development of small business. A set of instruments was prepared during last ten years, and one of the results presented in the paragraph before indicating that the effects of that policy is quite positive. Higher rates of establishment and survival are the best indicator that can confirm the importance and significance of appropriate national support to small business development.

Financial support is provided by the following institutions: Ministry of Economy, Development Fund of the Republic of Serbia, Development Fund of AP Vojvodina, Guarantee Fund of AP Vojvodina, Development Agency of Serbia, Regional Development Agency Eastern Serbia, Regional Agency for the development and EU integration Belgrade, Agency for Agricultural Payment and National Employment Service. Providing financial support to SMEs through mentioned institutions is regulated by the following laws and regulations: Law on a Development Fund of the Republic of Serbia (The Official Gazette of the Republic of Serbia No 36/2009, 88/2010, 119/2012 and 5/2015), Law on Public Agencies Act (The Official Gazette of the Republic of Serbia No. 18/2005, 81/2005 and 47/2018), Law on the Guarantee Fund of AP Vojvodina (The Official Gazette of the Republic of Serbia No. 124/2012), Law on Investment (The Official Gazette of the Republic of Serbia No. 89/2015 and 95/2018), Law on Agriculture and Rural Development (The Official Gazette of the Republic of Serbia No. 41/2009, 10/2013 and 101/2016), etc.

The importance of entrepreneurs for economic growth in overall is confirmed by adopting and implementing several strategies by the Government of the Republic of Serbia. Furthermore, the Government declared that 2016 is the “*Year of the Entrepreneurship*”. Institutional support included six different categories with 16 billion of dinars (one third is grants or subsidies).

Main types of financial support were:

- Programs of financial support to entrepreneurs who start-up business
- Programs of non-financial support to entrepreneurs who start-up business
- Programs for improving business
- Programs for business growth and development
- Programs for support to export

- Programs for innovations.

Every program has own characteristics and it is based on necessities and problems facing by owners of small business. But, one question must be raised in the near future – are those programs effective? Evaluation of such policies is still missing, especially in the domain of the quantifying the effects of government support. Implementation of quantitative methods can contribute to better distribution of funds. Maybe the effects of funds will be higher if they can be transferred to other sector of economy instead of current. Also, national government support in some cases can be considered as safe way to get funds for business and some owners loses their entrepreneurial spirit. The Government must not be the only option in the process of obtaining funding by credit incompetent entities (Erić et al., 2014). Developing of a legal framework that would provide ability of non-depository institutions to perform a non-bank lending will attract foreign direct investment, enable job creation and encourage the strengthening of the entrepreneurial spirit.\

Even the micro crediting is one of the programs for support of the development, especially for people with low income, it means that all over the world this instrument is used to bridge the gap between different income groups as well as to improve market position of small and medium sized entities. Microfinance institutions can be smaller non-profitable, non-governmental or large commercial banks (Veselinović, Drobnjaković, 2015.). According to Kovačević (2014.), the the microfinance institutions can be divided into following categories, by their nature:

- For profit small/medium sized microfinance institutions
- Mainstream banks operating microfinance windows
- Public entities operating microfinance windows
- Greenfield entities
- Dedicated microfinance vehicles often set up for a limited period of time, that invest in.

The main clients for significant number of banks in Serbia are enterprises or corporation with stable market position and good financial performances. Only few of them consider financing of micro entities or start-up enterprises because high risks of failure. Erste Bank is one of them who offers a program for financing entrepreneurs, social entities as well as social organization. Their program „*Step by step*“ is very interesting because provides not only financial support but also administrative and technical advices in running business. The client or users of loans can be enterprise which operate on market not longer than two years, and have up to 9 employees. They can apply for two types of loans: Investment loans and loans for permanent working capital. *Raiffeisen Bank* started to approve loans for start-ups and small business from February 2020 as part of „*National Program to Promote Entrepreneurship and Self-employment concept*“.

Table 9: Microfinancial support to start-up and micro-business by banks in Serbia in 2020

Bank	Loans	Clients	Amounts
Erste Bank	Loans for Investment, Loans for permanent working capital	Start-ups and entities up to 9 employees, up two years of business	No limit defined
Raiffeisen Bank	Loans for permanent woking capital	Micro and small entities, up to 24 months of business	Up to 30,000 euros
UniCredit Bank	Loans for Investment, Loans for permanent working capital	Start-ups, micro and small entities, up to 24 months of business	Up to 30,000 euros
Poštanska Štedionica	Loans for Investment, Loans for permanent working capital	Start-ups, micro and small entities, up to 24 months of business	Up to 30,000 euros

Source: Authors

According to official public data in Serbia were present three non-bank microcredit institutions – AgroInvest, Micro-Development Fund and MicroFinS that operated through local banks. Only AgroInvest still have a web-site with more details about their activities. Official data available in Serbian Business Registar Agency database shows that Micro-Development Fund (Mikro razvoj doo) was closed in 2016 (decision No. BU 10687/2016). All of them were focused on rural areas of Serbia.

Agro Invest as an affiliate of Vision Fund International start to operate in Serbia in 2005. Their aim is to support economic progress in undeveloped areas. Their mission is to serve and to empower rural families with high-quality financial services and support programmes.

Agroinvest Holding is an intermediary between the commercial banks and the small businesses, especially from undeveloped areas, that has difficulties to get financial support. The most popular credits are in the areas of agriculture, but also, they can be used in other sectors such as trade and services. Use of these loans presents a good practice of microfinance support to small business. Rural development is one of the national goals and it can be achieved through equal and stable development of small business and entrepreneurship. Loan programs are mainly intended for entrepreneurs who operate in rural areas, because their market position is inferior when compared to those who operate closer to the major cities and business areas.

Unfortunately, in Serbia still do not exist clear institutional framework which regulates operation of microfinance institutions. That represents a big challenge and main problem for wider use of microfinance support programmes. One of the consequences of the lack of regulation is closing of Micro-Development Fund in 2016.

Despite following absence of legislative framework, lack of research about microfinancing is important to notice. The last research about potential using of microfinance in business was conducted in 2012, and till now there is no clear evidence about real effect of using microfinance support of banks and non-banks institutions. The further research needs to be done because of the estimation of the effects of loans (from banks) on business performances. With evidence-based policy recommendation, it can be much easier to change the legislative and future microfinance framework.

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Sunset at the Lake Balaton

Photo © by Mária Szabó

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MICROCREDITING AND SMALL AND MEDIUM ENTERPRISES IN GEORGIA**ABSTRACT**

This paper provides information on the Georgian SME sector. It presents the legislative framework on microfinance, outlines the different microfinance organizations and microfinance intermediaries, and highlights their activities. Also indicates some problems to the financial sector and micro-financial organizations which was caused by a pandemic. The author also presents available government support measures. Finally, it shows the microfinance model. Last but not least, it concludes that microfinance loans are more accessible to the masses than bank loans.

Keywords: characteristics of the Georgian SME sector, microfinance legislation, microfinance organization, microfinance intermediaries, government support, microfinance model

JEL classification: G21, L26, O1

CHARACTERISTICS OF THE SMALL AND MEDIUM-SIZED ENTERPRISES (SME) SECTOR

The SME definition is based on employment size and turnover customized to Georgia's specificities and is used for the compilation of official statistics on the SME sector. Medium enterprises employ up to 100 persons annually and have a turnover up to GEL 1,500,000 annually. Small enterprises employ up to 20 persons annually and have an annual turnover up to GEL 500,000. [1]

In 2017, the National Statistics Office of Georgia approved a new methodology for the SME registry aimed at the harmonisation of SME definition for statistical purposes to EU SME definition (Eurostat), which becomes effective from the start of 2018. This was envisaged by the Georgia SME Strategy Action Plan 2016-2017 of the Government. The SME definition as per the new methodology was harmonised with that of the EU and the new turnover levels are set to bring the regulation in line with that of the EU. [2]

The new "Tax Code", which came in force from January 2011, provides simplified procedures for micro and small businesses. According to the new "Tax Code", Micro and Small businesses are covered by special tax regimes. This definition is used for taxation purposes only and was introduced to allow the provision of preferential treatment for small and micro businesses. **The status of microbusiness** is given to a physical person who is not using hired persons to work and is conducting economic activity independently from which annual total income does not exceed GEL 30,000. The Ministry of Finance of Georgia is responsible for granting and abolishing the status of microbusinesses. The tax organ is responsible for granting a certificate for the status. **A physical person who has been granted the status of microbusiness is free from income tax and current taxes.** The **status of small business** is given to a physical person/an individual/sole entrepreneur whose annual total income from economic activity does not exceeds GEL 100,000.

Small businesses only need pay one single tax. The tax rate for small businesses is 3% or 5% of income. The removal of bookkeeping requirements is in conformity with international standards. Although some small businesses are taxed at 5% of their income, they are only obliged to keep simple "purchases and sales journals" and cash registers. Small businesses are only taxed at 3% when they have documentary proof that 60% of their income has gone into expenditure and consumption. [3]

According to the Tax code of Georgia, businesses turnover not exceeding GEL 100,000 per annum are exempt from VAT. In addition, the supply of primary agricultural products is not subject to VAT. Certain businesses defined by the government are rated with taxes rate.

Micro businesses are exempted from income tax. The main purpose of introducing the micro and small business status and preferential tax treatment was two-fold: facilitation of registration of such businesses and reduction of the tax burden. According to Revenue Service statistics, after introduction of new Tax Code, 83 231 micro and small enterprises have been registered, out of which 39 470 are micro and 43 761 small.

In order to promote SMEs creation, development and support the growth of their competitiveness through the innovative approaches, in February 2014 the Entrepreneurship Development Agency (Enterprise Georgia) and the Innovation and Technology Agency (GITA) were established under the oversight of the Ministry of Economy and Sustainable Development (MoESD). Enterprise Georgia is responsible for coordination of implementation of SME supportive policies and programmes. The main aims of Enterprise Georgia are: improve private sector competitiveness; support start-ups; facilitate establishment of modern entrepreneurial culture; support diversification of export of goods and services, etc. GITA is a main coordinator and mediator in the process of building a national innovation ecosystem. The main mandate of GITA is: to create ecosystem and coordinate its development process; stimulate innovation, modern technologies and R&D, facilitate commercialization and usage of R&D; support to innovative start-ups and their competitiveness growth, facilitate cooperation between the representatives of scientists and businesses; cover whole country with high-speed internet connection and computerization process and etc. Institutional strengthening of Enterprise Georgia and GITA is important in order to address SMEs needs and provide target-oriented services. There are number of organizations assisting Georgian SMEs, among which are:

- Georgian Chamber of Commerce and Industry (GCCCI): was established as an independent public agency. Among the main functions of GCCCI is the provision of information and consultancy for businesses, support to improvement of business skills and business planning, promotion of export, support to internationalization of enterprises, etc.

- Georgian Employers' Association (GEA): GEA is an independent non-profit organization which unifies more than 1.000 SMEs. GEA provides consultancy services to SMEs and carries out different programmes related to entrepreneurial learning, business skills development.

- Georgian Small and Medium enterprises Association: GSMEA is an independent organization that aims at protecting the interests of small and medium enterprises.

In order to support SMEs development and establishment of new competitive industries, in 2014, the GoG launched the state programmes (among them is "Produce in Georgia") in order to support entrepreneurs related to industrial production and agri-processing, facilitate to create new enterprises/expand/reequip existing enterprises, increase competitiveness of private sector and export potential to finance through the access to real estate and technical assistance. Since 2015, Enterprise Georgia started Project - "Micro and Small Business Support Programme" in order to facilitate economic activities in the regions. Project includes two components: financial assistance and technical assistance. Under the technical assistance component beneficiaries are provided with business and individual consultancy support, training services.

Georgia actively participates in the Eastern Partnership SME Panel and cooperates closely with the OECD, ETF, EBRD and other international organizations in order to further improve SME policy according to international best practices. There are a number of SME-oriented projects implemented under the Eastern Partnership initiative. In 2015, Georgia and the EU signed the DCFTA and SMEs support agreement (budget - EUR 44.5 mln). The specific objectives of this Programme are: i) to further strengthen the DCFTA policy framework for trade and SME development; ii) to improve the overall functioning of priority trade and private-sector related institutions; and iii) to strengthen economic actors and SMEs along the DCFTA process. [1]

SMEs play a significant role in Georgia's economy, accounting for 94.1% of active enterprises, 67.7% of employment and 58.4% of value added in 2016, compared to the OECD averages of 99.8%, 70.7% and 66.7% respectively. [2] In Georgia, however, SMEs' share of GDP remains small at less than 20% (about 18% in 2014) of GDP. [1]

In 2018, there were 129,471 enterprises operating in the country. 98,3% (127,232) of these were small enterprises and 1,4% (1,825) were medium enterprises. Most businesses in Georgia are small and medium-sized enterprises (SMEs). The number of enterprises increased in 2019, increased by 1,8% from the previous year and 32,2% from 2016's figures. In 2019, the number of SMEs in Georgia increased by 1,8% from 2018's figures and 29,9% from 2016's figures. In 2018, 67% of employees in enterprises worked in SMEs, with 22% in medium-sized enterprises and 45% in small enterprises. The employment distribution in 2018, according to economic activities is as follows: Trade – 31.3%, Industry – 13.2%, Construction – 13.1%, Accommodation and food delivery – 7.3%, Health and social work – 6.6%, Transport and communications – 6.2%, Real estate – 3.2% etc.

47% of employees in the business sector in 2019 were employed in the capital of the country, Tbilisi; 12% in Imereti, 11% were in the Autonomous Republic of Adjara and 7% in the municipality of Kvemo Kartli. In the 2018, the Georgian business sector had a turnover of GEL 86.6 bn, 21% higher than the previous year. The business sector's production value also increased by 9% during the year. In the second quarter of 2014, the number of persons employed in the Georgian business sector rose by 3.7%. [4]

Georgia has improved the business environment for all enterprises (including SMEs) by simplifying administrative regulations, reducing tax burdens, fighting corruption, facilitating free trade, promoting privatization campaigns and initiating a policy partnership platform in order to build a national lifelong entrepreneurial learning concept. Anti-corruption measures are recognized as one of the most successful parts of the reform policy. Georgia made significant progress in reforming the operational environment for SMEs, particularly by streamlining the company registration process. Reforms to the company registration process have helped to remove burdensome regulations, saving time and reducing costs for SMEs and entrepreneurs. In Georgia, a broad range of public services are offered in one single location (Public Service Halls), thus increasing their accessibility and reducing the administrative burden for SMEs. The country has also improved its infrastructure for e-government by introducing electronic signatures. [4]

LEGISLATIVE FRAMEWORK ON MICROFINANCE

Law of Georgia on Microfinance Organizations

The Law of Georgia on Microfinance Organizations regulates the operation of microfinance organizations in Georgia and creates an environment conducive for their development.

A *Microfinance Organization* is a legal entity founded as a limited liability or a joint-stock company, and registered by the National Bank of Georgia on the basis of its application. It implements the activities stipulated by this law under the supervision of the National Bank of Georgia. A microfinance organization is obliged to create a supervisory board that is regulated by the stipulations of the Law of Georgia "On Entrepreneurship" for joint-stock company supervisory boards. Only a microfinance organization has the right to use the term "Microfinance Organization" or its abbreviation, MFO, in its company name apart from the denominations envisaged by the Law of Georgia on Entrepreneurship.

If the National Bank of Georgia determines that a microfinance organization has breached the norms stipulated by Georgian legislation, the National Bank of Georgia has the right to issue a warning, impose a financial fine, or adopt the decision to cancel the registration of the microfinance organization.

Microfinance Activities

1. A microfinance organization is authorized to provide the following activities only: Extend microloans, including personal, collateral, unsecured and group loans (credit) or loans on property and others to legal and real entities; Invest in state and public securities; Provide money transfer; Operate as an insurance agent;

Provide consultation services in microcredit; Receive loans (credit) from resident as well as non-resident legal and real entities; Possess the share of the authorized capital of a legal entity, the total amount of which does not exceed 15% of the authorized capital of the microfinance organization. Provide other services and operations defined by Georgian legislation including micro leasing, factoring, foreign exchange, issue, realization, refunding bonds and promissory notes and other operations connected with this.

2. A microfinance organization may provide the activities stipulated by this law only after it has been registered as a microfinance organization by the National Bank of Georgia under the rules defined by the Bank.

3. A microfinance organization shall not receive a deposit from either real or legal entities.

The concept and volume of microcredit are defined as follows:

1. Microcredit is money extended by a microfinance organization to a borrower or a group of borrowers under the conditions set by the credit contract defining the maturity, return, valuation and purpose of the microcredit.
2. The maximum total amount of microcredit extended by a microfinance organization to a single borrower may not exceed GEL 100,000.

Capital of a microfinance organization

The minimum amount of capital paid by a person for registration as a microfinance organization shall not be less than GEL 1,000,000 (one million). Expired capital should only be replenished in cash.

Auditing, Accounting and Reporting

1. A microfinance organization shall be responsible for: Carrying out transparent financial and tax accounting and applying the principle of publicity; Developing and implementing procedures of internal control; Inviting an external audit in compliance with Georgian legislation every year; Maintenance of accounting and submission of financial statements according to international standards and Georgian legislation; Reporting to the National Bank of Georgia. The form and the deadlines for submitting a report is stipulated by an administrative act of the National Bank of Georgia (act no. 1682, dated 24 September 2009, and enforced from 1 December 2009); Guaranteeing the truthfulness and accuracy of the submitted information and financial statement; From the end of each calendar year until June 15 of the following year, to publish on its website the audited annual financial statements for the previous year, prepared in accordance with the International Financial Reporting Standards (IFRS) approved by the International Accounting Standards Council and audited by the International Auditors In accordance with International Audit Standards (ISA).

2. In the event that a microfinance organization fails to comply with all the requirements on the submission of financial statements (as stipulated by the National Bank of Georgia) twice in succession, the Bank has the right to cancel the registration of the microfinance organization.

3. A microcredit organization is obliged to keep the following documents for a period of six years:

- a) Account books and records, inventory, balance sheets as well as their explanatory instructions and other organizational documents;
- b) Source documents evidencing the entries in the account book.

Conditions for Extending Microcredit

1. A microfinance organization and a borrower form a written credit contract in compliance with this law and the Civil Code of Georgia.

2. Credit stipulated by this article can be issued to a group or individual, and may be secured or non- secured. A microfinance organization will stipulate the rules and procedures for extending credit.

3. Interest rates, commission fees and service fees will be stipulated by the microfinance organization.
4. A microfinance organization has the right to monitor the purposeful use of credit by the borrower, and the borrower is obliged to provide opportunities for monitoring as mentioned above. If the borrower does not comply with the terms of using the issued credit with defined purpose, the microfinance organization may refuse to extend the undisbursed part of the credit and recall the credit prior to the agreed maturity period.
5. The National Bank of Georgia is authorized to impose on the microfinance organization the conditions and marginal amount of the advance payment for the refinancing of micro-loans issued by it or repayment with its own funds. [5]

Significant changes have been implemented in the normative base in regard to the regulation and supervision of the non-banking sector. In particular, new normative acts have been passed and existing legislation has undergone important alterations. For the purpose of increasing transparency and access to information related to the microfinance sector, a new rule of the “Manner and Term of Filing Financial Statements and Regulation of Submitting Accounts by Microfinance Organizations to the National Bank of Georgia” was approved. This rule has considerably changed the format of financial reporting. Active microfinance organizations (MFOs) are now required to publish information on their websites on a quarterly basis. Furthermore, MFOs have to conduct annual external audits and publish audit reports on their websites by 15 June of the following year. The rule on the registration of microfinance organizations has also undergone significant changes, with registration requirements having been made stricter. It has become mandatory for MFOs to provide information about their sources of capital and correspondence criteria were set for administrators and beneficiary owners. The National Bank approved the rule on “Assets Classification and the Creation of Reserves for Possible Losses by Microfinance Organizations” with the purpose of classifying assets according to risks and forming adequate reserves to compensate possible losses. To mitigate credit risks, microfinance organizations are supposed to establish and follow the written policy and procedures approved by a supervisory board and to present the National Bank with information about the reserves they have formed in accordance with the rule. This will allow creditors, management, shareholders, potential investors, the National Bank and other stakeholders to be informed about the organization’s real financial situation. The rule on the “Regulation and Supervision of Microfinance Organizations” defines relevant norms and limits, including capital liquidity, investments and other coefficients, as well as the minimum amount of supervisory capital and its methods of calculation. Moreover, a differentiated and more conservative approach has been taken towards those microfinance organizations whose funds from private individuals exceed 50% of their supervisory capital. As a result of these changes, the system has become more liquid and capitalized. Once the legal changes are completely enforced (by 30 June 2019), these indicators will most likely increase even further and thereby facilitate the improvement of solvency and encourage the stable functioning of system participants. Microfinance organizations have been obliged to register complaints received from consumers since 2017. However, the implementation of the legislative amendments on microfinance organizations revealed certain errors in this regard. In 2018, following the elimination of those deficiencies and the standardization of the process to receive reliable statistical data on consumer complaints, the NBG started the publication of data. During 2018, microfinance organizations received 1,459 complaints from consumers. The majority of which (84%) were related to consumer loans – which should be expected as consumer loans are the main product of microfinance organizations. [11]

GOVERNMENT PROGRAMMES SUPPORTING MICROFINANCE

Huge steps were made in order to simplify business regulations and insuring the good business environment in Georgia. Lot of reforms were carried by the Government of Georgia among them were market liberalization, taxation reduction, bureaucracy avoidance etc.

Favorable entrepreneurial and investment environment has a great impact on productivity as it has a direct impact on the efficient distribution of resources in the private sector. Business requirements generally experience rapid change due to fierce global competition and dynamic economic processes and constant work is therefore needed to improve the entrepreneurial and investment environment. Reforms aimed at liberalizing

Georgia's economy were launched in 2004, resulting in the removal of bureaucratic barriers and reductions to the overall tax burden. According to the 2014 edition of the World Bank's Doing Business Report, Georgia has been one of the world's leading reformers for the past several years; the country currently holds the 7th place out of 190 in the "Doing Business" rating. Improvements to the public access to information are also reflected in the 2020 edition of the World Bank's Doing Business Report, according to which Georgia improved its building quality control by increasing public access to information. According to study, *Comparing Business Regulation in 190 Economies*, Georgia took 7th place out of 190 countries, ranking among the world's top countries. For starting a business, for example, Georgia and New Zealand have the lowest number of procedures required. Georgia featured on the list of 10 top improvers for three consecutive Doing Business cycles. [10] Despite this, however, serious problems remain in certain areas, which hinder long-term economic growth and improvement of the private sector's competitiveness. Ensuring free market competition is still a problem, and concerns remain in terms of bankruptcy regulation and the resolution of commercial disputes as well as various other issues relevant to doing business.

The Government of Georgia takes active steps to eradicate existing deficiencies and sustain an attractive business and investment environment over the long term. It should be noted that EU-Georgia Association Agreement opens up new opportunities for Georgia to attract investments. In order to ensure attractive entrepreneurial and investment environment the implementation of various legislative and institutional changes is required, including efforts to strengthen the judiciary—particularly as a strong and independent judiciary is essential to efforts to improve the country's business and investment environment, especially in terms of protecting property rights. The Government of Georgia protects business from illegal interventions; in that regard, the Government's goal is to eradicate existing deficiencies while preserving achieved results. [6]

In 2014 the Government of Georgia adopted country's socio-economic development strategy – "Georgia 2020", which sets inclusive economic development as the main objective of the government. The notion is based on the increasing number of jobs, innovation and competitiveness of private sector. [7]

In order to improve access to get the finances for SMEs from the commercial banks, state program "Produce in Georgia" improve and enhance existing scheme of SMEs financing. With the aim of improving the finances from micro-financial organizations, cooperation between SMEs and MFIs, through organization of roundtables will be supported, the ultimate goal of which is to overcome the obstacles and identify the gaps related to finances and financial awareness. Such cooperation will facilitate the improvement of products and services provided by MFIs that hinder the financing of SMEs from commercial banks. Therefore, as well as improvement of SMEs capacities to better meet requirements of MFIs. [1]

Support of entrepreneurship, especially SMEs is included in the Governmental Strategy of Georgia. Social-economic Development Strategy of country claims that supporting the business sector will facilitate improvement of competitiveness of products and services produced in Georgia. Legislative and institutional harmonization with EU under the EU-Georgian Association Agreement implies meeting EU requirements and norms when carrying out business activities. The state elaborates efficient mechanisms for supporting business, especially small and medium businesses, with a view to decreasing costs associated with meeting the regulations and increase their competitiveness. Strengthening the business competitiveness depends on development/enhancement of entrepreneurial skills. Therefore, one of the main directions of work for legal entity of public law Entrepreneurship Development Agency is to development of entrepreneurial skills of the startup and small businesses' representatives. [6]

The business sector and especially the Small and Medium-sized Enterprises (SMEs) play an important role in the development of the economy, contributing significantly to the sustainable and inclusive growth. SMEs, having enormous potential in employment generation and job creation, as well as in fostering economic growth, could be considered as a backbone of each country's economy. A strong and well-developed SME sector significantly contributes to export, innovation, and creation of modern entrepreneurial culture, playing at the same time a significant role in achieving prosperity in the country.

Georgia has undertaken broad and comprehensive reforms, including economic reforms, which have touched upon every aspect of people's life. The main aim of those reforms was the creation of favourable environment for doing business and foreign direct investment (FDI) via liberalization of the economy,

reduction of administrative barriers and tax burden, streamlining public services, fighting against corruption, etc. Due to these reforms, Georgia achieved high rates of economic growth and significant FDI inflows. Georgia's economic policy was positively evaluated by different rating agencies and International Financial Institutions.

Despite the improvement of general business environment, Georgia faces broadly the same challenges in terms of SMEs development as many developing countries. Notwithstanding the fact that SMEs constitute the largest share of operating enterprises, their contribution to GDP is still very low and their performance remains weak.

The Government of Georgia (GoG) recognizes the importance and role of SMEs in economic development and is committed to the further improvement of the business environment in order to enable SMEs to develop and grow. [1]

The proper and due development of the micro-financial sector is of paramount importance for Georgia. The pandemic in 2020 has posed the problems to the financial sector and micro-financial organizations are of no exception and hence and Georgia does it's best to at a maximal extent mitigate the crisis effect. The Government strives to render support to the micro-financial organizations. The interest of Georgia implies the increase of the assets of the micro-financial sector and further extension of their scopes. Currently, they serve 600 000 customers. [9]

MAJOR MICROFINANCE INTERMEDIARIES AND INSTITUTIONS

As of 31 December 2018, the non-banking sector in Georgia was represented by 67 microfinance organizations, 1,018 currency exchange bureaus and two credit unions. During 2018, the total assets of microfinance organizations gradually increased until the last quarter of the year when the indicator started to decline. By the end of the year, total assets amounted to 1.45 billion GEL, which falls 66 million GEL short of the corresponding figure in 2017. This trend was triggered by several factors, including the initiation of liquidation processes in eight microfinance organizations, the trading of the credit portfolios of a number of microfinance organizations, and the formation of possible asset loss reserves – the latter of which have been required for microfinance organizations since 1 September 2018.

As of 31 December 2018, the total net portfolio amounted 1.03 billion GEL. The share of the net portfolio to total assets has not changed considerably in recent years and has remained around 71%.

The credit portfolio of the microfinance sector mainly covers three areas: 1) Consumer loans, amounting to 798 million GEL (72% of the total portfolio); 2) Trade & Services, amounting to 187 million GEL (17% of the total); and 3) Agriculture & Forestry, amounting to 95 million GEL (9% of the total).

The upsurge in the share of consumer loans in the total portfolio was caused by the technical reclassification of the credit portfolio. As a result of legal changes to Article 625 of the Civil Law, starting from January 2017 loans of less than 100,000 GEL granted to private individuals could no longer be issued in a foreign currency. As a consequence, in 2018, the dollarization rate of the credit portfolio of microfinance organizations decreased from 27% to 16%. Similar to previous years, the main source of asset funding (66% on average) remained attracted funds, and the share of non-resident lenders was 44%.

In 2018, the structure of the liabilities of microfinance organizations was modified. This has been reflected in the replacement of funds from private individuals with liabilities towards financial institutions. In particular, compared to 2017, the share of funds from private individuals has declined from 36% to 23% (by 153 million GEL) in 2018, whereas the share of credit from banks and financial institutions has increased from 41% to 58% (by 132 million GEL). Within the structure of funding from private individuals, there has been a decline in both the volume of funds and the quantity of creditors (in 2017 there were 2,202 creditors; in 2018 there were 816).

During 2018, the share of subordinated loans in total liabilities drastically increased (by 28 million GEL). This was due to the new regulations that require microfinance organizations to have a minimum

amount of supervisory capital. This, alongside the growth of share capital by 56 million GEL, has contributed to increased sustainability, growing resistance towards sectoral risks and an improvement of the liquidity position. As of 31 December 2018, the coefficients of capital adequacy and liquidity were 30% and 34% respectively. In 2018, the operational profit of the microfinance sector amounted to GEL 150 million; however, the net profit was GEL 31 million, which was caused by the one-time effect of possible asset loss reserve costs (GEL 106 million). This, along with the increase of capital, has considerably reduced the return on equity, which amounted to 7.6%. [11]

At the end of 2019, there were 48 microfinance organizations in the country. This is a 28.4% decrease from 2018. Within the last 4 year period of 2016-2019, the number of microfinance organizations are decreasing. [13]

At present, Georgia's financial system is dominated by commercial banks, which service the country's business sector and urban and middle class. However, accessing finance remains one of the main obstacles for small and medium enterprises in Georgia. With more than 52% of Georgia's population living in rural areas and around 30% living below the poverty line, commercial banks are out of reach for a large swathe of the population. Due to a lack of collateral and other guarantees usually required for lending, these communities face limited opportunities to access finance from commercial banks.

Under its BCtA commitment, some microfinancing organizations are addressing these challenges head-on. By offering business loans to entrepreneurs who wish to start their own businesses, organizations are supporting the development of the small and medium enterprise (SME) sector in Georgia. Additionally, some of them specifically are targeting low-income rural populations who would otherwise be excluded from the traditional financial system and providing them with affordable loans for business, housing, agriculture, education and more. [14]

The association of Development and Support of Microfinance Organizations of Georgia was established in August 2009. Its founders are microfinance organizations. The main goal of the Association is to support the development of microfinance sector in Georgia, to defend the rights of microfinance institutions, to support their juridical guaranties and the coordination of their activities as well as to prepare proposals for alterations in the legislation in force in order to ensure the same tax regulations for the microfinance organizations as it is in the case of commercial banks. 23 Georgian microfinance companies are members of this Association. [15]

SMEs are important to the Georgian economy because more than 99% of registered companies in the country are SMEs. SMEs also employ half of the country's labour force. The Georgian government acknowledges the importance of SMEs by offering several programmes devoted to the development and promotion of micro and small enterprises in the country. In addition to supporting micro and small enterprises, these government programmes also support business entities and entrepreneurs, develop regional markets and increase income.

In March 2018, the Government of Georgia launched a new support Program the Co-financing of Agricultural Machinery Program. A citizen of Georgia, an entrepreneur or a commercial legal entity (including agricultural cooperative) can apply for the purchase of agricultural equipment with government co-financing. The state Program provides 50% of the cost of agricultural equipment to a value of no more than GEL 150,000.

Credo Bank a former MFI has been providing in-store agri credit since 2014 after seeing the demand for it from town based small businesses in rural municipalities. In 2015 the MFI Crystal copied the same model with the same terms and conditions from Credo after seeing the demand for it from small town based businesses and that Credo had a very good agri portfolio at that time. [16]

The grant "Reaching Georgia's Rural Poor through Mobile Remittances" (2010 – 2012) implemented by International Organization for Migration and funded through IFAD's Financing Facility for Remittances was an interesting pilot initiative, focused on Tianeti region. [17]

The International Financial Corporation (IFC), a member of the World Bank Group, helps microfinance organizations in Georgia by increasing micro and small businesses' access to finance, especially in poor and

rural areas, creating jobs and reducing poverty in Georgia. IFC provides Georgian microfinance organizations with financial resources and loans, enabling the organizations to extend loans to underserved entrepreneurs across the country. Georgia became an IFC member in 1995. IFC has also partnered banks in order to expand financing for SMEs. In so doing, IFC supports their growth, job creation, and contributes to increasing the competitiveness of Georgia's economy. [18]

On 15th of January 2019, The European Fund for Southeast Europe (EFSE) has provided a senior loan of USD 10 million to the Bank of Georgia Group PLC (Bank of Georgia Group, or the Group) for on-lending to micro and small enterprises (MSEs). The funding will be distributed to MSEs through the Bank of Georgia Group's dominant subsidiary, the Bank of Georgia – one of the country's leading small-business lenders. [19]

On April 29, 2020, World Bank Pledged USD 80 million to Support Georgia's Response to COVID-19 Pandemic, which involves the support for MSMEs that have been affected by the pandemic. [12]

On May 30, 2020 a new agreement for the senior debt was signed between Symbiotics and FINCA Bank Georgia by which Symbiotics injects GEL 15 million to further support MSME lending programs of FINCA Bank Georgia. The financial resource will enable to continue serving clients, especially those, whose businesses were adversely affected by COVID19, increase outreach to more micro and small enterprises in rural areas to foster accessibility and financial inclusion. [21]

MODELS OF MICROFINANCE FOR SMEs

Microfinance in Georgia - as elsewhere in the world - consists of providing loans and other financial services for self-employment and business development. Generally, small amounts are disbursed as loans, and the timeframe for repayment is also smaller compared to commercial banks. Together with providing financial services, some microfinance institutions (MFIs) work for social development in the areas in which they operate and generally have the following characteristics: Providing small loans for the working capital requirements of the rural poor. Softer appraisal of borrowers and investments as compared to commercial banks. Collateral demanded to a lesser extent by those MFIs having more capacity to operate sound versus safe credit practices, applying innovative guarantee schemes.

The key challenges in rural financial markets have been: lack of credit in rural areas; absence of modern technology in agriculture in which to invest; low savings capacity in rural areas; and prevalence of usurious moneylenders, which the rural poor are forced to approach since commercial banks do not extend their credit schemes to them as they are not considered creditworthy. Georgian MFIs with socially oriented credit practices started to emerge in the late 1990s and early 2000s. However, only about a dozen organizations out of 100 officially registered organizations nominally called MFIs have the capacity to perform in the socially oriented credit sector.

Capital and expertise provided by international donors has enabled Georgian MFIs to provide the necessary monetary support to the rural population. MFI activities also include providing training for basic skills required for doing business, as well as marketing courses to undertake activities to improve agricultural practices and financial literacy. [17]

During the past year, the National Bank of Georgia strengthened the supervision framework for non-banking institutions. The NBG supervises and regulates non-banking institutions, including microfinance organizations, credit unions, loan-issuing entities (specifically those entities against whom 20 or more individuals have loan obligations) and currency exchange units. The share of non-banking institutions in total financial sector assets is around 5.5%. To ensure the stable functioning of these institutions and to protect their creditors, a legislative base has been created. During 2018, capital and liquidity requirements were introduced to strengthen the resilience of microfinance organizations. It should be noted that in December 2018 the capital adequacy coefficient of microfinance organizations equalled 30%, while the liquidity coefficient stood at 34%. During the past years, the lending practice of non-banking institutions led to accumulation of risks in the financial system and increased sector's vulnerability. In the absence of regulation, the essence of microfinance organization was distorted and high risk lending practices have been established. Above mentioned risky business model was financed raised by funds from natural persons. Given the low

transparency of this sector, there have also been flagrant violations of consumer rights. This practice could have led to severe consequences for the large part of the population and for the economy as well. According to the available estimates, the share of shadow banking in Georgia is low, but it has increasing tendencies. As of now, the risks stemming from the shadow banking to financial stability are not systemic. Georgia has one of the highest levels of household accessibility to formal banking services in the world. As a consequence, the demand for shadow banking in the country is low. Despite this, in previous years, the number of unregulated online lending companies appearing on the market increased. These were issuing high interest rate loans to the more financially vulnerable parts of the population, which translated into excessive lending and worsened those households' financial conditions.

The NBG's macroprudential efforts have been assisted by the government's actions. The amendment to the Civil Code, according to which, loans below GEL 200,000 are to only be issued in the local currency, will help protect households against foreign currency risks and will also support de-dollarization of the financial system. The maximum effective interest rate on loans has been set at 50%. The latter aims to further cut down the number of high-risk products on the market. The capital and liquidity requirements apply to both bank and non-bank lending institutions. The decree on responsible lending applies to all financial institutions under the supervision of the National Bank. Besides commercial banks, these organizations include non-bank depository institutions, credit unions, microfinance organizations and any entity towards which 20 or more people (including individual entrepreneurs) have loan obligations. Similar to commercial banks, the non-banking sector is required to assess a borrower's income and the value of collateral and to comply with the LTV/PTI limits. Moreover, with the approval of the Regulation on Supervision and Regulation of Microfinance Organization Activities in July 2018, regulatory capital and liquidity requirements have been set for microfinance institutions. [18]

As of 31 December 2018, two credit unions were operating in the non-banking sector with total assets of 2.4 million GEL.

According to the amendments made on 23 December 2017 to the "Law of Non-Bank Depository Institutions – Credit Unions", one of the main principles of Credit Union activity were defined as the unification of individuals living in the same administrative unit of the same self-governing community. Furthermore, the maximum number of union members was set at 200. The main purpose of these changes was to encourage the creation of such entities based on shared goals and necessity, rather than for the purpose of attracting deposits from members. These changes influenced events in this sector during 2018. In particular, five out of the eight previously licensed credit unions had their registration terminated and liquidation processes have begun upon their written request. In one case, a credit union was liquidated as a result of the NBG's supervisory engagements. As a result of the amendments made on 23 December 2017 to the Organic Law on the National Bank of Georgia, the NBG is authorized to supervise loan-issuing entities, including powers of registration, termination of registration, regulation, and the issuance of written directives, requests, restrictions and sanctions. [11]

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INSTITUTIONAL PROFILE



UNITED NATIONS – GENERAL ASSEMBLY RESOLUTION 52/194

Passed 18 December 1997

The General Assembly,

Taking note of the report of the Secretary-General on the observance of the International Year for the Eradication of Poverty (1996) and recommendations for the rest of the First United Nations Decade for the Eradication of Poverty (1997-2006).

Recognizing that people living in poverty are innately capable of working their way out of poverty with dignity, and can demonstrate creative potentials to improve their situation when an enabling environment and the right opportunities exist.

Noting that in many countries of the world, microcredit programmes, by providing access to small loans to people living in poverty, have succeeded in generating productive self-employment. Also noting that microcredit programmes have proved to be an effective tool in freeing people from the bondage of poverty, and have led to their increasing participation in the mainstream economic and political process of society.

Bearing in mind that microcredit programmes have especially benefitted women and have resulted in the achievement of their empowerment in a world where more women than men live in absolute poverty and that the imbalance continues to grow.

Recognizing that microcredit programmes, in addition to their role in the eradication of poverty, have also been a contributing factor to the social and human development process. Noting that the qualitative and quantitative development of microcredit institutions and their capacity to reach the marginalized groups requires the provision of an enabling environment, including a policy framework for the financial sector, as well as linkages to the formal financial sector.

Bearing in mind the importance of microfinance instruments such as credit, savings and related business services in providing access to capital for people living in poverty.

Noting that the provision of finance to microcredit institutions should be commensurate with their absorptive capacity and that efforts should be made to strengthen and enhance that capacity. Also noting the positive references in support of the role of microcredit contained in the final documents of the Twelfth Ministerial Conference of the Non-Aligned Movement (New Delhi, 4-8 April 1997), the Ninth South Asian Association for Regional Cooperation Summit (Male, 12-14 May 1997), the Organization of African Unity Summit (Harare, 2-3 June 1997), the substantive session of 1997 of the Economic and Social Council (Geneva, 30 June-25 July 1997) and the Commonwealth Heads of Government Meeting (Edinburgh, 24-27 October 1997) as well as the Group of Seven statement on economic and financial issues (Denver, Colorado, 21 June 1997).

1. Welcomes the launching of different microcredit initiatives in recent years and acknowledges their important contribution to the eradication of poverty, empowerment of women and social upliftment;

2. Welcomes also the outcome of the Microcredit Summit, held at Washington, D.C., from 2 to 4 February 1997, which through its Declaration and Plan of Action, endorsed a global campaign to reach 100 million of the world's poorest families, especially women of those families, with credit for self-employment and other financial and business services, by the year 2005;
3. Notes with satisfaction that, as called for in Assembly resolution 51/178 of 16 December 1996, many United Nations agencies and the World Bank actively participated in the Summit and thus contributed to its successful outcome;
4. Takes note of the Declaration and Plan of Action of the Microcredit Summit, the communique issued by the Council of Heads of State and Government at the Summit, and messages to the Summit from the Chairman of the Group of 77 and China and the Secretary-General of the United Nations;
5. Recognizes the important contributions being made by the United Nations system and by the Consultative Group to Assist the Poorest, sponsored by the World Bank, to develop and disseminate best practices among all organizations engaged in the provision of financial services on a sustainable basis to people living in poverty;
6. Encourages all involved in poverty eradication programmes to consider incorporating microcredit schemes in their strategies;
7. Also encourages them to adopt policies that support the development of microcredit institutions and their capacities so that credit and related services may be made available to increasing numbers of people living in poverty;
8. Calls upon the international donor community to support the strengthening of existing and emerging microcredit institutions in the developing countries, especially the least developed and the African countries;
9. Also calls upon the relevant organs, organizations and bodies of the United Nations system, in particular its funds and programmes and the regional commissions, as well as relevant international and regional financial institutions and donor agencies involved in the eradication of poverty, to explore including the microcredit approach in their programmes as a tool for the eradication of poverty and further developing, where appropriate, other microfinance instruments;
10. Calls upon all concerned non-governmental organizations, other actors of civil society and the private sector to support and incorporate, and appropriate, microcredit and related services in their programmes for the eradication of poverty;
11. Requests the Secretary-General, in collaboration with relevant organizations of the United Nations system, including funds and programmes, to submit to it at its fifty-third session a report on the role of microcredit in the eradication of poverty in follow-up to resolution 52/194 entitled "First United Nations Decade for the Eradication of Poverty";
12. Decides to include future discussions of the role of microcredit under the item entitled, "Implementations of the First United Nations Decade for the Eradication of Poverty (1997-2006).

EXTRACT MICROCREDIT IS A CONCEPT WITH VARIOUS DEFINITIONS

There is no single definition of microcredit. The term “microcredit” is generally used to refer to small loans provided to people excluded from the traditional financial system or lacking access to banks, with a view to helping them create or develop businesses. However, the definition of microcredit varies widely amongst Member States and stakeholders depending on the social environment, economic situation, and policy goals.

The demand for microcredit is sustained by a wide spectrum of borrowers. Microcredit may be only available to “micro-entrepreneurs”, self-employed people seeking to finance small businesses. It may also focus only on other groups such as socially excluded people trying to cope with emergencies, fund education, or even acquire basic household assets.

Microcredits are generally very small, short term and unsecured, with usually more frequent repayments and higher interest rates than conventional bank loans. However, beyond this general description, microcredits are granted under widely varying loan terms and conditions. For instance, the loan repayment term is generally less than six months, but may extend to ten years. As regards interest rates, an important factor determining their level is the existence of usury laws. Where usury laws are in place, lenders are not allowed to charge above a stated maximum interest rate. In Member States which do not have such restrictions, the interest rates may be higher than where there are usury laws. In amounts, microcredit generally refers to loans not exceeding EUR 25,000¹¹. However, a lot of European stakeholders define microcredit as loans with either much smaller or much higher amounts.

The activities carried out by micro lenders may go beyond lending and include other financial services, such as savings products, current accounts, payment services, transfer services, insurance, leasing, and so forth. This wide range of financial services should however be referred to as 'microfinance' and used in a wider sense than the term 'microcredit'.

The lack of a consistent and generally used definition of microcredit is an obstacle to collecting information and data about this activity, which makes it difficult to track the evolution of microcredit in the EU. Sound facts and figures on the volume of microcredit and related services, particularly for the EU as a whole, are difficult to find. Loans with similar characteristics may be classified alternatively as microcredit or conventional loans, depending on the context. They can be reported as consumer loans, retail loans, corporate loans or loans to small and medium-sized enterprises (SMEs).

¹¹ The European Commission refers to this amount in the EU microcredit programmes.

NEWS

Government, RBI - offer relief to microfinance lenders amid COVID-19 crisis

India expanded its list to allow non-bank lenders to resume operations from 20 April, aiming to kick-start the economy even as it extended the lockdown to contain the new coronavirus pandemic. Not only that, but the nation's central bank also stepped in to boost liquidity and support the battered sector. In continuation of the revised guidelines issued on 15 April, non-bank lenders, including housing finance companies and micro-finance institutions, are allowed to resume operations with bare minimum staff, according to an order by the Ministry of Home Affairs. Besides, all agricultural and horticultural activities, plantations, cooperative credit societies and construction activities in rural area are allowed to operate.

Separately, the Reserve Bank of India Governor *Shaktikanta Das* announced a second round of targeted long-term repo operations of Rs 50,000 crore to maintain ample liquidity among various segments of microfinance and non-bank financial companies.

Also, all India financial Institutions such as Nabard, Sidbi and the National Housing Bank will be provided with special refinance facility of Rs 50,000 crore at the repo rate, *Das* said.

- Of this, the National Bank for Agriculture and Rural Development has been allocated Rs 25,000 crore to enable refinancing of regional rural banks, cooperative banks and microfinance institutions.
- The Small Industries Development Bank of India has been given Rs 15,000 crore for on-lending and refinancing to scheduled commercial banks, non-banks and microfinance institutions.
- The National Housing Bank will receive Rs 10,000 crore to support housing finance companies.

Besides, the central bank cut the reverse repo rate by 25 basis points to 3.75%. That, according to *Keki Mistry*, Vice-Chairman and Chief Executive Officer at HDFC Ltd., should encourage banks to lend money.

In contrary to expectations, however, there was no announcement to cover NBFCs under a moratorium.

“In a scenario where MFIs do not receive moratorium on their bank loans, the liquidity levels they maintain will be an important determinant of their immediate term debt repayment ability,” Crisil Ratings Ltd. had said in a note dated 15 April.

The outbreak of the highly contagious pathogen stalled economic activities and India went into the world's biggest lockdown to curb its spread. Microfinance institutions faced disruptions as their operations are highly field intensive, including home visits and physical collection of cash. A cash shortfall for 29 microfinance institutions - accounting for 70% of the industry's loan portfolio - collectively stands at about Rs 2,600 crore in the absence of any external funding support by way of equity, additional debt or extension of moratorium, ICRA Ltd. had said in a prior report. These lenders have Rs 8,000 crore worth of repayment obligations and operational expenditure in the quarter ending June compared with on-balance liquidity buffer of around Rs 5,400 crore, the rating agency said in a note. Crisil, too, had said overdues were expected to rise once billings recommence because borrowers might not clear them immediately. “Collection efficiency is likely to take time to ramp up to pre-pandemic levels. Consequently, risk of larger credit losses and their impact on capitalisation metrics will be a key rating sensitivity factor in the road ahead.”

Ever since the nationwide lockdown was imposed, 24 March, shares of pure-play microfinance companies Spandana Sphoorty, Satin Creditcare Network Ltd., and CreditAccess Grameen Ltd. remained flat or fell as much as 13%.

Source: Read more at: <https://www.bloombergquint.com/business/government-rbi-offer-relief-to-microfinance-lenders-amid-covid-19-crisis> Copyright © BloombergQuint



ICSB 2020 CONGRESS

The 65th ICSB World Congress from 8 – 10 July 2020 will convene a world-wide gathering of entrepreneurs and thought leaders in Paris, France.

In April 1900 Paris hosted the “Exposition Universelle”. Countries from around the world were invited by France to showcase their lifestyles. The Exposition aimed to celebrate the achievements of the past century and to accelerate development into the next. The “Exposition Universelle” of 1900 was a uniting and learning experience.

ICSB, with the inspiration of the 1900’s “Exposition Universelle” announces that next July 2020, Paris will host the ICSB 65th World Congress with the title of *”L’Exposition Universelle de l’Entrepreneurship.”*

The ICSB’s 2020 Global Conference in Paris aims to celebrate the achievements of the past century and to call upon the world for another World Exposition similar to the 1900 Paris Exposition Universelle. Time for entrepreneurship and SMEs to take the lead in ushering the world into peace, prosperity, and happiness.

ICSB invites everyone from around the world to Paris, France to showcase their creative ideas, inventions, inspirations, and achievements in Entrepreneurship and support to SMEs.

ABOUT ICSB

The International Council for Small Business (ICSB) is a non-profit organization is devoted to the interests and advancement of small businesses globally.

Founded in 1955, the International Council for Small Business (ICSB) was the first international membership organization to promote the growth and development of small businesses worldwide. The organization brings together educators, researchers, policy-makers, and practitioners from around the world to share knowledge and expertise in their respective fields.

ICSB is the originator of the United Nations’ Resolution to create an International Name Day dedicated to Micro-, Small, and Medium-sized Enterprises on 27 June (MSMEs Day).

ICSB premier World Congress is held every June around the world and brings together leaders, experts, and entrepreneurs.



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