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- Economic and Monetary Affairs
- Employment and Social Affairs**
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Microcredit networks and existing national legislations with a view to the implementation of the microfinance instrument

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DIRECTORATE GENERAL FOR INTERNAL POLICIES
DIRECTORATE A: ECONOMIC AND SCIENTIFIC POLICIES

EMPLOYMENT AND SOCIAL AFFAIRS

**MICROCREDIT NETWORKS AND EXISTING
NATIONAL LEGISLATIONS WITH A VIEW TO THE
IMPLEMENTATION OF THE MICROFINANCE
INSTRUMENT**

BACKGROUND NOTE

Abstract

The report describes the microfinance sector in the European Union and the different forms it takes depending on the Member States and their particular banking and financial sectors, as well as the needs that it covers. It takes into account the regulatory framework and analysis and assesses the situation and trends in microfinance in the EU, in accordance with the institutions and intermediaries at work.

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CONTENTS

LIST OF ABBREVIATIONS	5
LIST OF TABLES	7
LIST OF FIGURES	8
1.1 The origins of microfinance	9
1.1.1 Grameen Bank	9
1.1.2 Self-help finance as a more traditional form of microfinance	9
1.1.3 Co-operatives as a traditional microfinance movement from Europe	10
1.2 Defining microfinance	11
1.3 Who practices microfinance in Europe?	11
1.3.1 NGOs & projects	11
1.3.2 Government	12
1.3.3 Trade Unions	13
1.3.4 Banks and Bank Foundations	13
1.3.5 Savings & Credit Cooperatives and Credit Unions	14
1.3.6 Foundations / charities	14
1.4 Segmentation by Microfinance Paradigms	14
1.4.1 Three institutional orientations	14
1.4.2 Market segmentation	16
1.4.3 Typical examples	17
1.5 Financial versus social trade-off?	18
1.6 Microlending techniques	19
1.7 Microfinance and market failure	19
1.8 Financial sustainability	20
1.9 What is success in microfinance?	21
1.10 Visions for microfinance in Europe	22
1.10.1 Microfinance as a tool for new welfare	22
1.10.2 Microfinance as a financial engineering tool	22
1.10.3 Microfinance as a tool of the new economy	23
PART II – THE LEGAL FRAMEWORK OF MICROFINANCE	24
2.1 Regulation of deposit-taking activities	24
2.2.1 The EU Banking Directives	24
2.2.2 Deposit-taking as a banking monopoly	24
2.2.3 Exemptions from the Banking Directive	24
2.2.4 Dealing otherwise with the deposit monopoly	25
2.2 Regulation of lending activities	25

2.2.5	Member States with a credit monopoly	25
2.2.6	Dealing with the credit monopoly	26
2.3	The position of banks	26
2.4	Categorisation of Member States	27
2.5	Regulation of interest	28
PART III - RESULTS OF THE SURVEY ON THE STATE OF MICROFINANCE IN EUROPE		30
3.1	Feedback on the EPMF	30
3.1.1	Level of awareness of EPMF	30
3.1.2	Interest in the EPMF Guarantee	31
3.1.3	Interest in the EPMF funding facilities	32
3.2	Priority needs	33
3.3	Additional comments from respondents	35
3.4	Legal issues	36
3.5	Feedback on microfinance demand	38
BIBLIOGRAPHY		42
USEFUL WEBSITES		44
ANNEX I. ONLINE SURVEY FORM		46
ANNEX II. EPMF QUESTIONNAIRE		52

LIST OF ABBREVIATIONS

ABCUL	Association of British Credit Unions
AECM	European Association of Mutual Guarantee Societies
ALMP	Active Labour Market Policy
CDFA	Community Development Finance Association
CDFI	Community Development Finance Institution
CEE	Central and Eastern Europe
CIP	Competitiveness and Innovation Framework Programme
CSR	Corporate Social Responsibility
CGAP	Consultative Group to Aid the Poor
CU	Credit Union
DMI	German Microfinance Institute (Deutsches Mikrofinanz Institut)
ECA	Europe and Central Asia
EDF	European Development Fund
EIB	European Investment Bank
EIF	European Investment Fund
EMN	European Microfinance Network
ENCU	European Network of Credit Unions
EPMF	European Progress Microfinance Facility
ERDF	European Regional Development Fund
ESF	European Social Fund
ICO	Instituto de Crédito Oficial
INAISE	International Association of Investors in the Social Economy
INL	Inclusion lending
KfW	Kreditanstalt für Wiederaufbau
MC	Microcredit
MF	Microfinance
MFC	Microfinance Centre for Central and Eastern Europe and the New Independent States
MEL	Microenterprise lending
MFI	Microfinance institution

ML	Microlending
MS	EU Member States
NEFI	Network of European Finance Institutions for SMEs
NGO	Non-governmental organisation
RITMI	Rete Italiana di Microfinanza (Italian Microfinance Network)
ROE	Return on equity
ROSCA	Rotating Savings and Credit Association
RUFAS	Red de Útiles Financieros Alternativos y Solidarios
UKCU	UK Credit Unions

LIST OF TABLES

TABLE 1: European MFIs according to their institutional priorities	15
TABLE 2: Objectives and Adjustment Strategies of the three main microfinance strategies	16
TABLE 3: Forms of microcredit techniques used by European microfinance institutions	19
TABLE 4: To what extent do MFIs cover their costs	20
TABLE 5: Which target groups do MFIs serve?	21
TABLE 6: Potential policy objectives of various MFIs	21
TABLE 7: Categorisation of EU Member States by their legislation on deposit-taking and credit (summary overview)	27
TABLE 8: Awareness of EPMF and sources of information	30
TABLE 9: Awareness of EPMF correlated with network membership	31
TABLE 10: Interest in EPMF guarantees	31
TABLE 11: Interest in EPMF funding	33
TABLE 12: Priority needs of MFIs	34
TABLE 13: MFIs experiencing legal and policy difficulties having to do with ...	36
TABLE 14: Quantitative Evaluation of Demand	40

LIST OF FIGURES

FIGURE 1: Market segmentation of the three microfinance types	17
FIGURE 2: Financial versus Social trade-off?	18
FIGURE 3: Priority needs of MFIs	34
FIGURE 4: Demand trends	38
FIGURE 5: Quantitative Evaluation of Demand	39
FIGURE 6: Nature of demand	41

PART I: UNDERSTANDING MICROFINANCE

1.1 The origins of microfinance

1.1.1 Grameen Bank

Microfinance (MF), or rather microcredit in our present-day understanding, is associated with Muhammad Yunus, an economics professor from the Chittagong University in Bangladesh who, during a major famine that his country went through in the 1970s, was frustrated by how little his science could do for the country. While Bangladesh was receiving billions of dollars worth of aid every year, it seemed that this aid was hardly reaching the poor, nor having significant effect on their lives.

In an attempt to find out why people were poor, or rather why it was that people could remain poor in spite of working hard, he visited several villages around the university to interview the people in order to understand what kept them in that condition. He understood that the key element was the lack of *access* to capital – not the ability to repay the capital, even at a high cost. The pattern he saw, which can also be observed in many circumstances in developed countries, is one where providers of or controllers of an activity are the ones who set the prices – both of the input and the output. The poor have no choice but to live with this situation, since they have no capital of their own.

Out of this insight, Professor Yunus then developed a lending technique based on peer groups, a technique by which a group of individuals collectively guarantee a loan to one of their members, and the incentive for repayment is that other members of the group will only receive a loan when the previous loan has been repaid. This technique therefore gives poor people access to capital by replacing material guarantees with a social capital technique of collective liability. The technique of peer group lending has allowed loans to be made to millions of poor Bangladeshis, and to women in particular, in a very sustainable way and with low losses. Today the Grameen Bank (which literally means "village bank") that grew out of this technique serves several million clients and is merely one out of several such financial institutions in Bangladesh, which deliver access to financial services to people who have traditionally not been considered as bankable.

The Grameen Bank has inspired several thousand similar initiatives across the developing world, several hundreds of which are of a size to have significant impact on their respective countries.¹

1.1.2 Self-help finance as a more traditional form of microfinance

At least since the Nobel peace prize was granted in 2006 to professor Muhammad Yunus, its founder, the concept of microfinance has mainly been associated with the Grameen Bank in Bangladesh. In fact the making of small low-risk loans is a practice that dates back at least to the invention of money itself and is present in every continent in the form of self-help kitties and mutual savings groups. Their sizes, purposes and mode of operation may differ, but they have in common that they are based on self-organisation and self-help. Members pool their savings and operate as ROSCAs (Rotating Savings and Credit Associations) or derived forms of these. They mostly finance members directly but can also serve to finance a common need of the group of the community more generally.

In Africa, such groups are traditionally present on almost all over the continent generally known in the French speaking part of the continent as "tontines"².

¹ For a database of some of the most significant MFIs in the world, see www.mixmarket.org.

They can be small groups or can be as large as a whole community or an entire professional group (market sellers, leather workers, taxi drivers, etc). They can be interest free, with interest or other forms of charges like prices determined through auctions. There are also sophisticated traditional money transfer systems such as through the hawala, a wide network of agents over several countries. Microfinance programmes are often building up on top of these traditional structures such as in the case of so-called "village banking" techniques. Here, the equivalent of the Bangladesh peer group is constituted by the entire local community or another similar association.

In Europe such forms of basic financial solidarity systems exist as well for instance at the level of small groups of entrepreneurs from the same area, sector or consortium who likewise will pool savings for instance for small scale loans for the members or guarantees to access a bank loan. Turkish migrant communities also use such techniques for interest-free savings often for the purpose of saving the deposit for a housing loan.

These traditional forms of microfinance respond to a general need for access to amounts of capital that go beyond what an individual could ever accumulate, especially when there are no savings systems available. They are also a response to inevitable life hazards and are a means of protecting oneself against the uncertainties of life. Even in such basic forms microfinance therefore plays several roles: giving access to capital, insuring against life hazards, enabling capital accumulation as well as money transfers.

This underlines also the crucial role such microfinance has on generating wider social capital. Microfinance creates interdependence, which is both a form of control and of support. By creating recognition, it gives the members access to other forms of aid that are not financial. Being part of such a scheme increases the individual spheres of interest and empathy and widens also the potential scope of the common good. It also creates market intelligence and enables collective projects, not only individual ones.

1.1.3 Co-operatives as a traditional microfinance movement from Europe

While it is true that very traditional forms of savings and credit associations have existed far back into history also in Europe, probably the most systematically developed model, which can be assimilated to micro-financial techniques, is the German savings and credit mutuals and co-operatives that date back to the mid-19th century, based on the models of Raiffeisen and Schulze-Delitzsch. These were movements based on the principle of mutual aid, according to which the savings of the members of the association or co-operative are pulled together to finance the needs of other members. They are in many ways similar to the basic self-help systems, and indeed build on this tradition, but are usually more complex (e.g. they have a central management system, a central savings fund and more differentiated credit systems) allowing them to grow larger and serve more diverse needs than the simpler rotating self-help systems. The principle of the peer group is in this context extended to the members of an entire network of people bonded together in one way or another (usually by virtue of living in the same area).

In addition to being not-for-profit, the fact that the members know each other and the combination of several microfinance services (credits, savings, money transfer and other non-financial services) enables the transaction costs to be kept very low and makes the loans both cheap and secure. This is what makes it possible to deliver sustainably very small loans to the members, and explains the remarkable success of this concept both in Europe and in the rest of the world.

² other names and slight variants are for instance the chilembe (Cameroon), stokvel (South Africa), susus (Ghana), iqqub (Ethiopia), upato (Burundi) ...

Savings and credit co-operatives are also one of the rare forms of microfinance that have shown to work in rural areas, usually the most challenging context to develop financial services (lower population density, lower profitability of agriculture-based activities and seasonal risks).

Savings and credit cooperatives have emerged in every European country at some point of history since the times of Raiffeisen. It is on this principle that some of Europe's most notable banks were built, such as the *Crédit Agricole* in France and Rabobank in the Netherlands. The concepts continue to be appealing, even in Europe and in particular in the transition context of the new Member States, in spite of European banking regulations having made their creation no longer feasible in most Member States through the first and second banking directives.³

1.2 Defining microfinance

There is not as such a legal or regulatory definition of what microfinance is, but rather a consensus that builds on practices that vary over time and place. Initial definitions tended to focus on the concept of *microcredit*, inspired in doing so by the model of the Grameen Bank whose activities were at that time entirely focused on delivering loans only. The first major world gathering of the sector, in 1997 in Washington, was accordingly titled "the First *Microcredit* Summit" and the then commonly accepted definition was (and to some degree still is), that microcredits are very small loans to poor people without collateral for income-generating purposes.

The definition has been evolving over time, and in fact the focus changed already at that first Summit itself, where the concept was broadened to "microfinance", as can be seen in most of the conference documents that followed the event. It was accepted then already that saving services were an important component too in helping people to grow out of poverty, a recognition that has been increasing ever since. This understanding has evolved to encompass further financial services as well as other purposes than direct business development alone. Accordingly the Consultative Group to Aid the Poor (CGAP)⁴ considers that:

"Microfinance offers poor people access to basic financial services such as loans, savings, money transfer services and micro-insurance. People living in poverty, like everyone else, need a diverse range of financial services to run their businesses, build assets, smooth consumption, and manage risks."

This exemplifies that the understanding, as well as the policies, regarding microfinance keeps evolving and that there are no strict boundaries to what it exactly encompasses.

1.3 Who practices microfinance in Europe?

1.3.1 NGOs & projects

The pioneers in this new microfinance field were and still are projects and NGOs that take advantage on the one hand of the most accessible legal form and on the other hand of funding opportunity made available through foundations or government programmes targeting social inclusion, small business creation or local development objectives.

³ as will be described in more detail in Part II, the banking directives have unified the banking sector by creating a single bank status, requiring a minimum capital of €5 million. This has de facto ended the European tradition of local cooperative banking since the end of the 1980s. Credit cooperatives and credit unions have only been possible to develop in those few Member States where an exemption from the EU Banking Directive was granted.

⁴ www.cgap.org. CGAP is a policy and research centre housed at the World Bank and dedicated to advancing financial access for the world's poor.

They are usually set up at the initiative of individuals or local organisations. In the majority of cases these initiatives do not survive beyond their initial funded period.

Project-based microfinance NGOs: A large number of microfinance initiatives are designed on the basis of funding opportunities. They make the best out of the existing small-scale and short term funding opportunities designed to address social exclusion, business development and local development, but not specifically designed for microfinance initiatives. This means that they have major imbalances and gaps in their operation. Their survival depends on the ability of continuously raising funds by going from one opportunity to the next. They will therefore have high overheads for fund-raising and grant management and their microfinance processes will only improve very gradually, cumulating rather multiple services and products with successive funding opportunities, rather than improving and multiplying existing products. This used to be mostly a western European phenomenon (typical of EN, DE, FR, BE, PT, ES, IT), but has also spread to Eastern Europe with the arrival of the EU Structural Funds. While the majority of these initiatives will stay at a low level of operation (rarely more than 100 credits per year), a few succeed in professionalising, gradually improving their processes over time such as in the case of ADIE (FR)⁵ who has developed a national network serving 15.000 clients in 2009.

Purpose-built microfinance providers: Other microfinancers are designed more systematically, benefitting from integrated funding targeted at microfinance, usually from the USA but also from Switzerland. These organisations are intentionally designed and supported to deliver microfinance and have received the most straightforward combination of institutional funding to finance their start-up and development, combined with capital resources to test and deliver optimised loan products. These are the microfinance providers with the biggest impact (delivering loans in the thousands per year) and the highest degree of sustainability, in that they cover at least their operational costs. The targeted support they have received, optimised from the start, means they can keep their overheads down. These are the microfinance providers that are most likely to eventually transform themselves into banks. They are exclusively in the new Member States and include institutions like Fundusz Mikro⁶ (financed by the US-Polish Enterprise Fund), Patria Credit⁷ (funded by World Vision International and Romanian-American Enterprise Fund), Opportunity Finance⁸ (promoted by Opportunity International) and Procredit Bank⁹ (promoted by IPC), as well as a series of smaller MFIs in Romania, Bulgaria and Poland.

1.3.2 Government

Government finance institutions and programmes: These are institutions and programmes implemented internally by a government department or a fairly independent financial institution at national, regional or local level, through so-called development financial institutions (in some cases with a bank status) or through other agencies with a similar purpose. Operating either regionally or nationally, these programmes mostly target the formally registered unemployed (and increasingly also people without employment) to help them start their own businesses. There is a difference of emphasis: while at one extreme of the spectrum NGOs can unconditionally serve excluded people and help them develop an income-generating activity, government bodies target people with a fairly defined status to generate a clearly identified outcome: a business or a self-employed status. This means that they tend to serve the higher end of the microcredit segment,

⁵ www.adie.org

⁶ www.funduszmikro.pl

⁷ www.patriacredit.ro

⁸ www.opportunity.ro

⁹ www.procreditbank.bg and www.procreditbank.ro

though efforts have been undertaken to downscale their interventions. Their strength and weakness is that they are policy dependent. Typical examples are KfW (Germany), Fonds de Participation (Belgium), ICO (Spain), ALMI (SE), MFB (Hungary) or Finnvera (Finland) – the latter having sustained a level of above 10,000 loans per year (with a peak at 24,000 in the past). At regional and local level there are institutions like the NRW Bank (for the Land of Nordrhein-Westphalen in Germany) or Brusoc (for the city of Brussels).

Local development funds & business development agencies: In some countries local business development agencies have evolved to offer microfinance products to complement their business advice and training activities. This is the case for instance in Italy, Poland and Hungary or can also work through private (but publicly subsidised) business agency networks like in Germany. They will mostly be low scale (making between 30 and 100 loans per year per local agency), but can also be large scale, regional or national programmes. Similar as the above, they target business starters who need to elaborate a business concept, a process by which more difficult target groups tend to be sorted out. Their core business being business support rather than microfinance as such explains why their costs are high and their level of activity will systematically be in relation to the amount of external support they receive. The Hungarian Microfinance Network is a fairly elaborate example of this category¹⁰.

Job centres: To varying degrees government agencies or similar agencies in charge of managing government funds intended for the jobless sometimes adopt complementary financing means in the form of refundable advances and loans for business creation purposes. These may be small add-on amounts ranging from €2,000 to 5,000 such as in the case of the ARGE job centres in Germany, which use this instrument unevenly across the country depending on the know-how of the local staff.

1.3.3 Trade Unions

Similar to what Job Centres do, Trade Unions can also offer their members microloans reaching €10,000-20,000 such as the Swedish trade unions supporting their unemployed members to start a business. In some cases this is considered as a capitalised form of social benefit to which workers are entitled. These programmes tend not to be highly promoted and have a secondary existence compared with the other sorts of help provided by such agencies.

1.3.4 Banks and Bank Foundations

In a few countries mainstream banks will get involved through their foundations, often delivering loans directly themselves. This is especially the case in Spain, starting with the example of the Un Sol Món Foundation belonging to the Caixa Catalunya. But many other similar savings banks have committed their respective foundations similarly such as in particular the French Caisse d'Epargne or the Spanish BBK¹¹, Caja Granada and La Caixa, the latter having created the MicroBank¹². For these banks this is a way of fulfilling their social mission prescribed by their constitutions. But there are also commercial banks who see this as part of their CSR policy such as the Bank of Ireland who helped to set up First Step Microfinance¹³, the Millennium Bank in Portugal who has dedicated three special branches to the practice of microfinance with fragile target groups and BNP Paribas who is providing institutional support to various microfinance initiatives.

¹⁰ www.mvfportal.hu

¹¹ www.bbk.es

¹² www.microbanklacaixa.es

¹³ www.first-step.ie

In addition, there are mainstream banks that work in partnership with MFIs through their core business, who will integrate microfinance clients into their own normal client portfolio and end up servicing them as normal clients of their own (e.g. as in the case of banks working with France Initiative). Finally, there are cases of ethical banks that adopt a proactive sector development approach, providing back-up services, finance and institution building support to accredited microfinancers such as in the case of the German GLS Bank.

1.3.5 Savings & Credit Cooperatives and Credit Unions

Their purpose is wider than providing business loans – they provide basic savings services and mostly personal loans. In some cases however credit unions are entirely based on a specialised profession, such as in the case of the London Taxi Drivers Credit Union, in which almost the entire loan portfolio is for professional use. Typical community-based credit unions i.e. those with a geographical common bond, will generally have 5 to 15% of their loans serving business purposes. This means that although professional loans are a small part of their business, the size of their turnover makes them by far the biggest providers of microfinance in those countries where they exist i.e. the UK, Ireland and Poland.¹⁴

1.3.6 Foundations / charities

Foundations other than those from the banking sector usually sponsor microfinance programmes but in some cases also deliver microloans themselves. Their focus will usually last as long as their policy priority dictates, meaning that the majority will be short-lived. In exceptional cases however they will become major programmes such as the Prince's Trust in the UK which arguably has for a long time been the largest microfinance provider in Europe during the 1980s and 90s¹⁵ providing annually up to 8,000 disadvantaged young people the opportunity to start a business of their own with the help of a large mentor network.

1.4 Segmentation by Microfinance Paradigms

1.4.1 Three institutional orientations

When asked what their objectives are, microfinance organisations will indistinguishably state that they are serving people with no bank access with small loans to develop or start their small business activity. Most microfinance organisations however will focus on one of the following priorities:

1. creating businesses (economic objective)
2. helping specific target groups (social objective)
3. delivering sustainable and low risk financial services (operational objective)

What determines an organization's orientation is not this priority as such but the way it adapts to not reaching one or more of the three objectives mentioned above. While all microfinance organisations will clearly state that all three objectives are equally important, in reality each will sacrifice one of them before another, depending on what kind of organisation it is. Its 'institutional genetics' will drive it to neglect one of them first, and it is this neglect that defines it. This distinction will show up as soon as an organisation experiences difficulties or losses in repayments. Unlike the situation in developing countries, completion exerts a discipline on profit margins. Therefore organisations will respond to this in three different ways.

¹⁴ To see the legal constraints limiting the creation of credit unions please refer to part II of this report.

¹⁵ www.princes-trust.org.uk or the Scottish Youth Business Trust: www.psybt.org.uk

1) The first group, when experiencing repayment difficulties, will decide this is a problem of the people they serve, and will see it as their task to better target the people who are the “real entrepreneurs”. Their response to loan losses will therefore be to select clients more strictly. This category is usually identified as **microenterprise lenders (MEL)** because in the end they will focus on creating what they see as viable businesses, and will therefore focus on the higher end of microcredit demand. They will also insist on training in “financial literacy” and in accompanying entrepreneurs, which helps them to limit their loss rates.

2) A second category of organisation will react differently to repayment difficulties. Under the direct influence of the origins of microfinance they will decide that microfinance is a tool intended for disadvantaged people and will stick to this objective. In so far as their funding allows, they will tend to tolerate higher loss rates and deal with it by increased fundraising, but will especially focus on more systematic monitoring and accompanying measures (e.g. via mentoring programmes). In exceptional cases they will see part of the problem in the financial instrument they are using and will start improving it, to limit their losses. Because of their focus on serving specific target groups of people, this second category can be seen as **inclusive lenders (INL)**.

3) The third category of organisations will make no or low losses, because this is what defines their activity right from the start. They also aim at financing people who have no access to other loans to help them develop an income-generating activity. However, either because of financial constraints or by design, their focus will be on delivering loans at the lowest risk possible for both the borrower and the lending organisation, as this is their understanding of microfinance. Their focus will be on delivering small loans that can be repaid in almost any circumstance – because of the design of the loan - sometimes in combination with step lending, group lending and pre-saving techniques, which are techniques that allow them to increase the leverage at low risk. This category can be called **microlenders (ML)**.

The following table clarifies and compares the priorities of the three types of institutions:

Table 1: European MFIs according to their institutional priorities

	create viable businesses	Support target groups	Provide accessible finance
MEL	1st priority	optimising variable	2 nd priority
INL	2 nd priority	1st priority	optimising variable
ML	optimising variable		1st priority

The first two types – MEL and INL – are classical small loans, only the third is technically a financial innovation. Yet each one of these techniques has its limits. One way of characterising them is to describe what each one of them will neglect, if forced to do so:

Microenterprise lenders (MEL) by focusing only on the “real entrepreneurs” will consider the majority of funding requests as non-viable. Its benign neglect will consist in low selection rates, ending up with ratios as low as 5% or less of initial requests (“not everybody can be an entrepreneur”);

Inclusive lenders (INL) will have their benign neglect determined by the kind of funding they receive, which is usually focused on social inclusion and employment generation. The dimension they will neglect will therefore be people that are already entrepreneurs, and/or people who are in no need of non-financial support (they will often impose the condition that borrowers must take part in a training programme). Paradoxically, since their focus is to deliver loans only to the unemployed and socially excluded (meaning that once they have started their business they are not eligible for a second loan), this can lead to their delivering larger loans to cover the first two years of the business's existence – which increases the risk.

In the third case, **microlenders** (ML), the kind of demands that will be off limits are those that are considered too big. Most loans of a size that microenterprise lenders see as a necessary investment for a viable business, is considered by microlenders to be too risky. Conversely, microenterprise lenders consider most microlender loans as too small for a real enterprise to live on.

Table 2: Objectives and Adjustment Strategies of the three main microfinance strategies

	Focus	Adjustment Strategy	Benign Neglect
MEL	Focus on the Enterprise and what is needed (in terms of capital) to start at a viable level	The main objective is the reduction of risk (loss rates). Selection of <i>real Entrepreneurs</i> ; Focus on the pre-evaluation (filter process) + Accompanying measures	- <i>plain</i> credit needs - business <i>concepts</i> that seem not defined enough - atypical entrepreneurs - <i>Mice</i> ¹⁶
INL	Focus on the Entrepreneur and what is needed (possibly in terms of capital) to start a liveable enterprise or an activity	For ex - Focus on repayment via thorough follow-up measures + strong accompaniment Better differentiation of the target groups and improved orientation (possibly development of better financial instruments)	Entrepreneurs with little (accompanying) or no support needs (training, etc); already started entrepreneurs
ML	Focus on the Credit and how one can design it as large as possible while staying repayable in any case (risk limitation for both the borrower and the lender)	Reach economies of scale and reduce the unit costs, <u>increase</u> of the credit leverage thanks to innovation	- Entrepreneurs with needs above the risk / size ceiling (too high loan requests)

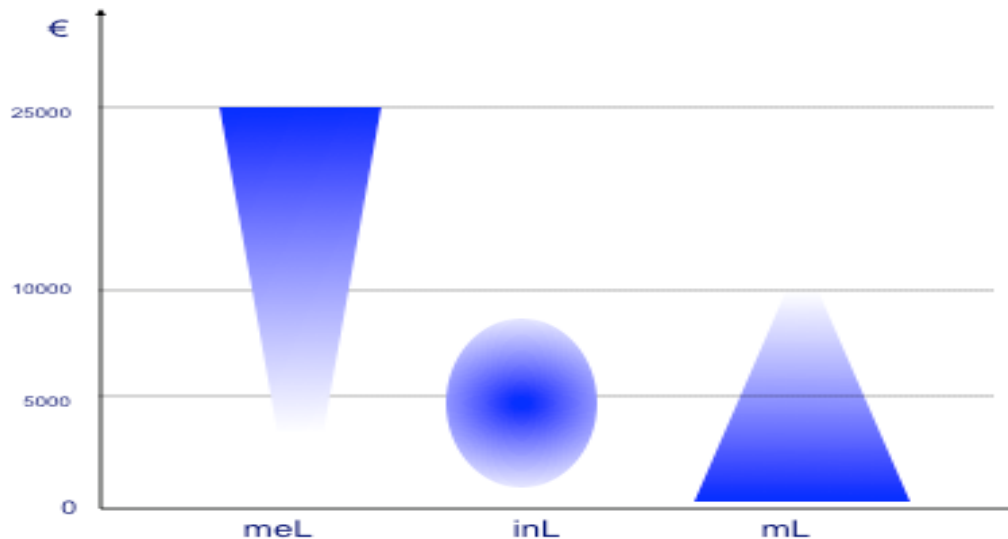
1.4.2 Market segmentation

The market positioning of these three families of microfinancers is quite distinct. Microenterprise lenders (MEL) tend to position themselves in the higher segment of microfinance demand, in the range €10,000 to €20,000 or €25,000, often wishing to go beyond this maximum level. At the other extreme of the spectrum, microlenders (ML) tend to make lower-sized loans based on ease of repayment and limitation of risk.

¹⁶ "Mice" are micro-enterprises (of whom the majority are self-employed people) who have no ambition or no capacity of ever growing substantially. Their purpose is mainly to earn their owners and promoters an income. This concept is contrasted to the concept of "gazelles" (small enterprises with high growth potential) and "elephants" (large existing businesses). Though each "mouse-type" company represents only a small potential of jobs, it is their large number that makes them relevant in terms of job creation. Out of 100 new companies, 95% are likely to be mice and 5% gazelles (who one day could become elephants). In terms of job creation strategies, it could be argued that the 70s to 80s were the times of elephant paradigm, the 80s to 90s the times of the gazelles paradigm, and that possibly the new millennium might finally be times for the mice.

Their tendency will be to have minimum loans starting below €1,000 – sometimes well below €1,000 – going up usually to €5,000-€6,000 and exceptionally towards €8,000 or €10,000. Inclusive lenders (INL) tend to be in between these two categories, basing their decisions on what can reasonably be repaid by a fragile target group over a period of two to three years. These amounts tend to be between €2,000 and €7,000.

Figure 1: Market segmentation of the three microfinance types



The segmentation reflects the starting points of the various categories. Most microfinancers evolve in various directions. Among the Microenterprise lenders (MEL) there is a minority who will go for lower loan sizes e.g. Finnvera in Finland and KfW in Germany with its latest programme called *StartGeld*.¹⁷ Inclusive lenders (INL) also have a trend to go towards smaller loans: for instance ADIE, which within its €6,000 limit has tended to push down its target loan amount. Between these two categories a great number will actually not change much over the years or remain static.

1.4.3 Typical examples

The typical **inclusive lender** is **ADIE**. ADIE was founded in 1987 to serve the disadvantaged in France, in particular long-term unemployed people and those on social benefits. Over time, other categories were added, such as Roma and young people living in the suburbs. Typical loans would go up to €6,000. However over the years ADIE has launched more specialised credit products designed to target lower segments within the €6,000, such as step loans starting at €500 for Roma people. Today ADIE finances about 15,000 people a year. Starting from loss rates in the early years that could be above 30%, ADIE's portfolio performance has improved and today losses are stable at 3%, with overhead costs well above sustainability.

The **Microlender** category includes very different types of organisations among which we see two extremes. On the other hand there are very traditional mutual organisations, like **credit unions**, whose sustainability is based on low costs, low profit targets and a high level of local social capital, allowing it to deliver low-risk relationship finance. This includes both loans and savings. In contrast we also have very new organisations based on the Grameen model, like **Fundusz Mikro** in Poland, which focuses on very standardised loan products, on scale, and sometimes on technology.

¹⁷ http://www.kfw-mittelstandsbank.de/DE/Home/Kredite/Die_Foerderprogramme_im_Einzelnem/KfW-StartGeld_/index.jsp

A typical **microenterprise lender** would be a public finance institution such as **KfW** in Germany; they usually focus on the unemployed and/or business starters working in co-operation with the national bank networks.

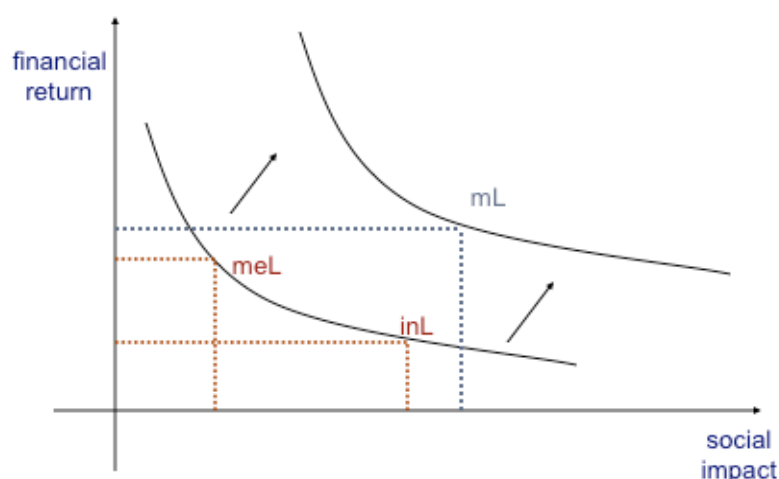
As regards segmentation these three types of organisations are in many ways complementary to each other and even within this bracket of small loans up to €25,000 they represent very different worlds of customers, ranging from market vendors up to software developers, people delivering neighbourhood services, caterers, small artisans, shopkeepers and founders of potential high-growth businesses. All of these represent extremely different need segments, which a diversity of organisations is best suited to serve.

1.5 Financial versus social trade-off?

For policy-makers and a large part of the research community there is a linear continuum from being bankable to being a financial risk, which leads to the conclusion that serving the lower end of the spectrum requires increased compensations of the financial institution. In this way of thinking there is a trade-off between financial return and social impact, as shown by the classic curve below. In other words, to reach out to less bankable people and bank-excluded people profits need to be foregone, if not be subsidised to fulfil the mission. This perspective has led EU policy for microfinance to distinguish between “social lenders” and who *de facto* need to be subsidised, and the rest of the microbanking sector (in the present understanding the “microenterprise lenders”) who were the target of the main financial instruments offered by the EU programmes.

The techniques of microfinance allow it to reach out to difficult target groups – to the lower market segments – while still being sustainable – as the example of credit unions and Fundusz Mikro show in different ways. By fragmenting loans into smaller more manageable sized loans, through step lending techniques, or by leveraging microsaving and using social capital (reputation, mutual help), they manage to overcome or transcend the academic dichotomy between return and social impact. Microfinance in its most essential forms allows to have positive results on both levels.

Figure 2: Financial versus Social trade-off?



1.6 Microlending techniques

Table 3: Forms of microcredit techniques used by European microfinance institutions

Business Plan based lending	The most widespread form of microfinance in (Western) Europe, involving basing the loan on an abridged or full fledged business plan. It is the most expensive credit process and involves the highest risk. Mostly used by MEL and INL and often combined with accompanying measures (e.g. mentoring).
Step lending	Credit methodology based on building up a credit history that starts with a small loan considered low risk. Good repayments lead to increasing successive loans. This technique is often combined with other techniques mentioned here. Mostly used by ML.
Peer group lending	Directly inspired from the Grameen model, organising clients in solidarity groups, which can be mutual help groups above all (in the case of INL) or real mutual guarantee groups (in the case of ML).
Savings-based lending	This method is almost exclusively used by credit cooperatives (i.e. ML) that require their members to pre-save for a loan, leading to a loan that is a multiplier of the pre-saved amount. The multiplier increases with successive loans as in the step-lending model.

1.7 Microfinance and market failure

Market failure, or the reason why banks are usually not serving the type of clients served by microfinance, can have several reasons. The most common proposed reason, that it is too costly for banks to provide small loans would not in itself be market failure, as it would mean that there is no market for banks in this segment. But that would mean also that there is only a single dimension to the trade-off between profitability and (social) outreach. This can depend on the financial technique used. A better finance method can indeed both increase outreach and profitability at the same time. In fact, banks actually do use many of the techniques applied in microfinance¹⁸, but not necessarily in Europe and not necessarily by targeting micro-entrepreneurs. They use these techniques for instance in consumer finance, on which higher margins can be earned.

Bank's minimum finance thresholds for small business (in the form of guarantees and minimum loan limits) have continuously increased over the last two decades, their products become increasingly standardised and their clients are increasingly segmented. Banks have moved away from traditional relationship banking, which is particularly important for small businesses. To understand why now it is more difficult to access to financing than three years ago, before the financial crisis, or even more so 25 years ago, before the integration of the banking sector, one has to consider how the market conditions have changed over the same period, specifically in terms of:

- Rising expectations of return: ROE (Return on Equity) targets have increased to an average of 15% across Europe, and stand even at 25% in the UK as well as for some specific universal banks across the continent;

¹⁸ Procredit Bank for instance, who operates in Romania and Bulgaria, uses optimised yet fairly standard retail banking methodologies to target micro- and small enterprises.

- Rising guarantee requirements: Regulatory changes have continuously increased the security conditions for small business finance, e.g. through the Basel II agreements, which require a 75% risk weight in the so-called standardised approach;
- Barriers to entry: The implementation of the Second Banking Directive in the mid-1980s unified all financial institutions under a single banking framework and increased the access threshold to the sector with a minimum capital requirement of €5m, which put an end to the historical people banking movement and the dual banking model in Europe.

One can argue whether all of these elements are part of market failure; however it does matter whether low profit seeking financial institutions are allowed to exist on the market place. This underlines in particular that being non-bankable is not only determined by the potential client alone, but more so by the market conditions and the regulatory frame in which banks operate.

1.8 Financial sustainability

There are different degrees of financial sustainability. It may be measured in degrees according to different cost elements. Placing these in ascending order, we may distinguish five levels of financial sustainability:

- Level 1: financial capital is kept intact – interest covers risks, funds remain stable;
- Level 2: operational costs are covered – staff and rent are paid for;
- Level 3: return on capital is covered – capital can be raised;
- Level 4: development costs are covered – institutional development can be pursued;
- Level 5: accompanying measures are covered (unheard of in practice)

The following table shows the extent to which the three types of microfinance institutions cover their costs from their business income (the darker the box, the greater share of these costs is covered):

Table 4: To what extent do MFIs cover their costs

	Microenterprise finance	Inclusion finance	Microfinance
Risk of lending – losses, guarantee fund contributions			
Loan Management costs			
Raising funds (profit)			
Accompanying measures			
Development / institution building			
Infrastructure (premises etc.)			

And this table shows the target groups that the three types of MFI serve:

Table 5: Which target groups do MFIs serve?

	Microenterprise finance	Inclusion finance	Microfinance
Bankable and profitable enough			
Bankable but not profitable enough			
Some risk & needing some support			
High risk & needing high support			

1.9 What is success in microfinance?

Market sustainability, as analysed in the previous section, is not the sole criterion of success in microfinance. Contrary to microfinance in developing countries, European microfinance does not have becoming part of the banking sector as a core objective. Its objectives are more diverse, which means that its success criterion is measured in very different ways, as can be summarised in the table below.

Table 6: Potential policy objectives of various MFIs

Objective	Examples
reaching out to as many people as possible	Fundusz Mikro (50,000 clients, Poland), ProCredit Bank (40,000 clients, Romania), PYBT (7,000 clients, UK), ADIE (15,000 clients, France)
helping specific target groups such as women, migrants, the young etc.	ADIE (long-term unemployed & benefit recipients), WEETU (unemployed women), PYBT (disadvantaged young people)
reacting fast to the economic crisis	Prizma (postwar reconstruction context, Bosnia and Herzegovina), PYBT (post-riot opportunity generation, English cities), Fundusz Mikro (conversion from state to market economy, Poland), Finnvera (collapse of USSR, Finland)
creating a strong local impact	CEIS (Strathclyde, Scotland), credit unions (Ireland)
establishing sustainable microfinance organisations	credit unions (Ireland, UK, Poland), Fundusz Mikro (Poland), Opportunity Finance (Romania)
establishing a dynamic (responsive) microfinance sector	Poland

This means that in terms of policy-making, there are choices to be made beyond helping people to access finance to start an income generating activity. While in developing countries, microfinance starts from a market coverage of 2% or 3% and aims at providing a very basic banking infrastructure to cover the biggest and most basic needs of the population, microfinance in Europe responds to a much more specific but also more diverse set of situations.

Especially in the Member States recently being part of the EU with contexts of economic transition and whose banking sectors need to be expanded and instruments diversified, microfinance has been about creating economic opportunities where the mainstream banks would not have been interested to go, for instance in rural areas, and for people without stable incomes, migrants and minorities and unemployed people. In the older Member States however, microfinance has been set up to serve a wide diversity of purposes such as listed in the previous table.

This means in particular that measuring microfinance institutions solely by financial sustainability, even by profitability, would easily be misleading. It disqualifies organisations whose objective could match well with the specific policy objective, such as helping people that have become victims of the crisis context (as defined by the European Progress Microfinance Facility).

1.10 Visions for microfinance in Europe

The diversity of the nature and objectives inherent to microfinance works in different direction in terms of policy choices supporting microfinance. Microfinance is not only about small loans, it is also a policy instrument within a larger policy frames.

1.10.1 Microfinance as a tool for new welfare

New welfare involves using new instruments that create less dependency and eliminate poverty traps. While welfare focuses on weaknesses (being unemployed, disabled, disadvantaged, etc) and on entitlements based on status, it focuses less on abilities. Complementing welfare policy with microfinance programmes could have a fundamental impact on how welfare interacts with people. It is about creating a culture which is more results-oriented than status determined. Microfinance as a part of social inclusion policy can for instance fit better with people who are more likely to be stigmatised, those who have no legal status, no (accepted) education title, insufficient literacy or language skills and those who are neither employed nor officially unemployed. Credit and the business development approach to social inclusion policy indeed tend to focus on the ability to run a successful business and to repay a loan more than anything else. This is what most of the Inclusion financiers and microfinancers in a strict sense do, and doing so they open up more options in terms of inclusion beyond welfare-compatibility.

1.10.2 Microfinance as a financial engineering tool

Microfinance can respond to targeted needs. It has been used over the years to respond to very specific situations, some of them even time-limited. This is the case for instance in post-crisis situations like the post-war context in Bosnia, where microfinance was used as a fast intervention policy for regenerating economic initiative and war demobilisation. This was true for the Prince's Youth Business Trust (PYBT)¹⁹ in English cities, which intervened after the youth riots in the 1980s to help young people create a future of their own through self-employment. And it was true of ADIE in the French *banlieues* in the early years of this century. Massive redundancies provide another context; for instance the Soros Foundation supported programmes in the coal-mining areas of Romania, and Fundusz Mikro was a reply to the transition from a state to a private-sector economy. In the Lofoten Islands, microfinance is a tool to prevent the mass emigration of women²⁰.

¹⁹ www.princes-trust.org.uk

²⁰ In Norway, Nettwerkskreditt was started to help women who tended to leave the remote areas and in particular the Lofoten islands to go study in the main cities, to come back and develop economic initiatives through self-help groups proposed by the microfinance organisation. Farms being traditionally hand down to the son in the family,

In each case microfinance is used in a different way, designed to serve a specific purpose. It is used as a tool, an object of design to serve policy purposes.

1.10.3 Microfinance as a tool of the new economy

Designing microfinance is an opportunity to promote a more open society. The architecture of finance impacts on the architecture of society and its economy, which means that the genetics of finance has to correspond to the vision that we have of where future added value and jobs can come from. If we want more entrepreneurs and self-employment then we need to adapt the financial system to serve them. If the vision is about creating a knowledge-based and service economy then it needs likewise a vision of a financial architecture that delivers financial services that don't require material assets. In that sense, microfinance can be an instrument of the new economy, contributing to competitiveness thanks to its inclusiveness.

the rural areas are at risk of dying out because women don't come back out of lack of economic opportunity. This phenomenon is in fact a fairly widespread one across Europe's rural communities.

PART II – THE LEGAL FRAMEWORK OF MICROFINANCE

2.1 Regulation of deposit-taking activities

2.2.1 The EU Banking Directives

In the European Union, banking is regulated by the EU Banking Directive²¹, whose purpose, through its successive versions since 1977, has been to create a level playing field for banking in the EU in order to generate a competitive environment for banking services. It has done this by unifying the previously diverse banking sector under a single banking status. The previous multiplicity of co-existing types of financial institutions – savings and loan associations, credit cooperatives, building societies, development finance institutions, commercial banks, investment banks, etc. – with their specific regulatory frameworks, supervisory authorities and access conditions, was unified through the creation of a single banking status, with single national supervising authorities and common minimum licensing conditions. One of the standard requirements introduced by the second EU Banking Directive in the 1980s is the minimum capital threshold of €5 million²², which sets an unprecedentedly high entry standard to the banking business²³.

2.2.2 Deposit-taking as a banking monopoly

While the EU Banking Directives regulate all "Credit Institutions" (or in other words: "Banks"), they concern exclusively financial institutions whose business is to take deposits. On the one hand this means that non-deposit taking financial institutions are not regulated by the EU Directives – indeed financial institutions whose lending is based on other forms of capital than people's savings are not the focus of the Directives and therefore do not need to be a bank on the basis of that regulation. On the other hand it means that all deposit taking institutions are required to be banks and that only banks are allowed to take deposits. While this does not exclude for instance a cooperative from being a financial institution, it does require that it comply with the conditions of the Directives (for instance that it should have the same minimum capital of €5 million) which makes it technically similar to a bank.

2.2.3 Exemptions from the Banking Directive

The Banking Directive explicitly names those Member States – Ireland, Latvia, Lithuania, Poland and the United Kingdom – that have obtained exemptions from the Banking Directives for their respective Credit Union and Credit Cooperative movements, an exemption negotiated and granted at the time these Member States joined the EU²⁴. These are the Member States where these forms of savings-based microfinance have had the best opportunity to develop and expand.

In at least four other Member States – Hungary, Slovenia, Romania and Cyprus – the existing savings and credit cooperative movements were strong enough to opt for the creation of a central banking institution of their own, that would in effect be the carrier of their banking licence.

²¹ Directive 2006/48/EC of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast).

²² Member States have the possibility to grant an intermediate level of €1 million minimum capital in individual cases if they request this of the European Commission.

²³ This high access threshold apparently had the purpose of limiting the perceived "over-banking" in the then EC-12 countries, and was accepted at the time by both the savings bank and the cooperative bank federations involved in the consultations.

²⁴ Other typically exempted finance institutions are public development finance institutions.

2.2.4 Dealing otherwise with the deposit monopoly

The majority of microfinance institutions are forced to find other sources of funding, and the majority of these solutions have shortcomings, such as that they can only at best be solutions for the start-up and early development phase. Sooner or later there is a necessity for private initiatives to tap directly or indirectly into savers' money. Meanwhile solutions have consisted in:

- Donor and investor funds: the largest and most successful microfinance initiatives have all secured their funds either through major donors (e.g. from foreign aid or major foundations) or through various investors, who will not take part in early stage developments²⁵. While this capital may be enough to carry the MFI as far as envisaging becoming a bank eventually, the drawback is that many of these funds push for the maximisation of profits²⁶.
- The second most common solution is to partner with one or several banks either to raise funding through loans or to refer the microcredit clients directly to them (or a combination of both). The drawback here is that the credit income goes to the bank²⁷ and reduces the sustainability potential of the microfinancing institution. Also, this solution has legal limitations especially in those Member States with a credit monopoly (see next section) where microfinance institutions are not permitted to borrow in order to on-lend the funds to their clients²⁸.
- A third but far less commonly used solution is to work with member shares, as in the case of cooperatives. However there are legal uncertainties attached to how bank supervisors interpret and tolerate such activities, especially when a large number of shareholders are involved. There is usually a thin line that separates such activities from being seen as public calls for savings (i.e. deposit collection). And this solution is not applicable in Member States that practice a credit monopoly (see next section).
- Finally, there are some Member States that practice a limited degree of tolerance vis-à-vis member-based non-bank institutions. But the legal uncertainties underlying this form of supervision are very important and prevent such financial organisations from developing their activities adequately.

2.2 Regulation of lending activities

2.2.5 Member States with a credit monopoly

As can be deduced from the previous section, the EU Banking Directives' core attention is on deposit taking institutions. The activity of credit is not as such its focus, i.e. it is not regulated at the EU level. In other words, EU legislation does not require non-deposit taking financial institutions to have a banking licence. Financial organisations which lend out some capital of their own (e.g. share capital) are not targeted by the banking directives. This means that, a priori, microfinance institutions that lend out of funds other than savings are not restricted by EU legislation.

²⁵ Minimum investments are rarely below several hundred thousand euros and will only be invested in institutions with existing track records.

²⁶ Paradoxically, it is mostly the public investment institutions from Europe that create the strongest drive for profit, as in the case of Procredit Bank.

²⁷ There can be agreements that return this income to the microfinance institution, as in the case of the GLS Bank in Germany, which pays the accredited microfinance institutions a return depending on their performance.

²⁸ This was the case until recently for instance in France, where ADIE was not allowed to take up loans from banks to serve its own clients. This restriction was lifted recently.

However there are several Member States which also place legal restrictions on non-deposit-taking financial institutions, as a result of national banking legislation. Similar to deposit-taking activity at the EU level, some EU Member States have at their own level restricted any lending activity to banks as well. This is the case notably for Germany, which has served as an example for many other Member States, especially those that have joined the EU since the mid-1980s, such as Spain, Portugal²⁹, Greece and the Czech Republic. In these Member States, any systematic lending activity by a non-bank, even when based on the lender's own capital, is prohibited without a banking licence.

2.2.6 Dealing with the credit monopoly

In Member States with a bank monopoly on credit on top of the monopoly on deposits, there are very few options left for non-bank institutions wishing to practice microfinance other than to find a bank willing to cooperate with them. But the options for partnerships are few; the level of inertia in these Member States is generally high because of the dominant position legally given to the banks. This void can however also produce in some exceptional circumstances rather exemplary partnerships, such as in Germany with the support of the GLS Bank³⁰, an ethical bank that has enabled the creation of a microfinance network (DMI³¹) and an accreditation system giving access to loan capital, or a similar system in the Netherlands created with the help of the Dutch government that similarly put in place a wholesale funder (Qredits³²) through which local microfinance partners can access loan capital for their clients. Alternatively, the most viable solutions left are ones entirely developed by the banks themselves (as in Spain) or through government institutions (as in Finland, Sweden and until recently Germany).

2.3 The position of banks

A very important drive towards involving banks is generated by the legal environment that prevails in the majority of EU Member States. Excepting the few countries where there are exemptions from the EU Banking Directives (Ireland, UK, Poland, Latvia and Lithuania) it is left to banks only to collect deposits. Microfinancers are left little choice but to cooperate with a bank to mobilise credit funds (unless they can obtain them from governments or another sponsor) and are even more constrained to do so when there is also a bank monopoly on credit in addition to the monopoly on deposits (such as in Germany, Spain, Greece, Portugal, the Czech Republic, etc). In effect, the legal framework paradoxically puts banks at a strategic advantage, leaving it to them to decide whether any microfinance initiative may develop or not.³³ Ultimately, only government programmes and agencies or major sponsors (usually American) are left to take up the lead if there is no bank agreeing to do so.

²⁹ The legislation was recently modified in Portugal and finally allows micro-finance institutions to lend directly to their clients without any partner bank.

³⁰ www.gls.de

³¹ www.mikrofinanz.net

³² www.qredits.nl

³³ The credit monopoly explains for instance why there is no microfinance in the Czech Republic, Slovakia or Greece, and why Germany has been such a late starter (with the exception of the programmes of KfW, a public finance institution): until recently no bank was willing to partner with a microfinance institution to deliver its loans. It is only since the GLS Bank, an ethical bank, agreed to do so that microfinance could start emerging, resulting in nearly 50 new microfinance initiatives by the end of 2010 in Germany.

2.4 Categorisation of Member States

The legal pattern, as summarised in the table below, is that there are broadly three groups of Member States. There is a larger number of Member States (at least ten altogether) that apply a double banking monopoly, both on deposits (as prescribed in the EU Banking Directive) and on credits. Unsurprisingly, these are the Member States where microfinance has developed hardly at all (Czech Republic, Denmark, Greece), or very little (Austria, Portugal), or where it is almost exclusively practised by one government institution (Finland, Sweden). In general these are the Member States where microfinance will largely remain under-challenged: methodologies will remain the same over time or change only insignificantly, either out of lack of challenge, or because of the dominance of key partners or rules that keep the situation locked. But, as mentioned in the previous section, there are also a few exceptional cases where this most unfavourable environment has generated solutions of a higher quality and cohesion level (such as in Germany, the Netherlands and Spain).

At the other extreme are those Member States that have obtained an exemption for their savings and credit cooperatives, in addition to the freedom to practise non-banking lending. This is where the widest opportunity for developing a diverse microfinance sector exists, which is the case in Ireland (where Credit Unions reach out to 75% of the population), the UK (two large microfinance networks) and Poland (two large microfinance networks and probably soon a microfinance bank).

In between are the Member States that allow non-banks to extend credit, which leads to a diversity of results stretching from Member States with very little microfinance (Slovakia), to Member States with dynamic sectors (Bulgaria, France, Romania), sometimes with the presence of some dominant government agencies (Belgium, Hungary).

Table 7: Categorisation of EU Member States by their legislation on deposit-taking and credit (summary overview) ³⁴

MS with a bank monopoly on deposits <i>and</i> on credit	MS with a bank monopoly on deposits only	MS with an exemption from the EU Banking directive for credit cooperatives
Austria	Belgium	Ireland
Czech Republic	Bulgaria	Latvia ³⁸
Denmark	France ³⁶	Lithuania
Finland	Hungary	Poland
Germany	Italy	United Kingdom
Greece	Romania ³⁷	
The Netherlands	Slovakia	
Portugal ³⁵		
Spain		
Sweden		

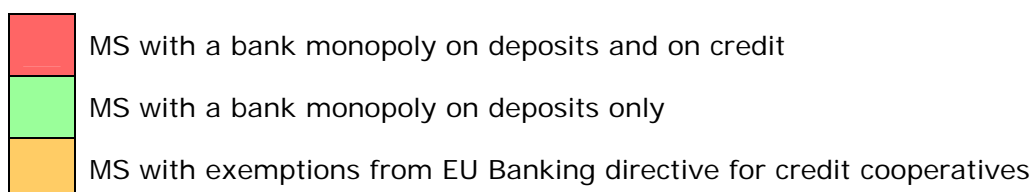
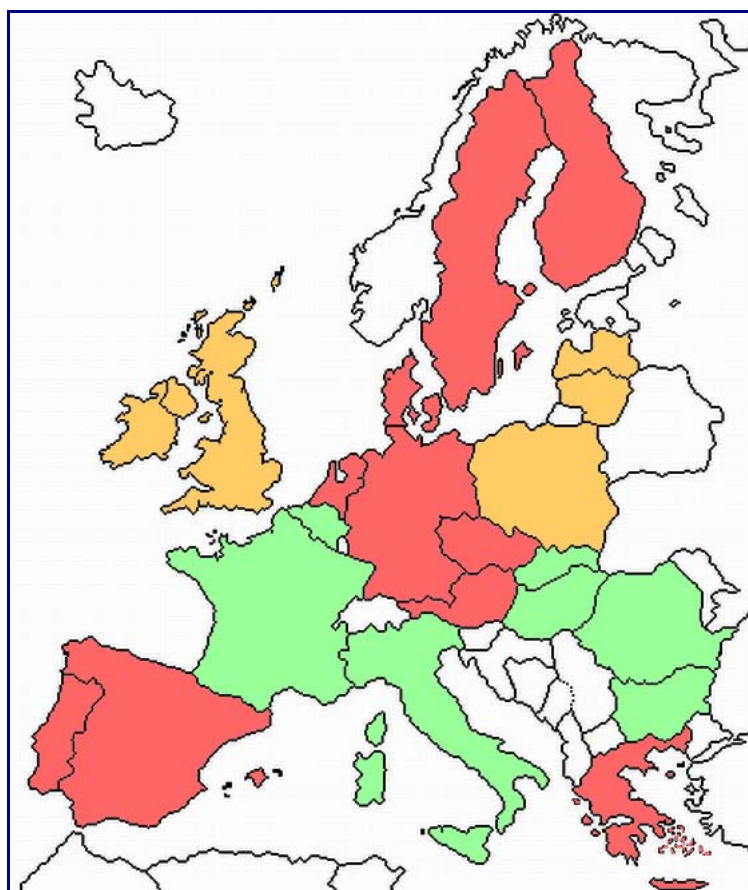
³⁴ Not included in this table are Malta, Estonia, Cyprus, Slovenia and Luxembourg, because of insufficient or conflicting information.

³⁵ Portugal has announced this year that it will lift the credit monopoly for microcredit institutions.

³⁶ France also has a credit monopoly in theory, but grants the possibility for microcredit institutions operating with low interest rates to work independently. In addition, the cap on interest has recently been eased.

³⁷ In fact Romania also has a bank monopoly on credits, but a special microfinance law allows specialised companies to operate independently nevertheless.

³⁸ It seems that Lithuania however also practises a bank monopoly on credit.



2.5 Regulation of interest

Interest and the way of providing loans are regulated by the EU consumer protection directive³⁹, which prescribes minimum binding rules as regards consumer information standards and interest calculation methods. The national credit consumer laws are usually a fair reflection of the EU directive, usually defining specific interest rate caps on the various forms of consumer products⁴⁰. However, as the name of the Directive implies, these prescriptions apply only to loans used for consumption purposes. Loans provided for professional purposes are explicitly not covered by this directive⁴¹. This means that microcredits for professional uses are not covered by this EU legislation, i.e. the EU does not regulate interest on microcredits in the strict sense which are used for income-generating purposes.

³⁹ Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements and consumers repealing Council Directive 87/102/EEC. Published in the OJ L133/66 on 22.5.2008

⁴⁰ National laws are most of the time complemented by decrees that contain the occasional revisions of the interest caps, depending for instance on changing inflation rate levels.

⁴¹ The Directive defines "consumer" as "a natural person who, in transactions covered by this Directive, is acting for purposes which are outside his trade, business or profession".

There are however some cases where microfinance institutions are subject to a cap on interest, which can be for various reasons:

- In the case of microfinance institutions that offer consumer-type loans such as personal loans and family loans, such as some of the institutions in Italy and Spain⁴², there is an obligatory application of the consumer credit law in these cases.
- Savings and credit cooperatives that finance both consumer and professional needs will likewise be required to apply the interest caps of the consumer law if their credit contracts do not differentiate the purpose of their loans. Often, this is an explicit choice of these organisations which prefer to submit themselves to the consumer laws for their members and clients.
- Likewise, microfinance institutions exclusively practising professional loans may, of their own choosing, opt to comply with the consumer regulation in spite of this carrying higher administrative costs⁴³. This is the case of the German microfinance network which wishes to send the message that they enforce high quality standards.
- Finally, in the specific case of France, which in principle has a bank monopoly on credit, exemptions to this monopoly are granted to institutions that provide loans at a low interest rate. The interest cap in this case is therefore not directly the result of a consumer protection law, but rather a consequence of the French banking law. This interest cap was however lifted in 2005 to enable institutions like ADIE to better cover their costs.

As can be seen, Member States or microfinance institutions are free to increase their consumer protection constraints, but this seems to be more the exception than the rule⁴⁴.

⁴² As in the case for instance of MicroBank in Spain (www.microbanklacaixa.com) or of Permico in Italy (www.permico.it)

⁴³ Consumer loan contracts involve a substantially higher amount of paperwork and require, since the latest revision of the Consumer Credit Directive in 2008, that the consumer be informed additionally on specific issues. This involves substantially higher staff costs for the finance providers.

⁴⁴ This statement is made in the knowledge of many EU reports stating that interest caps are a major issue for microfinance institutions in the EU (see for instance European Commission 2007), a statement that seems to be exclusively based on the case of France that was solved in 2005. All other country cases stated in these reports (Germany and Belgium in particular) seem to be based on erroneous confusion with the consumer loan regulation.

PART III - RESULTS OF THE SURVEY ON THE STATE OF MICROFINANCE IN EUROPE

3.1 Feedback on the EPMF

This section contains the feedback gathered from microfinance practitioners and stakeholders throughout Europe during the period of August to September 2010. The questionnaire was launched at the time when the call for expressions of interest for the EPMF guarantees had already been published for two months and had been presented and discussed at the London conference of the European Microfinance Network. There had a priori been time enough for the sector to take note of the opportunity, inquire about it and decide whether to respond to this support opportunity. However no call had yet been published regarding the other funding instruments, though some information was already published, to which the survey attracted attention. The information indicated in the previous section was already known, except for the senior loans.

3.1.1 Level of awareness of EPMF

As summarised in the next table, one third of the respondents had not heard of the European Progress Microfinance Facility. Considering that the main information media are the microfinance networks (half of those who knew had been informed by that route) it seems that membership of such a sector organisation makes an essential difference as regards being connected to information coming from the EU institutions. Still, one third of respondents had been informed through direct EU channels or through the media.

Table 8: Awareness of EPMF and sources of information

Number of valid respondents	81 ⁴⁵
Number of respondents not aware of EPMF	24 (35%)
Number of respondents aware of EPMF	44 (65%)
Sources of information (for those who were aware)	
Microfinance Networks	25 (51%)
EU institutions	11 (22%)
Media	6 (12%)
Word of mouth	5 (10%)
EU fund managers	1 (2%)
Other	1 (2%)

However institutions which are members of national networks only, or which are members of no microfinance network at all, are clearly less well informed. Their likelihood of knowing about the EPMF is only just above 50%, while those which are members of a transnational network show a likelihood of over 80% of knowing about the EU programme. This means that while the EU information channels need to include the transnational networks, EU policy makers need to broaden the scope of networking by including at least the national networks, where they exist, and possibly to increase the capacity of the sector organisations. Indeed several Member States had very poor response levels (e.g. Bulgaria,

⁴⁵ Respondents did not systematically answer all questions, which is why total responses per question may vary and not always add up to the total number of respondents.

Poland, Romania, Spain) in spite of there being fairly large numbers of MFIs and even, as in the case of Poland, a microfinance network.

Table 9: Awareness of EPMF correlated with network membership

Membership	Member of an EU network	Member of a national network only	Not member of a network	Total
Aware of EPMF	20 (83%)	13 (57%)	11 (52%)	44 (65%)
Not aware of EPMF	4 (17%)	10 (43%)	10 (48%)	24 (35%)
	24 (100%)	23 (100%)	21 (100%)	68 (100%)

3.1.2 Interest in the EPMF Guarantee

As summarised in the next table, a significant number of respondents (27%) intend to apply to the EPMF Guarantee offer, but about as many (31%) know that they will not do so. These latter also include those for whom this offer has no relevance, for instance because they are not a financial organisation, which reduces the relevant non-applicants by about half (and brings the percentage down to 18%). However the majority (50% when taking account only of the financial institutions) is as yet undecided.

Yet of all those financial organisations that will not apply or don't know yet, two-thirds (63%) do not consider EPMF guarantees to be relevant, because they already have other guarantees (30%), because guarantees are not what they need (26%) or because they prefer another of the EPMF offers (9%). There seems to be only one-third (35%) for whom an improvement of the offer could influence their participation: be it by making sure that the administrative burden remains limited or by paying attention to the selection criteria, which seem to exclude some significant organisations⁴⁶. The comments made by the respondents not counted above confirm most of the impressions so far: the majority still need to study the offer more closely, while the others say it is not relevant to them or that there is a problem concerning a lack of coordination with the national level.

Table 10: Interest in EPMF guarantees

do intend to apply	18 (27%)
do not intend to apply	21 (31%)
don't know yet	28 (42%)

If no intention to apply, or don't know yet, why not?

other guarantees available	7 (30%)
not a priority need	6 (26%)
administrative burden	6 (26%)
not eligible	2 (9%)
preference for other support	2 (9%)
not applicable	11 (-)

⁴⁶ E.g. such as France Initiative and Coop-Est, the latter being a wholesale (2nd tier) financier.

However a significant number of comments highlight the issue of scale: many are too small or too new to respond to the offer (although guarantees could precisely be the solution for them to grow), what others intend to solve through an application via their national network. However one comment underlines a missed remedy to this issue, which would be to work through wholesale institutions (who are a priori not eligible) that could bind the small-scale initiatives and link up with the MFIs that are isolated in countries where there is little microfinance or where the sector is not organised sectorally or where the sector organisation is too weak. In fact this pattern applies in one way or another to the vast majority of the Member States. This would require however that contrary to previous habits, the EPMF would be managed in a way to allow cross-country bids⁴⁷.

3.1.3 Interest in the EPMF funding facilities

The overall picture with regard to the EPMF funding facility is rather similar to the guarantee facility, with many additional comments that show that the level of uncertainty is higher in this case, due to the fact that information on the facility had not yet been published.

Among the quarter of respondents who intend to apply for this type of funding, over half (55%) seem to give priority to subordinated loans, followed by equity (30%). This is a surprising finding and in stark contradiction with what microfinancers have expressed in the next section as being their priority needs: this puts the need for capital at the top, a long way in front of loan funding (which comes out as the lowest priority need). An explanation of this contradiction can be found in the reasons why so many are hesitant or will not apply (see again next table), which show that by far the most common response is the unrealistic repayment horizon (50% of reasons). This means that they do not have a profitability level that would allow this and that the designers of EPMF have in mind. This confirms that microfinance is not sustainable in the classical banking sense, and that the classical standards of financial analysis are not good indicators of microfinance sustainability models.

The combined feedback on issues on administrative burden and comments about being too small to be eligible and attempting to access the funding via a sector organisation indicates again the issue of scale and the relevance of wholesale institutions, which again consider themselves here as non-eligible.

The availability of alternative funding at the national level is a fairly consistent feedback coming from the United Kingdom and Germany. This correlates with other feedback about the need to see the detailed EPMF conditions to make comparisons possible.

⁴⁷ Indeed the CIP micro-guarantee facility did not allow for such solutions as far as is known to us.

Table 11: Interest in EPMF funding

do intend to apply	17 (25%)
Which funding facility interests you most?	
Subordinated loans	11 (55%)
Mezzanine finance	3 (15%)
Equity	6 (30%)
do not intend to apply	20 (30%)
don't know yet	30 (45%)
If no intention to apply, or don't know yet, why not?	
Repayment time not realistic	22 (50%)
Other	10 (23%)
Availability of other funding	7 (16%)
Administrative burden	3 (7%)
Not eligible	2 (5%)
Not a priority	0 (0%)
Not applicable	8 (-)

3.2 Priority needs

In addition to collecting feedback on the proposed instruments of the EPMF, the survey has also adopted a direct approach towards identifying what the priority needs of the various microfinance institutions, or of the sector more generally, are⁴⁸. This gives the opportunity to get a sense of proportion as to how well the EPMF instruments compare with the sector's own priority, categorised in its own typical terms, in reaching out to as many people as possible.

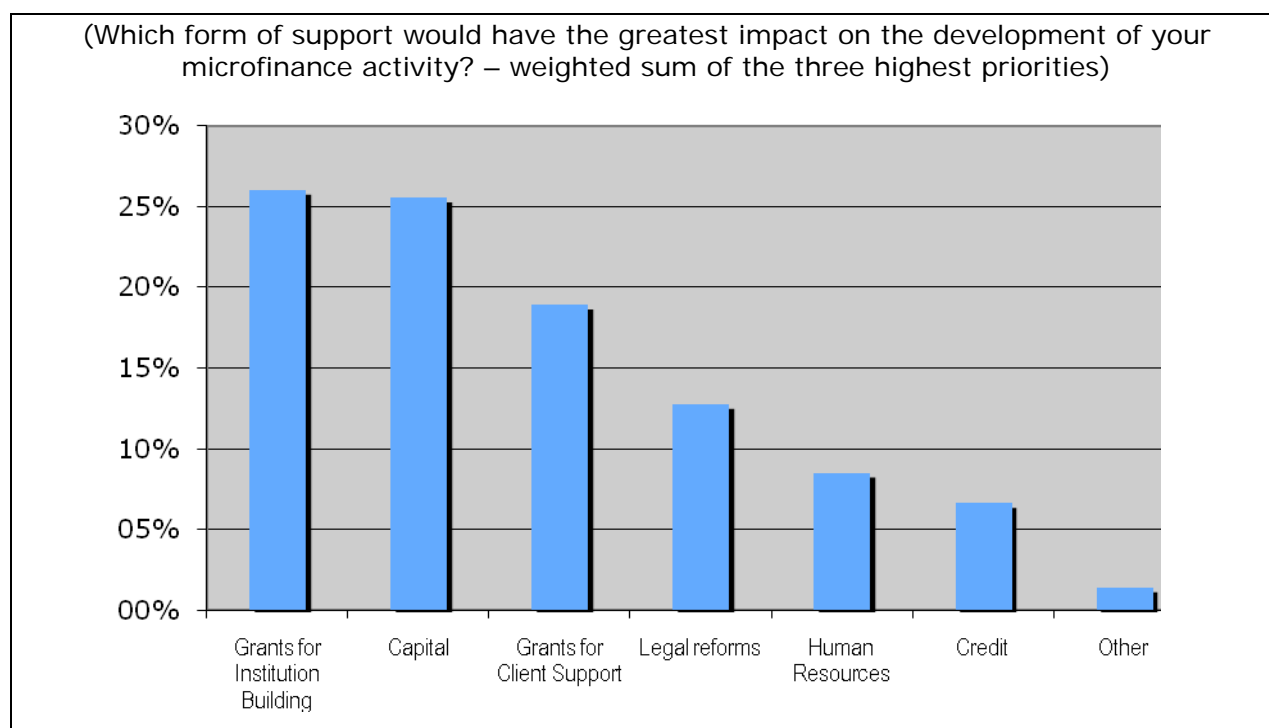
The results are quite challenging. While the responses confirm a high priority need for capital, what is very clearly needed in the first place is hard-core capital that helps to build up a microfinance institution. The need is not for transient funds, like loans, which are ranked as the lowest priority of all (see table and summary graph below). The need is neither for temporary equity capital, as we have seen in the previous section, which showed that there was little interest for the EPMF equity repayable after only 5 to 7 years. While some form of guarantees can serve, to a limited degree, as a substitute for risk capital, it seems apparent that the main EPMF instrument in the form of loans (whether senior or subordinated) does not meet the need of the sector. The greatest part of the sector does not have the maturity or the profitability that is implicitly expected through the EPMF. As for responses from banks or their foundations, they underline that it is not funds as such that they are in need of.

⁴⁸ The question asked in the survey was what kind of measures would have the highest impact on the development of the respondent's microfinance activity. Respondent were given three possible answers, ranked by order of impact. The question was also addressed to other stakeholders (i.e. not to practitioners alone) who were invited to give their opinion on the priority needs of the sector as a whole (the details of the survey questionnaire can be found in the annex).

Table 12: Priority needs of MFIs

(Question: which form of support would have the greatest impact on the development of your microfinance activity?)

	Grants for institution building	Capital	Grants for client support	Legal reforms	Human resources	Credit	Other
Highest impact	27%	32%	18%	15%	3%	4%	0%
2nd highest impact	27%	21%	19%	7%	13%	10%	3%
3rd highest impact	22%	13%	22%	16%	17%	7%	3%
Weighted total ⁴⁹	26.1%	25.6%	19.0%	12.8%	8.5%	6.6%	1.4%

Figure 3: Priority needs of MFIs

There is however a series of non-capital needs that come on top of the priorities, which are not as such proposed by the EPMF, nor by any other EU support measures at present. Ranked as the top priority, slightly in front of the need for equity, is the need for support for so-called “institution building”, i.e. funds that help a microfinance institution for instance to define its methodology, build up and train its staff, cover its start-up risks and costs, test and connect with its target groups, etc⁵⁰.

⁴⁹ The weighted total is the result of the addition of the highest, 2nd highest and 3rd highest impact support, respectively weighted with a multiplier of 3, 2 and 1.

⁵⁰ This form of funding can sometimes be found at least partially in the funding for pilot projects, which is however never large enough nor comprehensive enough to sufficiently cover this type of need of an early-stage MFI. As a comparison, Fundusz Mikro in Poland (www.funduszmikro.pl), which is seen as one of the best practice example in the sector in Europe, was set up with a \$5m fund for its institution building alone (including early-stage risk

This is, by the way, not the sort of support provided by the Jasmine programme, which offers Technical Assistance through external appraisals and ratings⁵¹.

Another non-capital form of support demanded by the survey respondents, ranked as the third priority some way behind the first two, is the need for grants that help to prepare, to appraise, to follow up and to monitor microfinance clients, considering the costs, the risks and the low return involved with serving these clients.

One further very significant need, especially expressed in Member States like Germany and Italy, is the need for legal reforms. This demand comes from both new and fairly well-established microfinance organisations, but it naturally does not include any feedback from non-existing microfinance institutions in places where the legal frame has prevented their existence.

While human resources merely rank as the fifth priority need altogether, their significance increases significantly when one considers the third priority need (see previous table), which means that when the first and second priority needs are covered and the primary conditions for growth are met, human resources very soon show up as the next bottleneck. This is particularly true, as one feedback comment underlines, in crisis areas to which it is difficult to find or attract good staff. It is also a need that is spotted at the sector level by the professional networks.

3.3 Additional comments from respondents

The comments that the survey respondents were invited to make about priority needs again underline some of the elements highlighted so far, such as the need for legal reforms that would make it possible to collect deposits as a non-bank, as well as consistently underlining the need for and the usefulness of funding for client support, and the sensitivity towards the weight of the administrative requirements involved in participating in government programmes.

There are in addition broadly two themes that stand out among the comments that deal on the one hand with policy and on the other hand with sector development:

- Research and awareness raising: several suggestions go in the direction of implementing public policy that would inform (e.g. through public information campaigns) potential clients about the opportunity of microfinance and in the direction of doing applied research on identifying the potential demand and the ways of connecting with it;
- Policy consistency: a few suggestions are made towards making policy choices more predictable, to increase the certainty and the visibility of policy actions, so that microfinance institutions can better position themselves. There is also demand for more integrated forms of support, i.e. support that combines the different complementary components in one package, in contrast to separate instruments that usually mutually exclude each other;

capital), before it was capitalised with a long-term loan fund of \$20m. The larger MFIs of Romania and Bulgaria have had similar institution building funds at their disposal. The only channel through which the EU has disbursed such forms of funding in a significant way is through the European Development Fund (EDF), which has served to set up some significant microfinance institutions in the developing world.

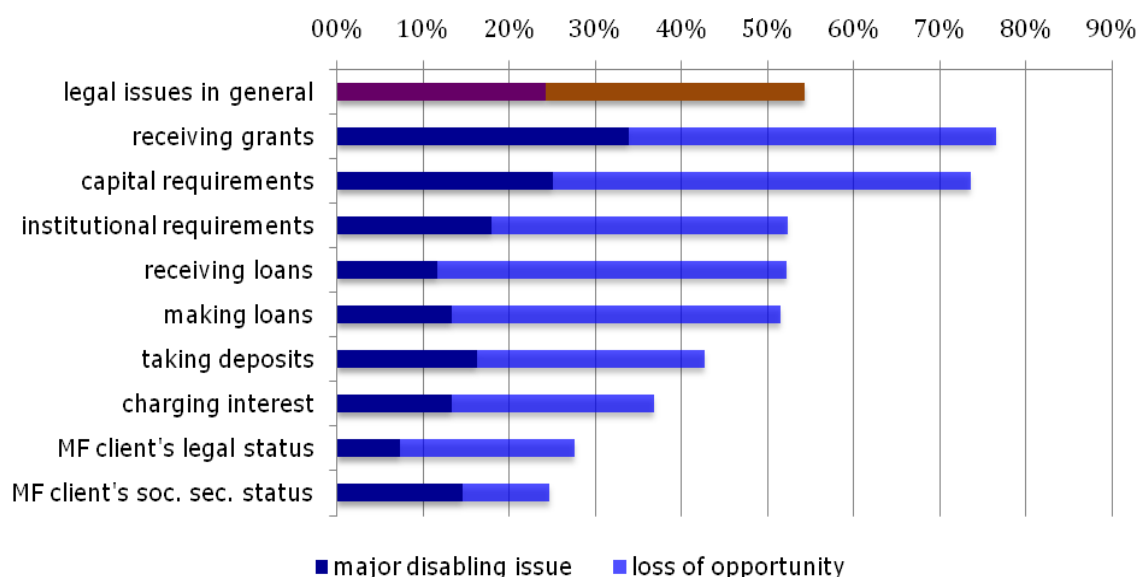
⁵¹ Discussions with Commission personnel during this study have shown that the concept of Institution Building is continuously confused with Technical Assistance, which is at best a very small part of the former.

- Coordination: especially in Germany and United Kingdom, comments also suggest that EU policy should be better coordinated with what exists already at the national level, to reduce redundancies and strengthen each policy through complementary actions;
- Banks: while some comments go in the direction of encouraging banks to get involved in microfinance either directly or through special partnerships with microfinance institutions, as many comments insist on the need to focus support less on the larger institutions and on banks (comments from Germany and Spain). These need not be contradictory recommendations. A similar comment comes from one of the largest microfinance institutions in Europe that operates on an interest-free basis yet generates every year more than half of the total number of jobs projected by EPMF⁵², which is not going to be eligible under EPMF due to the approach adopted by the EPMF.

3.4 Legal issues

The issues mentioned so far (regulation on deposit-taking, on credits, on interest) are not exhaustive, and there are many other legal and policy issues that affect microfinance. These are major hurdles that result in the non-existence of microfinance in many places and market segments. The survey conducted for this report among microfinance practitioners and stakeholders is a good indicator of the remaining issues, but is inevitably truncated in that it excludes all those initiatives that have failed to exist for legal reasons mentioned so far. Even so, the survey shows that, overall, legal and policy issues significantly affect existing microfinance institutions in Europe in over 50% of the answers provided (see more detailed results in next chapters) and in half of these cases in a very disabling way.

Table 13: MFIs experiencing legal and policy difficulties having to do with ...



⁵² The EPMF projects a total of 45,000 loans to be made through the entire intervention by 2017, notably thanks to the leverage of additional funds from transnational and national funding to form a total intervention of €500m.

Although caution should be exercised in interpreting the technical explanations behind the survey results, there are some major points to be drawn from it:

- The survey confirms, though as stated in a truncated way, the three issues discussed – receiving loans, making loans and taking deposits – and ranks them in 5th, 6th and 7th positions. For microfinance institutions that have succeeded in coming into existence, there are other issues that stand out as far more important;
- Ranked as the first legal and political issue (76% of respondents and 34% say this is a major disabling issue) is the fact that microfinance institutions experience difficulties in receiving grants: while this covers a diversity of situations, common problems have to do with the eligibility of microfinance due to the legal status of the institutions themselves (often a commercial status that is required or more credible when handling loans) that makes them ineligible for various forms of grants. This is even more true from a thematic point of view, when microfinance is categorised as part of business creation policy, in which it supposedly earns a return thanks to the interest charged on the loans (even though this is never enough to cover the costs).
- The second priority issue, ranked as almost as important as the preceding one (74% of respondents, amongst whom 25% say this is a major disabling issue), is the requirement for microfinance institutions to possess capital of their own, for instance as a condition of accessing loan funds⁵³. This is an even bigger handicap when dealing with microfinance institutions that intend to become banks, which are unable to accept loans because of over-leveraging issues. This invariably limits the microfinance sector's absorption capacity for loans.
- As for institutional requirements, which ranks as the third highest issue (52% of respondents, amongst whom 18% say this is a major disabling issue), there are numerous difficulties that can be listed here, such as the administrative requirements in the form of credit contracts, reporting and procedures. This is especially the case in Member States with a bank monopoly on credit, where microfinance institutions have to partner with a bank and thereby import procedures that have no obvious use for them. Anti-money-laundering procedures for instance make little sense in the case of credit-only financial institutions, yet are an obligatory requirement nevertheless.
- The issue of borrowing, from banks or from other sources, is an issue that ranks just as high as the latter (52% of respondents, amongst whom 12% say this is a major disabling issue): this can be an issue again in credit monopoly Member States where it may be prohibited for microfinance institutions to on-lend to their clients. Borrowing from other sources can be an issue as it can be assimilated to a public call for deposits which is illegal in all EU Member States for a non-bank. This again creates legal uncertainties and potential compliance costs.
- Issues related to the client's social or legal status are ranked last, which does not mean that they are negligible. Social security issues (a major issue in 15% of the cases) arise in relation with the abrupt loss of benefits, replaced in many EU Member States by social contributions non-related to the real income of the starting entrepreneur. This can add substantially to the risk of the start-up phase and the credit.

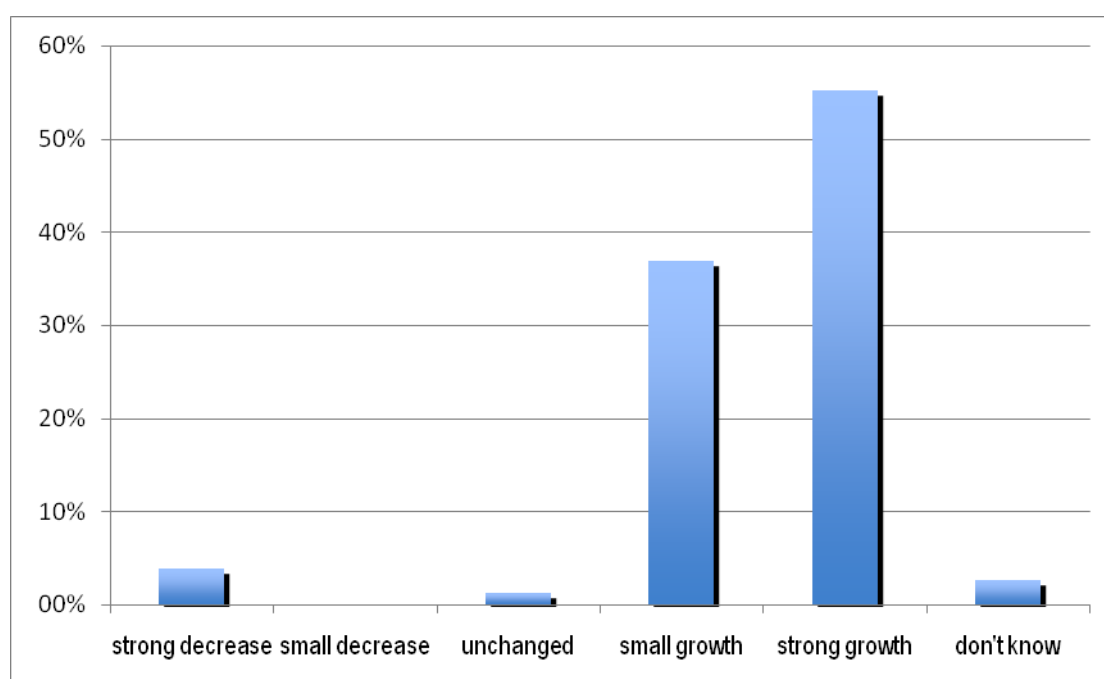
⁵³ This is for instance the main handicap experienced by the German microfinance institutions who are required to advance 20% of risk capital in order to access the German microcredit fund (www.mikrokreditfonds.gls.de).

3.5 Feedback on microfinance demand

The feedback obtained via the survey shows that the microfinance professionals perceive a substantially higher demand potential in their respective countries than most desk research comes up with. Over 55% of respondents state that there will be “strong growth” over the coming three years, and an additional 37% say that there is going to be growth, but at a more limited level. This constitutes a strong consensus of over 90% that demand will increase and that Europe’s microfinance sector is not yet close to reaching saturation. Whether this perspective builds on the context of economic crisis and the credit crunch, or whether it expresses the fact that the sector is still in early stage development, is not entirely clear.

Figure 4: Demand trends

Question: how do you see the likely evolution of demand for microfinance over the coming three years in your area of practice?



This perspective of high growth becomes even more obvious when microfinance practitioners and stakeholders are asked to evaluate the approximate total demand for microfinance in their respective countries. While those in Western European Member States situate the total number of potential users at levels between 0 and approximately 1% of the total population, those in the newer Member States situate the demand between 1% and 2% of the total population. Interestingly, the newcomers to microfinance, Germany and the Netherlands, have the most conservative views on potential demand, which arguably may confirm that the understanding of the specifics and the potential of this market grows through practice.⁵⁴

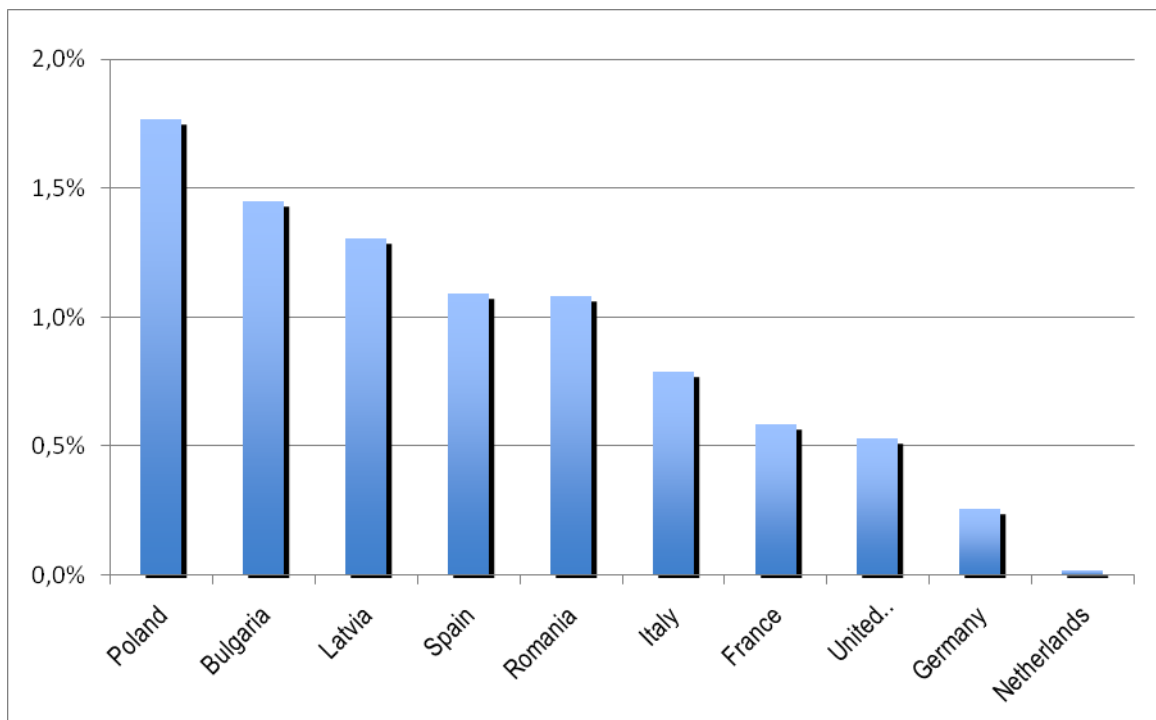
⁵⁴ It is commonly argued that demand in these countries is indeed lower than in other countries, thanks to well performing banking sectors and strong welfare systems. Yet other countries have similarly well developed banking infrastructures and in many ways similar social protection systems and still have identified a relevant demand for microfinance services.

While this method of evaluating demand by asking microfinance practitioners themselves can have flaws (e.g. potentially expressing group consensus rather than individually self-assessed evaluations, as well as weighing equally guesses of microfinance beginners with assessments of seasoned practitioners), it has the quality of being based on the views of practitioners as such, who probably are in a good position to see what demand looks like and to extrapolate what they see as realistically reachable at the field level⁵⁵.

Expressed in absolute figures, (see table below) this practitioner-based evaluation of demand would sum up to a total of about 3 million microfinance users for the 10 Member States that took part in the survey.

Figure 5: Quantitative Evaluation of Demand

Question: how large do you evaluate the demand for microfinance services, in terms of numbers of users, in your country of operation⁵⁶



⁵⁵ One can also be struck for instance by the demand evaluation made by new starters in the microfinance business who are still hesitant about their target groups and the nature of the demand. Many of the German microfinancers who are still in their first or their second year of existence tend to view potential demand below 100,000, or even 10,000 clients for the whole of the country, while the older practitioners more easily see the potential above 100,000 clients, or even 1 million.

⁵⁶ Answers are expressed in percentages of total population and are the average of the views expressed for each Member State.

Table 14: Quantitative Evaluation of Demand

Question: how large do you evaluate the demand for microfinance services, in terms of numbers of users, in your country of operation

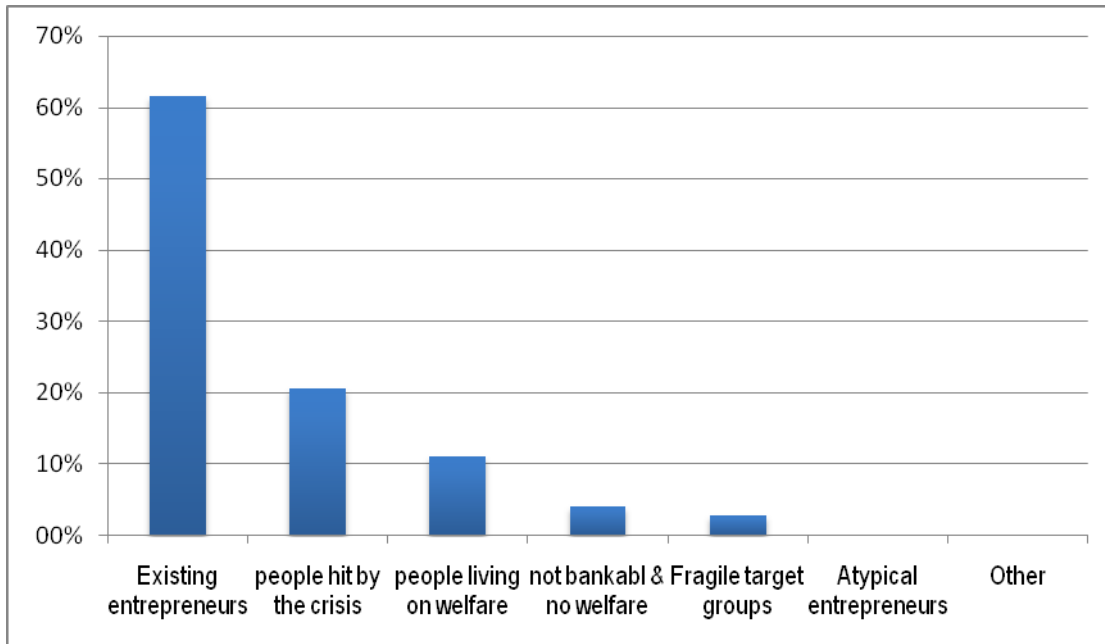
Member States	Average evaluation of potential demand	As a percentage of total population
Poland	675,000	1,8%
Bulgaria	110,000	1,5%
Latvia	30,000	1,3%
Spain	500,000	1,1%
Romania	230,000	1,1%
Italy	475,000	0,8%
France	375,000	0,6%
United Kingdom	325,000	0,5%
Germany	210,000	0,3%
Netherlands	5,000	0,02%
Total	2,935,000	

As regards the nature of the demand, the survey confirms (20% of responses) the perception that a significant number of potential microfinance clients are people that are newly unemployed and/or hit by the crisis and wishing to start a business. This is followed at some distance by the more classical microfinance target groups, people who are long-term unemployed or living on social benefits (12% of responses), or who are excluded both from welfare and the market (4% of responses) or who are part of typically fragile groups such as single parents, the young, migrants (4% of responses), who likewise intend to start an economic initiative. In fact, all the latter categories taken together add up to a similar demand potential (20%) as the crisis-hit people and the newly unemployed. This could be roughly interpreted as that the crisis has doubled the demand potential for microfinance in Europe, considering merely potential business starters alone.

However beyond the starters as such, microfinancers see (with 60% of the responses) an even bigger need among existing entrepreneurs. This is a reminder that microfinance is not only about the initial financing phase of entrepreneurship, but also very much about what happens after start-up. This is also an indicator of the significant financing gaps that exist in the needs chain stretching from start-up finance and complete bankability. Start-up finance represents only a part, even if significant, of the palette of financial services that are needed for a small business to stay alive, and to grow.

Figure 6: Nature of demand

Question: which categories do you see as the biggest sources for micro-financial needs?⁵⁷



⁵⁷ Respondents were given the possibility of giving two answers.

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USEFUL WEBSITES

EU Institutions

- European Commission webpage on EPMF: <http://ec.europa.eu/social/main.jsp?langId=en&catId=836>
- European Investment Fund webpage on EPMF: http://www.eif.org/what_we_do/microfinance/progress/index.htm
- European Commission DG Enterprise, Access to Finance: http://ec.europa.eu/enterprise/policies/finance/index_en.htm

Microfinance Networks (Europe)

- European Microfinance Network (EMN): www.european-microfinance.org
- European Network of Credit Unions (ENCU): www.creditunionnetwork.eu
- Microfinance Centre for Central and Eastern Europe and the New Independent States (MFC): www.mfc.org.pl

Microfinance Networks (National Level)

- Community Development Finance Association (CDFA): www.cdfa.org.uk
- Deutsches Mikrofinanz Institut (DMI): www.mikrofinanz.net
- Rete Italiana di Microfinanza (RITMI): www.microfinanza-italia.org

Microfinance Networks (National level, specialised networks)

- Association of British Credit Unions (ABCUL): www.abc.ul.org
- Central Federation of Romanian Credit Unions (FEDCAR): www.fedcar.ro
- Hungarian Microfinance Network: www.mvfportal.hu
- Irish League of Credit Unions (ILCU): www.creditunion.ie
- National Association of Co-operative Savings and Credit Unions, Poland (SKOK): www.skok.pl
- Red de Útiles Financieros Alternativos y Solidarios (RUFAS) http://www.economiasolidaria.org/redes/red_rufas

Other networks

- European Association of Mutual Guarantee Societies (AECM): www.aecm.be
- International Association of Investors in the Social Economy (INAISE): www.inaise.org
- Network of European Financial Institutions for SMEs (NEFI): www.nefi.be
- Women's World Banking (WWB): www.swwb.org

Selected Microfinance Institutions

- Grameen Bank: www.grameen-info.org
- Association pour le Droit à l'Initiative Economique (ADIE): www.adie.org

- Fundusz Mikro : www.funduszmikro.pl
- Finnvera: www.finnvera.fi
- MicroBank: www.microbanklacaixa.com
- Qredits: www.qredits.nl

Other relevant links

- Consultative Group to Assist the Poor (CGAP): www.cgap.org
- Fundacion Nantik Lum: www.nantiklum.org
- Microfinance Information Exchange (Mixmarket): www.mixmarket.org
- Mikrokreditfonds Deutschland: www.mikrokreditfonds.gls.de

ANNEX I. ONLINE SURVEY FORM

The survey aimed to gather data on the stakeholders' vision of the sector and on the issues and priorities set out in the call for proposals of the EPMF. Moreover, the questionnaire left space to issue open, free-form opinions.

The fieldwork was carried out between 17 September and 12 October 2010.

Survey methodology and implementation

The methodology used included two preparatory activities:

- The collection of names and addresses and the construction of a database of microfinance organisations to be invited to participate in the survey;
- The development of a questionnaire to be used to survey the contact persons/experts in the organisations identified.

Construction of a database of stakeholders

The first step was the compilation of a database of names and (e-mail) addresses of relevant organisations in the sector, including relevant:

- government agencies
- microfinance institutions
- social economy organisations (cooperatives, mutuals, associations etc.)
- banks, saving banks and ethical banks
- networks
- advocacy organisations
- research and development bodies
- consultants, trainers and service providers

The main method used to collect information was over the phone and through Internet searches. All addresses, organisations and contact persons were included in a uniform way within an overall database. The e-mail addresses were transferred into an Excel database, ready-made for the fieldwork. In total the addresses of 316 organisations and individuals within those organisations were collected in this way.

Development of the questionnaire

The development of the questionnaire ran parallel to the construction of the database of stakeholders. This was done in several steps:

- a first draft of the questionnaire was elaborated by the director of the study;
- the draft questionnaire was discussed with the team members of the study;
- the draft questionnaire was tested with several selected stakeholders;
- comments and amendments were assembled and included in a definitive version of the questionnaire;
- the final English-language questionnaire was translated into French and Spanish;

- the final questionnaire text was put online and tested in three separate language versions (English, French and Spanish);

Structure of the questionnaire

The questionnaire contains blocks of questions about the following subjects:

- participant information (type of organisation, nationality, etc.)
- potential demand
- vision for microfinance in Europe
- role of the government
- priorities and bottlenecks
- legal, regulatory and policy environment
- preliminary assessment of the applicability of the EPMF

Results

In total 316 invitations were sent out, divided into two batches. Typically, 10-15% of survey letters sent are not received for various reasons: spam filters, corporate blocking of websites outside the organisation, etc. The average time required to fill in the questionnaire completely was 15-20 minutes.

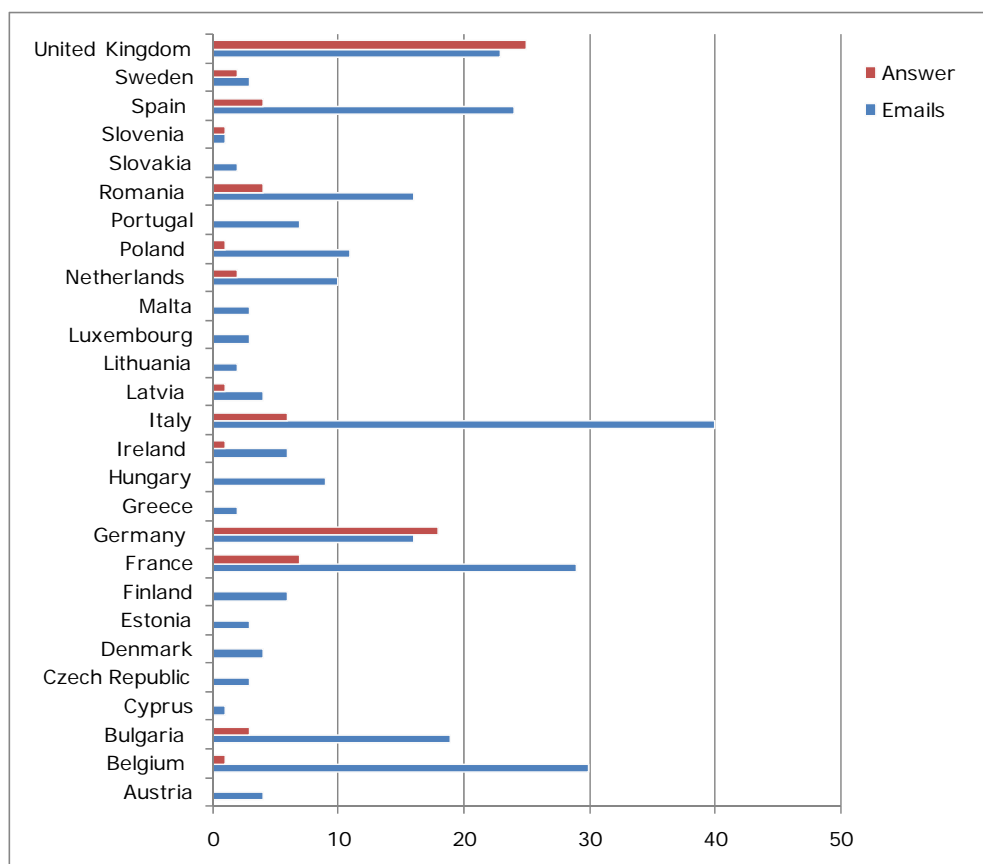
The survey achieved a response rate of 26 per cent. The response of 81 fully completed questionnaires across many Member States and types of actors in the microfinance sector in EU allows a reliable insight to be obtained, although it cannot be said to be statistically representative.

More answers were received than e-mail addresses compiled in Member States such as UK and Germany, as a result of recipients forwarding the questionnaire to other interested parties in other organisations within the same national network.

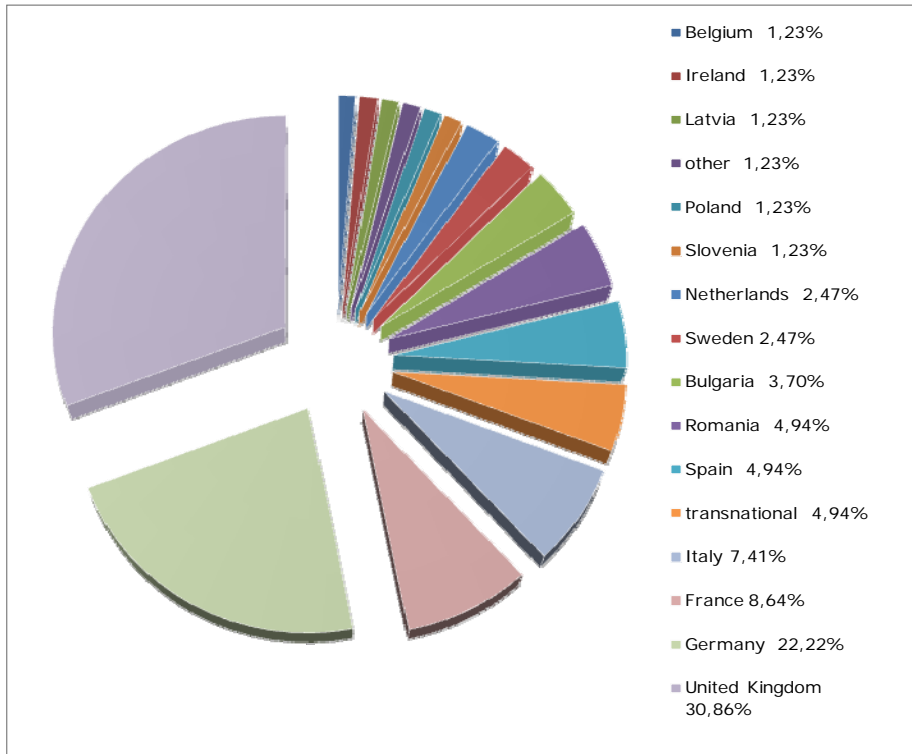
E-mails sent and answers received per country

Country	E-mails	Answers
Austria	4	0
Belgium	30	1
Bulgaria	19	3
Cyprus	1	0
Czech Republic	3	0
Denmark	4	0
Estonia	3	0
Finland	6	0
France	29	7
Germany	16	18
Greece	2	0
Hungary	9	0
Ireland	6	1
Italy	40	6

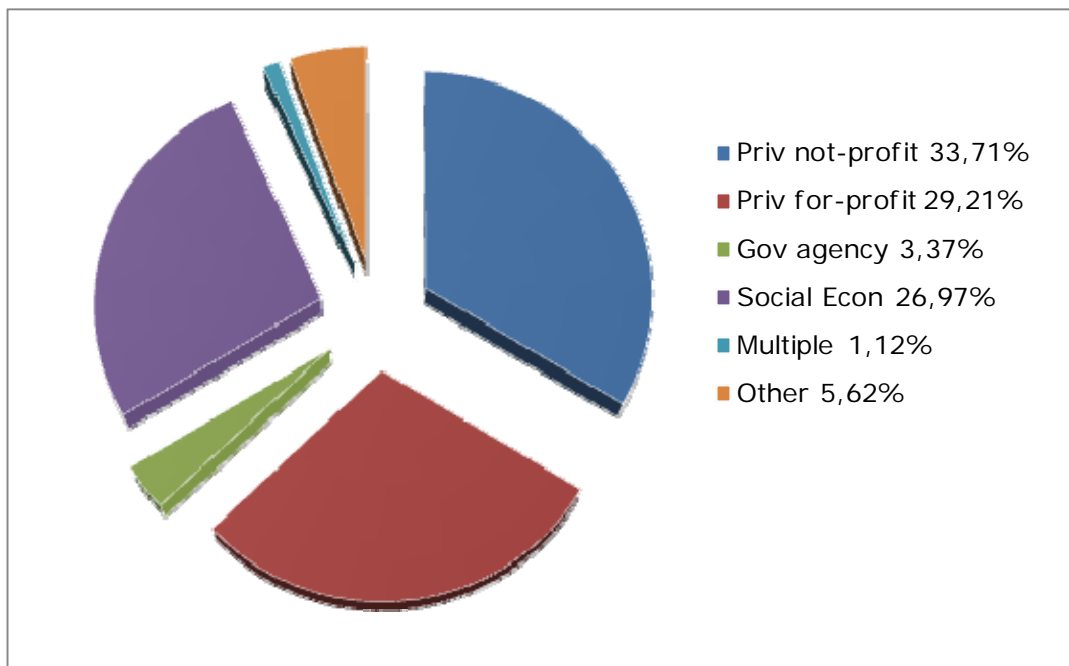
Country	E-mails	Answers
Latvia	4	1
Lithuania	2	0
Luxembourg	3	0
Malta	3	0
Netherlands	10	2
Poland	11	1
Portugal	7	0
Romania	16	4
Slovakia	2	0
Slovenia	1	1
Spain	24	4
Sweden	3	2
United Kingdom	23	25



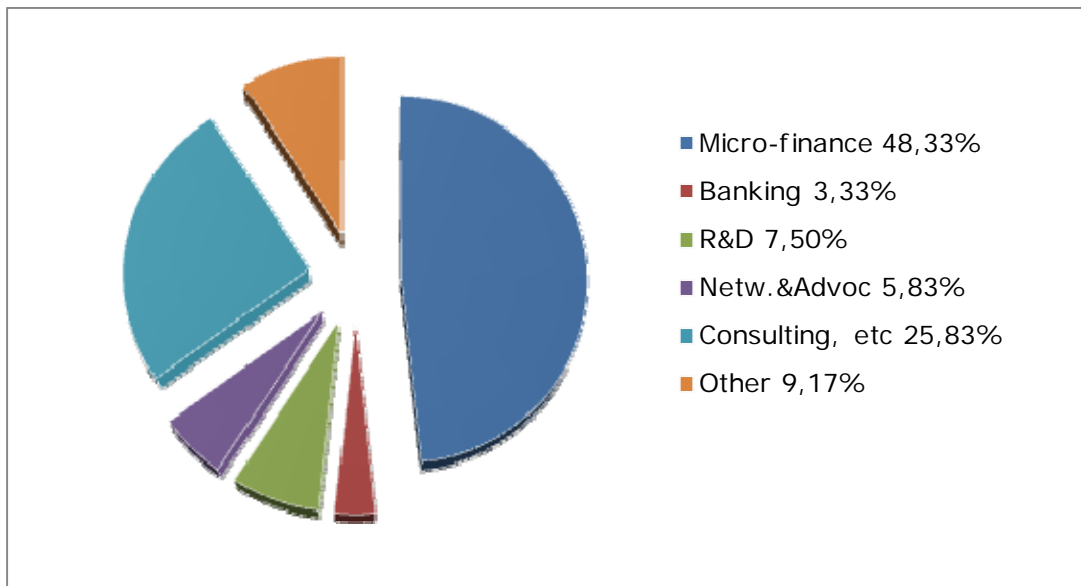
The number of answers per Member State shows a large variation. Thus, most answers were received from the United Kingdom (25), Germany (18) and, some way behind, France (7) and Italy (6).



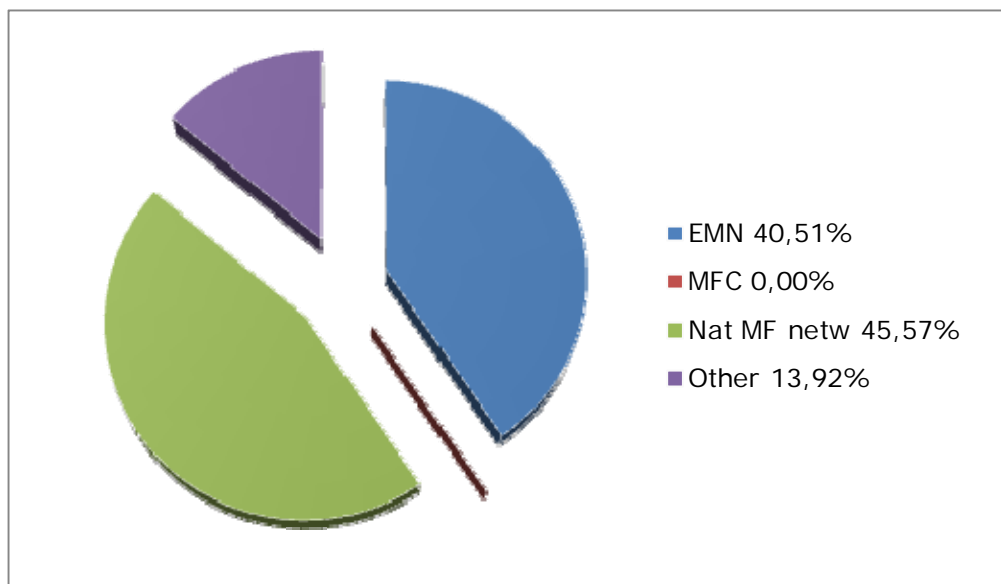
Answers can mainly be grouped into three categories by type of organisation: first, non-profit organisations (30 answers), followed by for-profit organisations (26) and, close behind, organisations in the social economy (24).



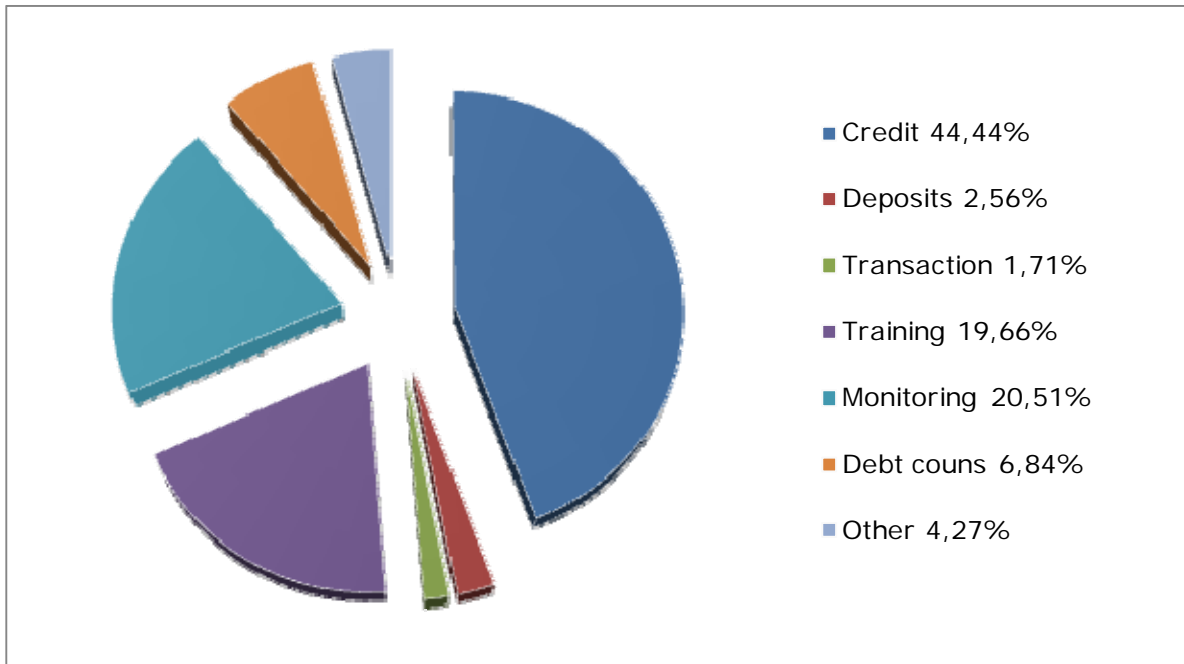
Microfinance is the predominant activity of practically half of the organisations answering the survey, followed at a distance by organisations whose main activity is consulting in this sector (one quarter).



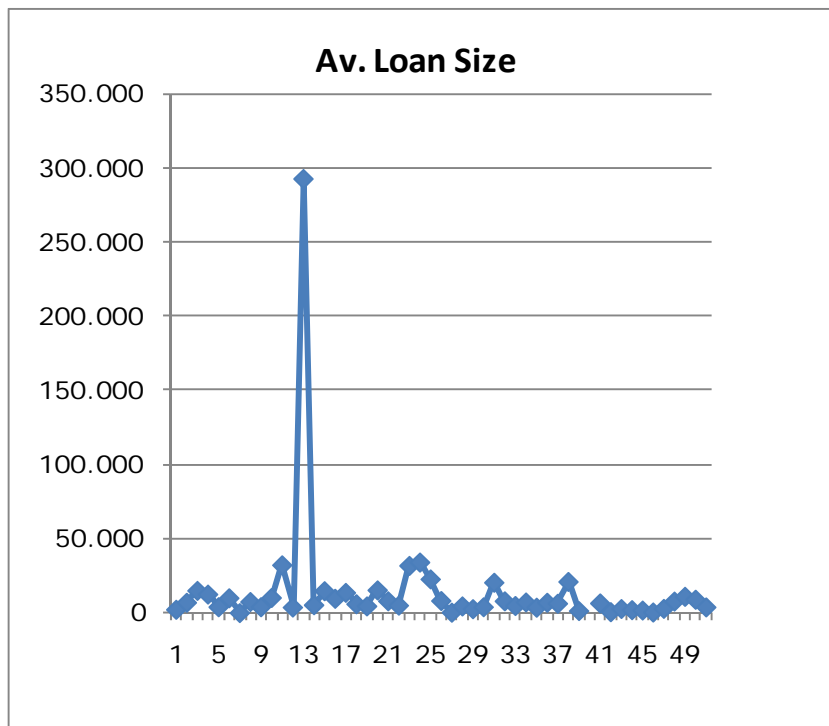
Most of the answers received (36) are from organisations that are part of national microfinance networks; also, a significant number are members of EMN (32).



The main service offered by the organisations answering the survey is offering microfinance services (52 out of 81). One-fifth of the organisations offer training and monitoring services, whilst a small proportion is dedicated to deposit taking and other financial transactions.



Most organisations offering loans do so for an average amount below €10,000.



ANNEX II. EPMF QUESTIONNAIRE

1. Identification & activities

Name of the Organisation (optional) _____

Name of the respondent (optional) _____

Function of the respondent (optional) _____

E-mail address (optional) _____

Type of organisation

Private not-for-profit

Private for-profit

Government agency

Social Economy (cooperative, mutual, associative, ...)

Multiple status

Other _____

Type of main activity

Microfinance

Banking

Research & development

Networking & advocacy

Consulting, training & service provision

Other _____

Network membership

EMN

National microfinance network _____

MFC

Other relevant networks _____

Country of practice

Austria

Czech Republic

France

Ireland

Luxembourg

Portugal

Spain

Other _____

Belgium

Denmark

Germany

Italy

Malta

Romania

Sweden

Bulgaria

Estonia

Greece

Latvia

Netherlands

Slovakia

United Kingdom

Cyprus

Finland

Hungary

Lithuania

Poland

Slovenia

Transnational

In case you are a Microfinance organisation, please indicate your type of services

- | | |
|--|--|
| <input type="checkbox"/> Credit | <input type="checkbox"/> Transaction and transfer services |
| <input type="checkbox"/> Deposits | <input type="checkbox"/> Debt counselling |
| <input type="checkbox"/> Business training | <input type="checkbox"/> Other _____ |
| <input type="checkbox"/> Business monitoring | |

- | | |
|---|----------------------|
| Number of loans delivered in 2009 | <input type="text"/> |
| Average size of loans in 2009 (€) | <input type="text"/> |
| Percentage of women clients in 2009 | <input type="text"/> |
| Percentage of clients above 50 years of age in 2009 | <input type="text"/> |
| Percentage of clients below 25 years of age in 2009 | <input type="text"/> |
| Percentage of clients that were initially unemployed among all those financed in 2009 | <input type="text"/> |

2. Potential Demand

2.1 Quantitative Evaluation: how large do you evaluate the demand for microfinance services, in terms of numbers of users, in your country of operation

- | | |
|--|--|
| <input type="checkbox"/> Less than 1.000 | <input type="checkbox"/> Between 1.000 and 10.000 |
| <input type="checkbox"/> Between 10.000 and 50.000 | <input type="checkbox"/> Between 50.000 and 100.000 |
| <input type="checkbox"/> Between 100.000 and 350.000 | <input type="checkbox"/> Between 350.000 and 1 million |
| <input type="checkbox"/> More than 1 million | <input type="checkbox"/> Don't know |

2.2 Trends: how do you see the likely evolution of demand over the coming three years in your area of practice?

- | | |
|--|---|
| <input type="checkbox"/> Strong decrease | <input type="checkbox"/> Small decrease |
| <input type="checkbox"/> Unchanged | <input type="checkbox"/> Small growth |
| <input type="checkbox"/> Strong growth | <input type="checkbox"/> Don't know |

Nature of Demand: which categories do you see as the biggest sources for micro-financial needs? (maximum two choices)

- Existing self-employed and micro-entrepreneurs in general
- People hit by the crisis wanting to start a business (newly unemployed, people at risk of being made redundant,...)
- People living on welfare wanting to become self-employed (long term unemployed, people living on social benefits, ...)
- People both at the margin of banking and welfare (migrants, ...)
- Professionally and socially fragile categories (young people, elderly professionals, single parents ...)
- Atypical forms of business (not-for-profit businesses, ...)
- Other _____

3. Vision for Microfinance in Europe

Microfinance paradigms: which of the following affirmations comes closest to your belief about what microfinance is about and who it is for?

Microfinance is not for everyone: it is for those who, though experiencing difficulties with accessing capital, are able to create and develop viable businesses. When a microfinance institution experiences repayment difficulties it should focus on better selecting those who are the real entrepreneurs and on training them to improve their chances of success. (Microfinance is for entrepreneurs)

Microfinance should be granted to everyone, especially to the disadvantaged: all people should be given the chance to create an income-generating activity. The belief that only some people are born to be self-employed is a myth. Higher risks and costs are an aspect that have to be coped with and which probably will not be solved completely in a European context. These issues should however be tackled primarily by improving guidance, training and monitoring as well as adapting the financial services, but not by increasing selectivity and focussing somehow only on the best of the clients. (Microfinance is for the excluded)

Microfinance is above all a financial service that focuses on delivering an accessible (which is not equal to low cost) and low risk financial service. The focus is on the credit itself and its repayability. The smallness of the loans is part of this risk reduction which means that, while microfinance is designed to be widely accessible by everyone, it is restrictive in terms of the size and nature of projects that can be financed. (Microfinance is accessible finance, but not suited for everything)

Role of Government

Please indicate how these affirmations coincide with your view on the role of Government:

All microfinance is ultimately part of banking and should eventually be based on self-sustaining financial institutions. Government's role should consist in creating the risk and cost-reducing incentives for banks to engage in this area. Beyond what banks can do, it is the government's role to take care of the non-bankable.

- | | |
|--|---|
| <input type="checkbox"/> totally agree | <input type="checkbox"/> rather agree |
| <input type="checkbox"/> rather disagree | <input type="checkbox"/> totally disagree |
| <input type="checkbox"/> don't know | |

Microfinance is a financial innovation and is part of a dynamic that cannot be reduced to banks. If banks develop an interest in microfinance, it is because they are challenged by these new players and their innovations serving the bottom end of the market. It should be the role of Governments to stimulate through institution building grants and similar incentives the entry of new players where the market is failing or served inadequately.

- | | |
|--|---|
| <input type="checkbox"/> totally agree | <input type="checkbox"/> rather agree |
| <input type="checkbox"/> rather disagree | <input type="checkbox"/> totally disagree |
| <input type="checkbox"/> don't know | |

Microfinance serves (also) people whose cost and risk profile cannot be served in a self-sustaining way in the context of Europe: this is the case where microfinance is a tool for "new welfare". At least in these cases there is a need both for institution building support but also continuous aid for appraising and following up such clients.

- | | |
|--|---|
| <input type="checkbox"/> totally agree | <input type="checkbox"/> rather agree |
| <input type="checkbox"/> rather disagree | <input type="checkbox"/> totally disagree |
| <input type="checkbox"/> don't know | |

Microfinancial services used to be delivered through non-profit maximising financial institutions of the social and local economy such as credit cooperatives and savings banks. The majority of microfinance clients are people who are actually bankable but not profitable enough to be serviced by mainstream banks. It should be the government's role to enable the legal existence of people-based financial institutions that do not seek the maximisation of profit.

- | | |
|--|---|
| <input type="checkbox"/> totally agree | <input type="checkbox"/> rather agree |
| <input type="checkbox"/> rather disagree | <input type="checkbox"/> totally disagree |
| <input type="checkbox"/> don't know | |

4. Priority Needs and Bottlenecks

4.1 Bottlenecks: What are the priority issues with regard to growing your Microfinance Institution? (NB: if you are not a microfinance institution, please indicate what you consider as a priority issue for your country as a whole)

Issues with the Legal, Regulatory and policy framework (imposing institutional requirements, constraints on lending, constraint on deposit taking, etc):

- Minor issue / not an issue
- Significant issue causing some loss of opportunity
- Major issue with obstructing effects

Access to Capital

- Minor issue / not an issue
- Significant issue causing some loss of opportunity
- Major issue with disabling effects

Access to Loan funding

- Minor issue / not an issue
- Significant issue causing some loss of opportunity
- Major issue with disabling effects

Access to grant funding for "institution building" (technology, market exploration, R&D, methodology development, start-up risk, infrastructure, etc)

- Minor issue / not an issue
- Significant issue causing some loss of opportunity
- Major issue with disabling effects

Access to grant funding for on-going client support (costs for training, appraisal, accompanying, etc)

- Minor issue / not an issue
- Significant issue causing some loss of opportunity
- Major issue with disabling effects

Human resources

- Minor issue / not an issue
- Significant issue causing some loss of opportunity
- Major issue with disabling effects
- Other major issue _____

4.2 Explanations & Comments: please give us in a few words some additional information on some of the major issues you have highlighted above

4.3 Support Leverage: which form of support would have the greatest impact on the development of your Microfinance activity (select the three best support measures by order of priority) ? NB: if you are not a microfinance institution, please select the answers that are relevant for your country as a whole.

Which support measure would have the highest impact on your Microfinance activity

- Changes in the legal and regulatory framework
- Capital investment
- Debt finance
- Grant funding for "institution building"
- Grant funding for on-going client support
- Human resources
- Other _____

Comments (precision on the condition or the purpose of the support, etc)

Which support measure would have the second highest impact on your Microfinance activity

- Changes in the legal and regulatory framework
- Capital investment
- Debt finance
- Grant funding for "institution building"
- Grant funding for on-going client support
- Human resources
- Other _____

Comments (precision on the condition or the purpose of the support, etc)

Which support measure would have the third highest impact on your Microfinance activity

- Changes in the legal and regulatory framework
- Capital investment
- Debt finance
- Grant funding for "institution building"
- Grant funding for on-going client support
- Human resources
- Other _____

Comments (precision on the condition or the purpose of the support, etc)

5. Legal, regulatory and policy environment

5.1 Are there legal, regulatory or policy issues that hinder or reduce your ability to start or to develop your Microfinance practice in your country?

Issues with Institutional requirements:

- Minor issue / not an issue
- Significant issue causing some loss of opportunity
- Major issue with disabling effects

Issues with Capital requirements

- Minor issue / not an issue
- Significant issue causing some loss of opportunity
- Major issue with disabling effects

Issues with Taking up loans

- Minor issue / not an issue
- Significant issue causing some loss of opportunity
- Major issue with disabling effects

Issues with receiving grants / subsidies

- Minor issue / not an issue
- Significant issue causing some loss of opportunity
- Major issue with disabling effects

Issues with Deposit taking activity

- Minor issue / not an issue
- Significant issue causing some loss of opportunity
- Major issue with disabling effects

Issues with Lending activity

- Minor issue / not an issue
- Significant issue causing some loss of opportunity
- Major issue with disabling effects

Issues with Interest and other costs chargeable to microfinance clients

- Minor issue / not an issue
- Significant issue causing some loss of opportunity
- Major issue with disabling effects

Issues with Social security and tax status of microfinance clients

- Minor issue / not an issue
- Significant issue causing some loss of opportunity
- Major issue with disabling effects

Issues with Legal status of microfinance clients

- Minor issue / not an issue
- Significant issue causing some loss of opportunity
- Major issue with disabling effects

Other major issues with regard to the legal, regulatory and policy environment:

5.2 Explanations & Comments : please give us in a few words some additional information on some of the major issues you have highlighted above

6. European Progress Microfinance Facility (EPMF)

6.1 Awareness: were you aware of the Progress Microfinance Facility (EPMF) before completing this survey?

- Yes
- No

6.2 If yes, how were you informed about the EPMF? (multiple choices possible)

- Media (press, TV, radio, web news)
- News / Mailing from the EU institutions
- News / Mailing from national EU fund management authorities
- News / Mailing via Microfinance federation / network
- Word of mouth
- Other _____

6.3 EPMF Guarantee facility: the programme is offering a 75% guarantee to serve vulnerable target groups. The call for proposals is now open and ongoing until 2013 (for more information on this facility, see: http://www.eif.org/what_we_do/microfinance/progress/Progress_Microcredit_Guarantees_3.htm). Do you intend to apply to the call on guarantees?

- Yes
- No
- We don't know yet

6.4 If not, why not? (multiple choices possible)

- Not relevant for us (we are not a financial institution)
- We are not eligible
- We have apprehensions vis-à-vis the administrative burden of the application and the management of the support
- Guarantees are not a priority need for us
- We have access to other guarantee facilities (e.g. at national level)
- We have a preference for the other EPMF funding facilities
- We have access to other support measures that are preferable to guarantees
- Other _____

6.5 EPMF Funding facility: in addition to guarantees, the EPMF will offer in the second half of the year funding facilities mainly in the form of subordinated loans, but also to a lesser degree in the form of mezzanine finance and equity funding. All are repayable within 5 and 7 years. Funding can be granted below market rates. More information on this funding facility will be available later in the year here: http://www.eif.org/what_we_do/microfinance/progress/index.htm. Do you intend to apply for this funding facility?

- Yes
- No
- We don't know yet

6.6 If yes (or don't known yet), which of the funding possibilities might you be most interested in?

- Subordinated loans
- Mezzanine funding
- Equity funding

6.7 If not, why not? (multiple choices possible)

- Not relevant for us (we are not a financial institution)
- We are not eligible
- We have apprehensions vis-à-vis the administrative burden of the application and the management of the support
- These forms of funding are not a priority need for us
- The repayment conditions are not realistic for our Microfinance activity
- We have access to other funding facilities (e.g. at national level)
- Other _____

6.7 EPMF Feedback: what questions, suggestions or alternatives do you want to address to the EPMF to help improve your outreach even better??

Comment:

Thank you!

We thank you for your cooperation.

DIRECTORATE-GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT ECONOMIC AND SCIENTIFIC POLICY **A**

Role

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