

Microfinance

(Text largely based on “Retail Banking in Europe - The Way Forward” - ESBG 2009)

Small and medium-sized enterprises (SMEs) are considered the backbone of the European economy and serve as principal creators of innovation, jobs and wealth. At the European level, an SME is defined as an enterprise with fewer than 250 employees, a turnover of up to EUR 50 million or a balance sheet of no more than EUR 43 million. SMEs represent a major part of the European economy. It is estimated that some 23 million SMEs in the EU provide approximately 75 million jobs. Ninety-nine percent of all enterprises in Europe are SMEs, under the Commission’s definition, and in some industrial sectors SMEs represent almost 80% of the total employment. They play a central role in achieving the Lisbon goals of the European Union to become the most competitive and dynamic knowledge based economy in the world.

Against this background, SME policy has become a natural priority for the European Commission seeking to improve the business environment for SMEs in general, to simplify the regulatory environment for European companies and to tackle the financing problems that small and medium-sized enterprises face. This has resulted in a number of initiatives like the Small Business Act for Europe (SBA) and several financial support systems at the European level, such as the Competitiveness and Innovation Framework Programme (CIP), European Fund for Regional Development (EFRD), European Social Fund (ESF), the Joint European Resources for Micro to Medium Enterprises initiative (JEREMIE), the Joint Action to Support Micro Finance Institutions in Europe (JASMINE) and the proposed Progress microfinance facility.

JASMINE

In November 2007, the European Commission adopted a Communication¹ to improve access to finance for micro-entrepreneurs and financially excluded people. The proposed initiative had four different strands:

- improving the legal and institutional environment in the Member States;
- changing the climate in favour of entrepreneurship;
- promoting the spread of best practices, including training; and
- providing additional financial capital for microfinance institutions.

The Communication recommended setting up a dedicated support structure for microcredit with the view towards developing mentoring services which are essential to support micro-borrowers setting up a business, to develop good market practices by creating a specific microcredit label and a guide of good conduct.

The Communication also put forward a proposal to create, together with the European Investment Fund (EIF) and the European Investment Bank (EIB), a facility for financial support to microcredit. A microcredit initiative – the so called Microfund – was proposed for this means. The initiative was planned to be embedded in the JASMINE project, an instrument developed by DG Regional Policy of the European Commission, the European Investment Bank (EIB) and the European Investment Fund (EIF) to increase the range of

¹ European Commission. 2007. Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions A European Initiative for the development of micro-credit in support of growth and employment [COM(2007) 708 final/2], 20 December.

microcredit available in Europe through supporting the non-bank institutions providing such credits.

The JASMINE initiative was launched in September 2008. It covers the provision of funding in a co-finance facility which started to be operational in spring 2009, technical assistance to be provided to the microfinance institutions by the European Commission, as well as the development of a Code of Conduct for microfinance institutions.

In relation to the Commission's activities in this field, an own-initiative Report on Microcredit was drafted in the European Parliament's Committee on Economic and Monetary Affairs (ECON) in 2008 and voted in Plenary in March 2009.²

Progress Microfinance Facility

On 2 July 2009, the Commission issued a proposal for a Decision to establish a European Microfinance Facility for Employment and Social Inclusion. The so-called Progress Microfinance Facility was one of the actions announced by the Commission Communication 'A shared commitment for Employment'.³ In order to fund the new facility, the Commission will reallocate EUR 100 million from the existing EU budget and aims to leverage up to EUR 500 million in cooperation with international financial institutions and in particular the European Investment Bank (EIB) Group. The facility is open to public and private bodies established in Member States which provide microfinance to persons and micro enterprises in the EU. It will facilitate access to microcredit by providing equity and debt financing. In addition, it will also support measures such as training and mentoring. The Progress Microfinance Facility is expected to be approved by the end of 2009 and be operational in 2010.

ESBG Views

ESBG in general welcomes the measures taken by the European Commission towards improving the business environment for SMEs. Nevertheless, there is still work to be done in the area of administrative rules and regulations, the access to finance in the form of financial support programmes, microcredit and lending, cross-border activities and CSR for SMEs.

Savings Banks are important partners of SMEs throughout their lifecycle

ESBG members are traditionally natural business partners of SMEs, following their business development throughout the SME's lifecycle, tackling problems that may arise and sharing successes. Indeed, it is predominantly the savings banks' "proximity model" of local presence, in combination with their clear focus on retail banking which is at the root of the close relationship between savings banks and local businesses. As a result, savings banks belong to Europe's most important providers of SME finance, and are furthermore important partners to micro enterprises. They provide the whole range of financial products to SMEs at

² European Parliament. 2009. Report on European initiative for the development of micro-credit in support of growth and employment (2008/2122(INI)) Committee on Economic and Monetary affairs of 29 January 2009, Rapporteur: Zsolt Laszlo Becsey.

³ European Commission. 2009. Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions. A Shared Commitment for Employment [COM(2009) 257 final], 3 June.

local level, giving access to loans, guarantees, microcredits as well as to the equity and capital markets. In addition, savings banks often try to support SMEs from the very onset of their existence, or at later stages by providing alternative services, such as private equity. Given the close and long-standing business relationships between SMEs and savings banks, ESBG is committed to taking an active part in the work in this field, and to assist the Commission in its work towards a better business and financial environment for European SMEs.

CSR should be promoted for SMEs

The idea of the Commission presented in its SBA, to turn the environmental challenge into opportunities for SMEs is very welcome and in line with ESBG's general approach towards assisting SMEs in becoming more aware about the environment in which they operate. Considering the importance given to social responsibility within their own organisations, savings banks take every opportunity to assist their SME clients to improve and promote their respective work carried out in the field of social responsibility. ESBG members have a longstanding contribution to CSR and a number of schemes within ESBG member institutions target SMEs specifically.

Microcredit

Target groups of EU microcredit programmes should be better differentiated and clearly defined

The savings banks' activity in providing credits to small and micro enterprises comes naturally due to their mandate to contribute to their regions and be socially responsible institutions. In this regard, microcredit has in recent times been recognised as an important tool for growth, jobs and for fighting financial exclusion among European policymakers. However, there is a potential lack of coherence between the different initiatives at the EU level regarding the target groups for the support envisaged. There is no formal definition of the term "microcredit" although the European Commission has suggested all loans not exceeding EUR 25,000 be considered microcredits. A more general provision of the term is that offering microcredit means extending smaller loans to the poor or to those who cannot access finance through ordinary banking structures. This can be due to a lack of experience, collateral, or knowledge about the national legal and business environment - for example in the case of migrant entrepreneurs. Therefore, ESBG advocates for a clear definition of target groups of microcredit. Their specific hurdles for finance and requirements for qualification differ widely, depending on whether sustainable and commercially viable projects, start-ups or projects with a socio-political component are addressed. Simple "labels", such as migrants, the unemployed or women, are not useful as they are not indicative for any decision on credit or business viability.

Microcredit should first be facilitated at national, regional and local level

Tradition and longstanding experience of the local market is crucial for evaluating the viability of a business concept whatever its scope and size, and including small-scale projects. Given the local dimension of microcredit, the EU focus should primarily be on facilitating microcredit at the national, regional or local level - as close to the client as possible - before looking at the creation of a single market for microcredit per se. For example, this can be done through targeted cooperation between local banks and available support organisations (such as economic chambers, promotion agencies, microfinance institutions or start-up initiatives). In such a case, a solution in some European markets could be for the latter to focus on providing support services, leaving banks with the task of credit provision.

Risk, costs and consequences of microcredit should be better addressed

In addition, the increased risks and costs involved in microcredit activity need to be counteracted - for example through additional business support and accompaniment of the entrepreneur or through targeted support schemes where the maximisation of profit is not the sole aim of the activity. Specific challenges for micro or start-up credits are in some cases caused by a lack of quality of demand rather than by a lack of supply. The aim must be to integrate clients with adequate potential into the general banking system and not to transfer them to a second credit market, labelling them "non-bankable" and thus stigmatising them.

Financial institutions - especially savings banks - are key providers in financial education and advice to SMEs

ESBG has participated with great interest in the debate at the EU level on financial education. Knowledge about financial matters is an important tool for creating a successful enterprise. Many small business entities lack an understanding of basic financial services products, and most small enterprises cannot afford expensive consultancy services. Although financial education is primarily the responsibility of Member States, financial institutions can contribute as "educators", both in various schemes at the international, national or local level, and in the everyday meeting with their SME clients. As the local partners of SMEs, the employees of savings banks often take on the role of explaining and guiding SMEs in the financial services field and beyond throughout their life cycle. Due to the higher risk that smaller entities face resulting from a larger exposure to external risk factors, financial institutions can also play a role in explaining the use of the risk management products on offer to SMEs. Savings banks across Europe have operated in this spirit at the local level for more than a century and used microcredit as a means to help entrepreneurs to integrate, or re-integrate into social and economic life. Specific targeted schemes have developed within savings banks focussing on increasing the level of financial literacy among European citizens and SMEs.

EU microcredit measures need proper eligibility criteria for borrowers

In this respect it is of utmost importance to recognize that clients whose lack of qualification as an entrepreneur or lack of a viable business idea are too big to be overcome by adequate support measures, should not be driven into debt through subsidized microcredit offers. Any EU support measures which allow national or regional managing authorities to enter into uncalculated financing risks at lowest interest rates should therefore be avoided since such unfair competition makes any existing attempts by private suppliers to provide micro credits and corresponding support in commercial terms fruitless.

JASMINE should target *all* intermediaries providing microcredit

Throughout the discussions on microcredit at the EU level, ESBG has been actively involved and continuously called for a more comprehensive approach towards microcredit. It is important to acknowledge that there is a wide-ranging variety of institutions offering microcredit in Europe. All have diverse aims and targets, but all actively contribute to reaching a higher level of financial inclusion in Europe - whether they are banks, non-banks or other types of institutions. Against this background, and in order to reap the full benefits of microcredit in the form of growth and job creation, the support measures in favour of microcredit, such as the recently launched JASMINE initiative should be targeted at all intermediaries providing micro-credit.

Follow-up actions & recommendations of EU microcredit programmes need full attention

It would also particularly be required to ensure that all microcredit services initiatives throughout the EU, whatever the status or the legal structure of the provider involved, are able to develop optimally, and with a view to optimize the advantages brought to the beneficiaries. In this regard, specific attention will need to be given to the scope and focus of follow-up actions or recommendations eventually launched by the Commission and/or the Member States. This will be all the more important for promoting the exchange of best practices, especially between banks and non banks, as suggested by the Commission.