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Accompanying document to the

DECISION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

establishing a European Microfinance Facility for Employment and Social Inclusion (Progress Microfinance Facility)

EX-ANTE EVALUATION

{COM(2009) 333 final}

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INTRODUCTION

The present ex-ante evaluation[1] follows the announcement by the Commission in its recent communication on "A Shared Commitment for Employment"[2]:

To offer a new chance to the unemployed and open the road to entrepreneurship for some of Europe's most disadvantaged groups, including the young, the Commission will shortly propose a new EU microfinance facility for employment, to develop micro-enterprises and the social economy. By reallocating EUR 100 million from the existing budget which could leverage more than EUR 500 million, in a joint initiative with international financial institutions particularly the EIB Group, this new facility will extend the range of targeted financial support to new entrepreneurs in the current context of a reduced credit supply. Founders of microenterprises will also be supported by mentoring, training, coaching and capacity building, in addition to interest-rate support by the ESF.

This announcement is in line with the Communication of 20 November 2007[3] in which the Commission presented a European initiative for the development of micro-credit in support of growth and employment. The Communication identified four priority areas for action: improving the legal and institutional environment in the Member States, changing the climate in favour of employment and entrepreneurship, promotion of best practises and providing addional financial capital for new and non-bank microcredit finance institutions.[4] As a first step in implementing this agenda, the Commission and the European Investment Bank (EIB) created JASMINE in 2008 which it provides mentoring for non-bank microcredit finance institutions and a financing window for a global amount of EUR 20 Mio offered by the EIB.

The European Parliament in its resolution of 24 March 2009 requested that the Commission reinforces its efforts to develop microcredits in support of growth and employment and offered an additional EUR 5 Mio of support for a pilot action to be implemented in the context of the JASMINE framework. The European Parliament called on the Commission to cofinance projects for microcredits in particular for disadvantaged target groups.

Micro-credit in the EU means loans under EUR25,000[5]. It is tailored for micro-enterprises, employing less than 10 people[6] (91% of all European enterprises), and unemployed or inactive people who want to go into self-employment but do not have access to traditional banking services.

1 This ex-ante evaluation has been prepared by the Commission's Employment, Social Affairs and Equal Opportunities DG in close cooperation with the other most concerned Commission services: the Economic and Financial Affairs DG, Enterprise and Industry DG and the Regional Policy DG. The report benefitted from important input received from the EIF and the EIB and uses the latest data available with regard to the micro-finance sector in the EU.

2 COM (2009) 257, 3.6.2009

3 A European initiative for the development of microcredit in support of growth and employment, COM(2007) 708 final /2.

4 COM(2007) 708.

5 A European initiative for the development of microcredit in support of growth and employment, COM(2007) 708 final /2.

6 Recommendation 2003/361/EC regarding the SME definition (OJ L 124, 20.5.2003, p. 36).

1. PROBLEM DEFINITION

The positive employment growth of 6 million during 2007/8 has been totally reversed by the economic crisis and Europe is now being confronted with very high levels of unemployment increase – possibly as much as 2.5 million in 2009 and 3.0 million in 2010.

Recent data from the Bank for international settlements shows a dramatic fall in outstanding loans accounting for more than EUR1.98bn. This is the most significant reduction ever recorded in the history in a single quarter[7]. The slowdown in lending points to the still tight credit conditions facing businesses and individuals, serving as a warning that while recovery is emerging in the economy, low levels of lending by banks and borrowing could have a negative effect. In addition, national central banks report on falling lending to companies and households.

The combination of the general credit squeeze with the increasing levels of unemployment means that people who would like to either become self-employed or start a micro enterprise cannot do so. Further, vulnerable groups[8] have insufficient access to micro-credit as main stream banks in particular consider them as too risky and cost intensive (the latter due to the relative small size of loans). However, most Member States have public institutions which offer finance to SMEs and individual entrepreneurs including micro-loans.

1.1. High potential demand for micro-credit not met

Micro and small enterprises form the core of the Western European economic system. 99% of the 2 million start-up enterprises that are created every year are micro or small enterprises. One third of these enterprises are launched by the unemployed.[9]

With regard to the job-creation potential of loan/micro-credit guarantee instruments existing evaluation evidence of the Growth and Employment initiative[10], suggests that the loan/ micro-credit window on average created 1.2 jobs per assisted SME. Only one in seven SMEs receiving guaranteed credit via the micro-credit window reported that alternative sources, covering the full amount of loan, were available to them which shows that the target effectiveness of this scheme was very high.

In December 2007, with the EC Communication "A European initiative for the development

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7 www.bis.org./statistics/rppb0904

8 In particular those considered as being 'non-bankable', i.e. not having access to normal credit systems; young people, or those who live in circumstance of financial uncertainty (single mothers, disabled, migrants, redundant workers).

9 EMN (2008): Overview of the Microcredit Sector in the European Union 2006 - 2007; EMN Working paper No.5, July 2008; see also: http://www.european-microfinance.org/characteristic_en.php

10 As quoted in the interim evaluation of the entrepreneurship and innovation programme: http://ec.europa.eu/enterprise/dg/files/evaluation/final_report_eip_interim_evaluation_04_2009_en.pdf

of micro-credit in support of growth and employment"[11], the EC has acknowledged that Europe lacks the necessary intermediaries, capital and environment to unlock the potential of micro-credit in the EU. According to estimates based on *Eurostat* data, potential demand for micro-credit in the EU could amount to over 700,000 new loans, worth approximately EUR 6296 million in the short term[12]. This demand is however currently not met as can be concluded from the country studies summarised in Annexes 4 and 5.

1.2. A situation worsened by the crisis

The crisis is affecting micro-finance institutions mainly by:

(1) difficulties in accessing external sources of funding: many financial institutions are currently facing major problems and refocusing on their core business and less riskier market segment (liquidity tightening, rising costs of borrowing)[13];

(2) an expected increase in defaults and losses (higher defaults, higher indebtedness of micro-finance institutions' customers, possibly exposure to foreign currency risk);

(3) an increased demand driven by "riskier bank customers" which are not served by banks anymore;

(4) deposit taking micro-finance institutions report that client cash needs have gone up, causing savings to be withdrawn and sometimes straining repayments[14]

By far the majority of micro-credit to disadvantaged persons in the EU is provided by non-commercial micro-finance institutions (NGOs, Foundations, Government bodies, Member States' promotional banks, non-bank financial institutions) but these providers do not currently have the capacity to meet the important demand. Also banks such as the savings banks and cooperative banks in cooperation with NGOs are offering microloans[15]. Although efforts have been undertaken to extend the financial capacity of micro-finance institutions[16], those have so far not fully responded to the immediate need for access to finance of those affected by the economic crisis. Since the main source of finance for these institutions consists of capital provided by shareholders and grants, the current crisis worsens their situation due to the scarcity of (public) resources.

Moreover, the banking sector considers lending to the microcredit target groups as risky and cost intensive. The lack of an adequate track record and lack of (sufficient) collateral translate into a higher risk profile of these clients for the banks, with a concomitant risk of higher

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[11] COM(2007) 708 final/2;
see: http://eur-lex.europa.eu/LexUriServ/site/en/com/2007/com2007_0708en01.pdf

[12] See Annex 4 of the Communication "A European initiative for the development of micro-credit in support of growth and employment" - COM(2007)708 final/ 2, 20.12.2007.

[13] See e.g. Fitch Ratings Ltd. (2009): Microfinance – Testing its resilience to the Global Financial Crisis; 22.1.2009.

[14] CGAP (2009): The Global Financial Crisis and its impact on Microfinance; Focus Note No. 52, February 2009.

[15] Source: EMN Working Paper No. 5 "Overview of the Micro-credit Sector in the European Union 2006-2007", July 2008.

[16] One of the aims of JASMINE is to build up this capacity.

default rates, lower recovery rates and ultimately higher net losses. In addition the granting of microcredit entails higher operational costs, due to the handling costs. Clients also need intense business support services and advice. As a result, banks are not interested in certain client segments which end up being 'non-bankable', unless additional funding or risk-sharing is made available to support the risk. The issue of costs for project evaluation, other handling costs and advice to borrowers has in some Member States been solved through a close cooperation between banks and regional and local public business development agencies where these costs are partly covered by the public institutions.

1.3. Specific risks for target groups

The EMN working paper "Overview of the Microcredit sector in the European Union 2006-2007" (July 2008) highlights that the clients targeted by the EU microlenders surveyed for this study are, in order of importance, financially excluded individuals followed by women, unemployed persons, ethnic minorities and immigrants. There is considerable overlap amongst many of these groups. Youth (18-25 years) and disabled people remain as lower priority groups. In 2007, 44% of microloan clients were women, 2% of clients were from ethnic minorities, 12% were immigrants, 12% were youth and less than 1% of microloan clients were disabled people. Women are underrepresented amongst microloan clients when compared to their proportion in the population and to microlending programmes operating in developing countries, where they represent 85.2% of total clients (Daley-Harris, 2007). The relevance of other at risk groups such as immigrants and youth as microcredit clients is significant in some countries. For example, in Spain and France, immigrants are represented well over their proportion in the population whereas in Hungary and Spain young people are represented well over their proportion of the entrepreneurs’ population.

The effects of the crisis on the overall financial situation (and the limitations on lending as described above) combined with the pressure on social protection systems and rising unemployment rates will worsen the situation of the mentioned groups. Not only will the group of potential clients increase, they will have even more difficulties to access finance.

2. THE CURRENT INITIATIVES AT THE EU LEVEL

The present section examines the main ongoing initiatives at EU level aiming at promoting micro-credit[17].

2.1. CIP

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

[17] For a complete overview of the current ongoing initiatives see Annex 3

guarantees to financial intermediaries for loans of up to EUR 25 000 to micro-enterprises with up to nine employees, particularly entrepreneurs starting a new business or self-employment.

2.2. JEREMIE

The JEREMIE initiative allows for combining contributions from operational programmes of the European Regional Development Fund (ERDF) and the European Social Fund (ESF) with loan capital and other sources of finance to support the creation and expansion of micro, small and medium-sized enterprises. The decision to implement JEREMIE rests with the Managing Authorities of the Member States and regions.

As of May 2009, 9 holding fund agreements have been signed between the EIF and the Managing Authorities in: Greece, Romania, Latvia, Lithuania, Slovakia, Languedoc-Roussillon (France), Campania (Italy), Bulgaria and Cyprus. Further agreements have been signed with national or regional institutions acting as holding funds. The financial contributions managing authorities need to transfer to the holding fund reduces however the available funding of ESF operational programmes targeted at employment measures.

The Commission launched in 2007 "JASMINE" a new European-level facility which aims at supporting the development of non-bank micro finance institutions in Member States. Financial support comes from the existing technical assistance budget of the Structural Funds (European Regional Development Fund - ERDF) which the European Commission manages. The facility is managed within the European Investment Fund (EIF), which is already a partner of the Commission in the field of micro-credit through JEREMIE.

2.3. JASMINE

On 10-11 September 2008, the Commission together with the EIB launched "JASMINE", a new initiative which aims at supporting the development of non-bank MFIs/micro-credit providers in Member States and regions. JASMINE is the operational arm of the micro-credit initiative of the Commission. The initiative is also supported by a preparatory action of the European Parliament.

The Commission and the EIB decided to set up a specific micro-credit facility, whose purpose will be to channel various forms of technical assistance and funding primarily to selected non-bank MFIs/micro-credit providers to help them to improve the quality of their operations, to expand and to become sustainable. The facility is managed within the European Investment Fund (EIF), which is already a partner of the Commission in the field of micro-credit through JEREMIE. The initiative starts with a pilot phase covering the years 2009-2011. The objective of the pilot phase is to acquire experience and know-how in delivering funds and technical assistance to some selected MFIs/micro-credit providers.

Technical assistance part will be financed in 95% by the Commission (technical assistance budget of the European Regional Development Fund - ERDF) and in 5% by the EIF. Technical assistance will comprise among others: mentoring as well as technical and financial advice to MFIs/micro-credit providers; evaluation and rating of MFIs/micro-credit providers; promotion of good practices and dissemination of know-how

Regarding funding, the EIB has decided to contribute an amount of EUR 20 M to the EIF in the framework of the EIF Risk Capital Mandate micro-credit pilot facility together with additional funding provided by co-financing partners. During the pilot phase, the EIF is identifying a number of investment opportunities supporting micro-credit in the EU, e.g. with participations in microfinance funds/vehicles and with risk sharing arrangements (both funded and unfunded).

The European Parliament in its resolution of 24 March 2009 requested that the Commission reinforces its efforts to develop micro-credit in support of growth and employment and offered an additional 4 Mio € of support for a preparatory action to be implemented in the context of the JASMINE initiative, in particular to provide seed funding for non-bank micro-credit institutions. The European Parliament called on the Commission to co-finance projects for micro-credit in particular for disadvantaged target groups and to make use of EU budgetary allocations.

The pilot phase of JASMINE shows there is scope to address a further demand mainly for following reasons:

- As the majority of micro-credit in the EU is delivered through non-commercial micro-finance institutions (NGOs, Foundations, Government bodies, non-bank financial institutions), compliance with the financial requirements of the facility have proven difficult. So far only 30% of the proposals received under this microcredit pilot facility[18] meet the requirements of the pilot.

- Further as a co-financing facility, EIF's operations under the EIB microcredit pilot facility must have a sufficiently commercial profile so as to address co-financer's return requirements. Given the specificity of the market for micro-credit (higher risk and cost intensive), bank's have tended to adopt a 'risk-averse' approach especially in markets where micro credit is not well established.

- Finally, the EIB Microcredit pilot facility (EUR 20m to cover EU27 and candidate countries) would require additional resources to be of a sufficient scale to generate the market.

2.4. Conclusion

It appears from the above that the ongoing Community and national efforts have to be strengthened as to increase the supply of micro-credits on a sufficient scale and within a reasonable time-frame so as to address the high demand of those who need it most in this period of crisis i.e. unemployed or vulnerable people who want to go into self-employment but do not have access to bank credits.

There is relatively little ESF experience of using funding facilities. For instance the UK used the system in 2000-06 with results that were satisfactory, but has not brought it forward to the new programming period 2007-13.

Further, the use of ESF resources for the purpose of micro-credit could negatively impact on the implementation of other anti-crisis measures and not establish the EU-wide risk-sharing mechanism required for alleviating the general lending constraints.

[18] EIB - RCM Microcredit pilot facility established under JASMINE

3. THE NEED TO GO BEYOND CURRENT ACTION: CREATING A MICRO-FINANCE FACILITY

The above shows there is scope for new action in order to make full use of the potential of micro-finance in terms of job creation and social inclusion. This action would support increased loan volumes to final beneficiaries among others by sharing the costs of defaults through guarantees and other risk-sharing arrangements. This would allow non-bank micro-finance institutions to expand their activities.

Using Community resources would be the most appropriate since this allows to reach out to all those affected by the crisis throughout the European Union and avoid a dispersed approach towards increasing micro-credit supply by individual Member States. This intervention would among other things, take the form of a risk-sharing mechanism in order to compensate for the risks incurred by the micro finance institutions and enhance their access to wholesale lending. It should therefore be set up at EU level in order to maintain a level-playing field between all micro-finance institutions in the European Union.

Creating a microfinance facility (Facility) within the Community budget, would moreover be in line with the indications given by the European Parliament to provide for the (co-)financing of projects relating to the provision by national or EU funds of guarantees for providers of micro-credit; and where appropriate, that the financial implications of the requested proposal or proposals should be covered by EU budgetary allocations.

3.1. Objectives of the Facility

Strategic objective

As a response to the current crisis and to address the structural problems disadvantaged groups have when financing the setting-up or development of a business, set up an EU microfinance facility for employment to offer a new chance to the unemployed and open the road to entrepreneurship for some of Europe’s most disadvantaged groups, including the young.

Operational objectives

Providing additional EU resources to increase access to micro-credit for:

- those who have lost their job or are at risk of losing their job, and disadvantaged people including the young, that want to start or further develop their own micro-enterprise, including self-employment
- micro-enterprises, in particular in the social economy, that benefit to those who have lost their job and disadvantaged groups including the young.

The specific objective is to generate approximately 45.000 loans for these target groups over the period of the Facility (up to 8 years).

3.2. Functioning of the Facility

The functioning of the Facility would build on the experience with CIP and be based upon a Community contribution over four years to the EIB group and/or where relevant another international financial institution. The Facility would run for a maximum period of eight years. At the closing of the Facility, remaining capital will be returned to the Community budget.

The detailed terms and conditions for the implementation of the Facility will be laid down in a mandate agreement between the Commission and the EIB group/IFI. In implementing the Facility and achieving its objectives several instruments can be used:

- guarantees and risk-sharing instruments
- equity instruments
- debt instruments
- support measures

Possible products developed under the Facility could be[19]:

1. Debt Instruments:

Debt instruments may take the form of loans to micro-finance institutions (either senior or subordinated) or bond subscription. These are instruments designed in order to provide liquidity to the micro-finance institutions that will in turn use the funding to extend loans to final beneficiaries (e.g. microborrowers, social venture funds, etc) over a certain period of time. Specific terms of the financing would be agreed over on a case by case basis (e.g. eligibility criteria). Subordinated loans may be used, for instance, when the micro-finance institution needs to strengthen its financial/capital base but the legal environment does not permit (or easily permit) to increase the equity. The terms of the loans could be structured so as to lead to a re-utilisation of the funding by the micro-finance institution (e.g. loan to the micro-finance institution of 6 years, with an average maturity of the micro-loans of 2 years => the reutilisation could be of up to three times).

Debt instruments could be also utilised to finance Investment Vehicles providing liquidity to various micro-finance institutions, e.g. under the form of bond subscription (senior, mezzanine or junior bonds).

Another possibility would be that the EIF/IFI grants a loan to micro-finance institutions to finance eligible loans or guarantee/issue credit protection on a third party loan to a micro-finance institution. The Commission would compensate the EIF/IFI for the credit risk associated with such exposure so that a micro-finance institution gets access to and/or receives a loan under more favourable conditions. The term of the transaction should not exceed 3 years. Such intervention will be conditional on achievements of certain targets by

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[19] The products listed are purely indicative.

micro-finance institutions, like volumes of financing, failing to reach this the credit risk premium could be claimed back from the micro-finance institutions.2. Equity Instruments:

Equity instruments may take the form of equity participation either in micro-finance institutions or in Investment Vehicles providing funding to micro-finance institutions. In case of equity participation in a micro-finance institution, in addition to the funding provided, by increasing the equity base the micro-finance institution receives more stable resources that would also have the effect of facilitate its access to external sources of funding (e.g. other IFIs, banks, etc). In case of an Investment Vehicle, the investment in equity would increase and strengthen the risk protection provided to other investors (e.g. bond investors) while directly finance micro-finance institutions.

3. Guarantee products:

Guarantee products may take the form of

a) Direct guarantees issued to the benefit of micro-finance institutions to cover part of their microloans portfolio on the basis of pre-defined eligibility criteria (e.g. only new loans can be guaranteed, maximum loan amount, availability period, % of risk covered etc);

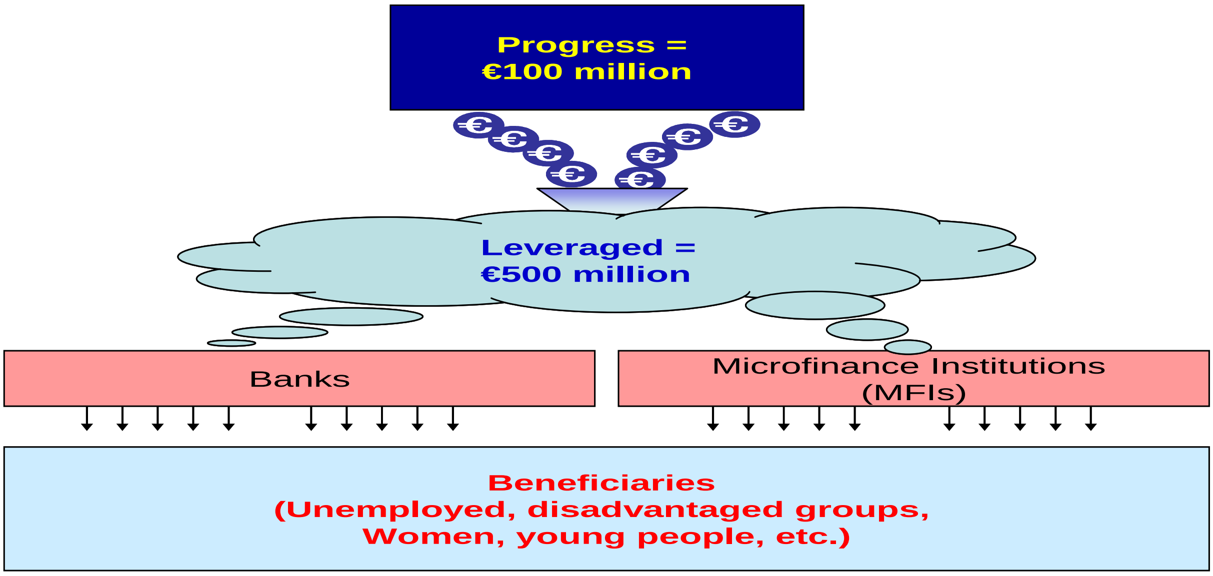
b) Funded risk sharing agreements, i.e. loans granted to provide liquidity to the micro-finance institutions (see above) with in addition the risk share of part of the portfolio (e.g. 50%). In this case, the micro-finance institution would write off from the amount it has to repay to EIF/IFI under the loan the share of losses covered by EIF/IFI on each microloan.

c) An unconditional (but partial, eg. 50%) guarantee of the micro-finance institutions' portfolio of eligible loans. The Commission would pay the corresponding guarantee fee. It could consist of loans generated in the future, in which case the guarantee premium will be paid gradually as the portfolio builds up, depending on the portfolio's risk profile. The origination period should not exceed 2 years, but could be extended several times.

3.3. Funding of the Facility

Setting up the Facility would require non-refundable contributions in the form of liquidities to IFI. Given the volume of funding required for impact, the ceilings and margin available in the Financial Perspectives would not accommodate additional funding to be drawn down from the Community budget. The only realistic possibility would therefore be to reallocate funding from an existing budget line. The Progress budget line seems to be the most appropriate in this regard. The reallocation from Progress will require a modification of the Progress decision and the adoption of a Decision by the European Parliament and Council establishing a new legal base for the Facility. Article 159 par. 3 would serve as a legal basis. The beneficiaries would be established in the EU Member States.

It is proposed to commit EUR 100 M over 4 years. In the Commission's initial proposal for Progress (in 2004) a budget of EUR 558 M (2004 prices) was proposed. During the negotiations, the EP had decided to add EUR 100 M (2004 prices, equivalent to EUR 114 M in current prices). This additional amount would now be used with a direct benefit for citizens concerned by Progress actions. The EUR 100 M could leverage up to EUR 500 million and meets the requirements in terms of feasibility in the context of the current Financial Perspectives.



Investing a lower amount could improve the current situation but risks not to create the critical mass necessary to alleviate the current lending constraints and boost the micro-finance provision for the targeted groups.

Investing a higher amount than the proposed EUR 100 M could be desirable, but the screening of the current budget line of Progress has shown that the re-allocation of such a higher amount would negatively affect the objectives and priorities set under the Progress Decision.

3.4. Coordination of the Facility

From the Commission side the overall coordination would be ensured through the already existing CIP/JEREMIE coordinating committee (see under "coherence" below).

The day-to-day implementation of the Facility would be entrusted to the EIF Programme Management Unit of the Economic and Financial Affairs Directorate General since this Unit has the responsibility for the implementation of the Competitiveness and Innovation Framework Programme (2007-2013) (CIP). In order to ensure the coherence between the particular transactions, the specific objectives of the Facility and the Community objectives in the field of employment and social affairs in general, the Commission services will set up an investment committee with representatives of the Commission's Employment, Social Affairs and Equal Opportunities Directorate General and the Economic and Financial Affairs Directorate General. This will be the decision making committee in respect of the transactions concerning the Facility.

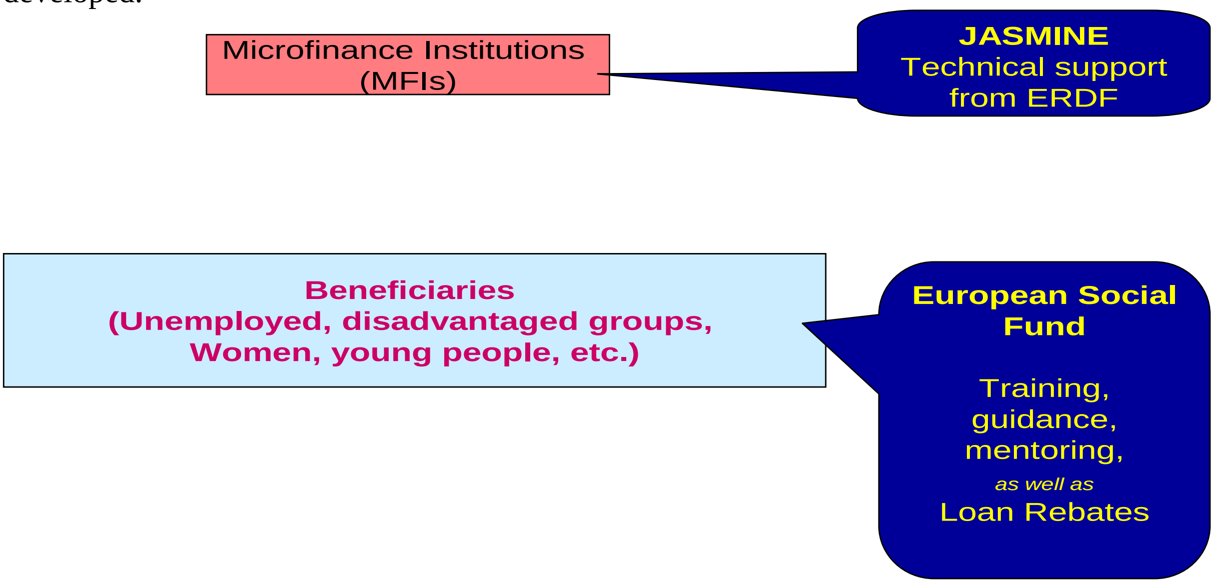
Directorate General Employment, Social Affairs and Equal Opportunities will participate, at a senior management level, in the policy co-ordination committee (consisting currently of representatives of the Enterprise and Industry DG, Economic and Financial Affairs DG, Regional Affairs DG and EIF) which ensures a co-ordinated and synergistic operation of financial instruments.

3.5. Accompanying measures

- All of the analysis and literature on enterprise start-ups points to the essential requirement of support for the entrepreneur. This includes training, guidance, mentoring and coaching, as well as further support such as interest rebates. These are the core activities of the ESF – which will directly support this initiative.

- ESF technical assistance will help to improve the capacity within the Member States to absorb the funds and to reach out to the 'ESF beneficiaries' e.g. through the Public employment services and NGOs. Managing authorities will be supported to set up (or to help set up) micro-credit provision. The interest rebate foreseen by the current Regulation can also be applied.

These actions would be complementary to the accompanying measures financed through the ERDF technical assistance under the JASMINE facility aiming at building the capacity of non-bank micro-credit providers and creating the necessary conditions for micro-credits to be developed.



3.6. Volume of appropriations, human resources and other administrative expenditure

The Community intervention for the period 2010-2013 will amount to EUR 100 M. The financial envelope may also cover expenditure related to preparatory actions, monitoring, control, audit and evaluation directly necessary for the effective and efficient implementation of the Facility and the achievement of its objectives. The budget for these support actions shall not exceed 1% of the budget of the Facility and will be managed by the Commission.

Furthermore, the management of the Facility will entail related administrative work by the services of the Commission. It is estimated that 1 AD post would need to be redeployed internally in the Employment, Social Affairs and Equal Opportunities Directorate General to manage the Microfinance Facility and to ensure the synergies with ESF Managing Authorities. 2 external staff would also need to be added in the EIF Programme Management Unit of the Economic and Financial Affairs Directorate General. Since the Facility will continue to receive payments after the commitment period 2010-2013 and due to its revolving nature, this additional staff would be required beyond the commitment period until the winding down of the Facility.

4. ASSESSMENT OF THE CHOSEN ACTION

4.1. Effectiveness – Added value

Overall the creation of a microfinance facility (Facility) with a dedicated budget would allow for achieving the objectives set in terms of disbursing loans to the unemployed and disadvantaged groups and thus creating employment and social inclusion.

Given the currently reduced level of lending and the dramatic fall in outstanding loans (cited earlier), the added-value of the Facility relates to a) the rapidity and timeliness of its intervention; and b) the targeted support offered to individuals and enterprises whose lack of credit rating or credit history is an obstacle to get funding for the creation of economic activity. Currently existing initiatives do not specifically target employment and social inclusion.

The effects of the Facility will depend on the products deployed and the general economic situation, but there are indications, e.g. from the Growth and Employment initiative[20] that there is a significant job creation potential.

In addition, the Facility could help in risk sharing with the banking sector in order to alleviate existing risk-management related lending constraints.

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[20] See section 1.1.

As indicated above, the Financial Perspectives require the funding of the Facility by means of a reallocation from an existing budget line (*in casu* Progress).

4.2. Efficiency

The efficiency of the initiative can be measured in particular by examining the leverage effect it could have in relation to the product developed and the risk taken.

In particular guarantee schemes have a high leverage effect, in that the budget allocated allows supporting a higher loan volume. This is due to two reasons:

- The EU budget covers only the estimated risk exposure at the level of the microcredit portfolio

- There is a chain of actors with risk-sharing arrangements, increasing further the leverage effect

Loan guarantees for example, have high leverage as they are often provided in the form of counter-guarantees to institutions that in turn provide guarantees to other actors, such as intermediaries and banks. Due to the risk-sharing between these various actors, the leverage in terms of volume of loans supported is very high. For micro-loans, the situation is usually different, in that the microfinance institution will typically provide loans directly to the final beneficiaries, and that there will therefore be a more limited number of actors in the chain, sharing risks. In addition, the risk profile of the final beneficiaries is typically higher, resulting in higher expected default rates. Leverage is therefore generally lower than for loan guarantees. However, based on experience under CIP and taking into account the risk profile of the targeted final beneficiaries, it is expected that leverage will be a ratio of approximately 1 to 5, meaning that a budget allocation of EUR 100 M could allow to leverage approximately EUR 500 M of microcredit to final beneficiaries.

4.3. Coherence

As shown above, the Facility will act in coherence with other ongoing Community initiatives and complement these. This coherence will be strengthened by the proposed sub delegation to the services of the Economic and Financial Affairs DG for the day-to-day implementation of the Facility and monitoring of the IFI(s).

Moreover, the currently existing coordination committee on CIP/JEREMIE will be extended to cover the Facility as well. It is foreseen that this committee meets on a regular basis at the level of senior management and with representatives of EIF to give general guidance ensuring coherent action.

4.4. Time needed for implementation

Setting up the Facility requires the adoption of a new legal base through a decision by the European Parliament and the Council and an adaptation of the Progress decision in order to allow for the re-allocation of funds. The legislative process will require time, but could most likely proceed quickly since the change to the Progress decision will be very limited and the new legal base will be following the standard approach for this type of Decision.

4.5. Conclusion

Taking into account the limitations of the currently running initiatives and the strong Community interest in meeting the objectives for this initiative in a term as short as possible, the setting up of a microfinance facility through the adoption of a new legal base and the reallocation of EUR 100 M from the Progress programme seems to be the most appropriate solution.

The reallocation of funds from the Progress Decision will require an adjustment of the activities developed under the different strands of activities. The services of the Employment, Social Affairs and Equal Opportunities DG have carried out a screening which shows that the reallocation of EUR 100 M in current prices could be managed in order not to endanger the achievement of the overall objectives and envisaged outcomes of the Progress programme. Moreover, from a political point of view it is generally accepted that the current economic crisis requires a redeployment of resources to actions that can benefit more directly those groups of European citizens that are affected by the crisis.

5. MONITORING AND EVALUATION

Monitoring and evaluation requirements will be part of the mandate to the EIB group/IFI. On a yearly basis, data will be reported by or on behalf of the EIB group/IFI on:

- Number and the size of loans
- break-down of the final beneficiaries by:
  - Gender
  - Age group
  - Educational attainment
  - Vulnerable groups (minorities, migrants, disabled, other disadvantaged)
- Sectors of activity covered
- Number of agreements with eligible intermediaries
- The degree of leverage

Evaluation will take place after 4 years and at the end of the mandate period. The evaluations shall in particular examine the extent to which the objectives of the Facility have been reached and formulate recommendations for improvement or possible follow-up.

ANNEX 1 – MAIN FEATURES OF MICRO-CREDIT IN THE EU

Micro-credit is the extension of very small loans (micro-loans) to entrepreneurs, to social economy enterprises, to employees who wish to become self-employed, to people working in the informal economy and to the unemployed and others living in poverty who are not considered bankable. It stands at the crossroads between economic and social preoccupations. It contributes to economic initiative and entrepreneurship, job creation and self-employment, the development of skills and active inclusion for people suffering disadvantages.

Micro-credit has also proven its cost effectiveness as a public policy tool, costing a fraction of equivalent passive labour market measures: the average cost of support for micro-credit schemes in Europe is reported to be under EUR 5 000 per job created[21].

Experience shows a survival rate of well over 60 % after two years for businesses set up thanks to micro-credit. In purely economic terms public support for micro-credit is worthwhile even if the job created only lasts a year.

Micro-credit is defined by:

– its target: micro-entrepreneurs, the self-employed, and socially excluded people lacking access to traditional sources of capital;

– its object: the creation or expansion of income-generating and job-creating activities or micro-enterprises, whose principal need is usually the financing of initial investment or of the working capital;

– the small amount of the individual loans required which in turn relates to the limited debt-servicing capacity of the target clientele. Typically, this amount does not exceed EUR 25 000. The average micro-loan provided by Micro-finance Institutions in Europe is approximately EUR 11 002[22]

– a more labour-intensive delivery system for making loans, involving greater knowledge of borrower capacity and a close relationship with the borrower, especially during the start-up phase of the micro-enterprise, through mentoring and general business support.

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21 Estimates of between EUR 1 000 and EUR 8 000 - Financial Instruments of the Social Economy in Europe and their impact on job creation, 1997. Under EUR5 000 - Finance for Local Development 2002: http://www.localdeveurope.org

22 Source: EMN Working Paper No. 5 "Overview of the Micro-credit Sector in the European Union 2006-2007, July 2008.

ANNEX 2 - IDENTIFIED FUNDING NEEDS

Under the JEREMIE contribution agreements for 2007 and 2008, the Commission has co-financed together with the EIF (85%/15%) micro-credit studies covering 12 Member States to examine how these Member States could improve their own micro-credit environment in the areas highlighted in the micro-credit initiative of the Commission.

According to these studies, the main challenge for micro-finance institutions/micro-credit providers in the EU is to develop and maintain a flexible and sustainable funding model for micro-credit operations that allows them to realise their individual approach towards providing micro-credit (target groups, objectives) as well as to enlarge their portfolio and develop their institutional capacity. In this regard it is crucial to differentiate between different types of finance for specific micro-finance institutions need. Capital is needed for equity and the refinancing of loans to increase the portfolio. Expenses connected to operational and risk costs need to be covered mainly from operational income or additional sources.

The whole continuum of funding needs for micro-credit operations in the EU can be structured as follows:

Funding need	Description	Typical sources of funding
Start-up costs/ Institutional development	Any costs connected to the creation or substantial expansion of a micro-finance institution	Donations and public subsidies
Equity	Any sustainable micro-finance institution needs equity capital. Due to the special nature of its operations the equity ratio should go well beyond the one set for credit institutions in the minimum capital requirements (Basle II).	Donations and public subsidies Retained earnings Venture philanthropy
Refinancing loan capital	Many micro-finance institutions start their lending out of own equity. To reach scale it is necessary to find other resources to refinance the loan capital.	Capital market through partner banks, revolving loan funds set up using European structural funds (ERDF/ESF). Recapitalisation with public funds
Operational costs of lending operations	1. Transaction costs connected to the provision of microloans 2. Risk costs arising from defaulted loans	Income from interest and subsidies, in some cases the costs of expected defaults are shared with public authorities through guarantee structures (e.g. CIP)
Operational costs of non-financial services provided	Additional non-financial services provided to microenterprises (by specialised service providers)	Donations and public subsidies, partly using existing schemes co-financing Business Development Services revenues from users of services
Income subsidies for microfinance clients	Some of the microfinance clients need additional income subsidies in the start-up phase of their business. In some countries schemes have been successfully established to encourage people, who receive social welfare payments, to become self-employed. People retain a certain percentage of their welfare payments for some time after becoming self-employed.	Public funds

Source: EVERS & JUNG and EIF Market studies on Micro Lending in the European Union: Capacity Building and Policy Recommendations, March 2009

ANNEX 3 - EXISTING COMMUNITY INITIATIVES ON MICRO-CREDIT

The JEREMIE (Joint European Resources for Micro and Medium Enterprises) initiative has been set up further to the possibilities offered by Article 44 of Regulation (EC) No 1083/2006 and Articles 43 to 46 of Commission Regulation (EC) No 1828/2006. In the past, national and regional programmes supported by the Structural Funds have provided capital and other support in a less systematic way for micro-credit operations, for example, in disadvantaged urban areas. The JEREMIE initiative allows for a combination of contributions from operational programmes of the European Regional Development Fund (ERDF) and the European Social Fund (ESF) with loan capital and other sources of finance to support the creation and expansion of micro, small and medium-sized enterprises. Funding from instruments established through JEREMIE may also be combined with business support and institution-building measures financed by the Structural Funds.

Under the growth and employment initiative (1998-2000)[23] and the multi-annual programme for the promotion of enterprise and entrepreneurship, in particular SMEs (2001-2005),[24] the European Union provided partial guarantees to cover portfolios of micro-loans for borrowers lacking security. These provisions have been extended to cover 2007-2013 with the Competitiveness and Innovation Framework Programme (CIP)[25]. The micro-credit guarantee window is managed by the European Investment Fund (EIF) on behalf of the European Commission.

The Community Programme for Employment and Social Solidarity (Progress) 2007-2013 supports the European Microfinance Network (EMN) with a view to promoting microfinance as a tool to fight social and economic exclusion and to promoting micro-entrepreneurship and self-employment.

Under the new generation of rural development programmes, the European Agricultural Fund for Rural Development (EAFRD) may co-finance expenditure in respect of an operation comprising contributions to support venture capital funds, guarantee funds and loan funds. EAFRD supports also the creation and development of micro-enterprises[26].

The European Globalisation Adjustment Fund, which can intervene to mitigate the economic and social impacts of restructuring and relocation, can provide support for redundant workers to create new businesses or move into self-employment[27].

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[23] Council Decision 98/347/EC of 19 May 1998 on measures of financial assistance for innovative and job-creating small and medium-sized enterprises (SMEs) - the growth and employment initiative (OJ L 155, 29.5.1998).

[24] Council Decision 2000/819/EC of 20 December 2000 on a multiannual programme for enterprise and entrepreneurship, and in particular for small and medium-sized enterprises (SMEs) (2001-2005) (OJ L 333, 29.12.2000).

[25] Decision No 1639/2006/EC of the European Parliament and of the Council of 24 October 2006 establishing a Competitiveness and Innovation Framework Programme (2007 to 2013) (OJ L 310, 9.11.2006).

[26] Article 71(5) of Regulation (EC) No 1698/2005 of 20 September 2005 on support for rural development by the European Agricultural Fund for Rural Development (EAFRD) (OJ L 277, 21.10.2005), and Articles 50 to 52 of Regulation (EC) No 1974/2006 (the relevant implementing rules) (OJ L 368, 23.12.2006).

[27] Regulation (EC) No 1927/2006/EC of the European Parliament and of the Council of 20 December 2006 – OJ L 406 on establishing the European Globalisation Adjustment Fund (OJ L 406, 30.12.2006).

In the context of its Communication on "A European initiative for the development of micro-credit in support of growth and employment"[28], the Commission together with the EIB launched in 2008 "JASMINE" , a new initiative which aims at supporting the development of primarily non-bank MFIs/micro-credit providers in Member States and regions. The Commission and the EIB decided to set up a specific micro-credit facility, managed by the EIF, whose purpose is to channel various forms of technical assistance and funding primarily to non-bank MFIs/micro-credit providers to help them to improve the quality of their operations, to expand and to become sustainable. Technical assistance is co-financed by the Commission (95%) and the EIF (5%), while funding will be provided by the EIB, which has contributed € 20 M from its own sources, together with additional funding from other financial institutions. JASMINE is also supported by a preparatory action of the European Parliament (€ 4 M).

In the context of a EUR 5 M pilot project aimed at Roma inclusion, the Commission will over the period 2010-2011 dedicate resources for supporting microcredit programs on a pilot basis.

[28] COM(2007)708 final/ 2, 20.12.2007.

ANNEX 4 - SUMMARY OF MICRO-CREDIT STUDIES CARRIED OUT IN THE CONTEXT OF JEREMIE CONTRIBUTION AGREEMENTS BETWEEN THE COMMISSION AND THE EIF FOR 2007 AND 2008

The main results of the studies can be summarised as follows:

Western Europe - Summary (UK, Spain, Germany, Italy)

Western Europe - Main findings

The findings of this study constitute the first in-depth look into the Western European microfinance market in an attempt to formulate an overall picture of how microfinance has developed so far and evaluate what are its greatest needs and challenges in order to plan an appropriate course for its promotion. The existence alone of these markets is a recent development and their overall organisation is still not well established. In the four countries examined in this study, the market place is no more than a decade old on average. Based on the uniform market immaturity as well as the similar economic, political and social contexts of the four countries, many similar trends presented themselves. The fundamental challenge for most microfinance institutions in these countries is achieving efficient operational models that can maximise social as well as financial performance. In these countries that is complicated by the pre-existence of competitive financial service sectors along with elaborate and well-enforced legal oversight structure. The individual reports and more importantly the overall Capacity Building report that Evers & Jung (Germany) has compiled discuss the details of the deficiencies and practical recommendations for their improvement.

Western Europe - A common background

In the Western European context the scope of demand is naturally limited by the dual realities of the relatively low-prevalence of poverty and financial exclusion. Furthermore, combating poverty using microcredit in countries with well-established social security benefits systems is a separate discussion entirely. The economic and social contexts of these countries are well outlined at the beginning of each country report, but can be summarised as wealthy, well financed, competitive, and regulated, although, with small pockets within each population composed of specific groups that are chronically vulnerable to social and financial exclusion. The general contextual similarities bring about a series of more specific connections that currently affect the microfinance markets. These countries all have more robust legal establishments than the developing countries where microfinance institutions have flourished over the past three decades. Yet, despite the maturity of their legal structures, the national legislatures in all four countries have not enacted any microfinance specific legislation. The lack of regulation is most pronounced in the UK where microfinance does not officially exist. Above all, the lack of microfinance specific regulation has meant that institutions wanting to be microfinance institutions or at least open microfinance operations, must be licensed as some type of traditional financial institution, or operate in partnership with one. Until 2007, when MicroBank was established in Spain, no microfinance specialised, financial institution existed in Western Europe.

In general, microcredit in Western Europe is disbursed from banks through diverse collections of microfinance focused, social organisations. Yet, because of banking laws and fairly strict regulatory oversight, these social organisations are not able to completely integrate loan portfolio management into their operations and especially are not able to take deposits. Another characteristic that all these markets share is a lack of reliable information. Specific information regarding microfinance was not readily available in any of the four countries.

Western Europe - Varied country features

Despite a high degree of contextual uniformity, the reports show that the prevalent business models in each country differ.

In **Spain**, the model is based on partnerships between diverse groupings of non-profit institutions known as Social Microcredit Support Organisations (SMSOs) which represent private as well as public entities, and Savings Banks which are also non-profit. While differences exist in disbursement models, all microcredit is originally supplied by the Savings Banks. New model innovations are attempting to make the SMSOs more independent and more responsible in risk-sharing. These include providing SMSOs with guarantee and capital funds while placing portfolio management in their hands and in turn applying performance criteria to their operations.

The **Italian** model is similar to that of Spain but slightly more diverse in terms of the types of actors. Microcredit is provided by more than one type of bank (including for-profits), but as in Spain, these loans are not disbursed directly by the banks. The funds are channelled through both private and public entities that provide loan management services to the banks and Business Development Services to the borrowers. In **Germany**, the formal source of microcredit is programmes of the regional promotional banks and the federal bank (KfW Bankengruppe), and more significantly, joint ventures between social services and municipal authorities (ARGEs). A third, less prevalent arrangement, is the DMI model composed of private, start-up centres that partner with banks (much in the way private social organisations in Spain and Italy operate). The German market is a diverse mix of for- and non-profits and public sector entities and many of the lenders. The promotional banks are only ones that lend any significant volume as the rest grant only minimal numbers of loans per year (in many cases, much less than 50). The **UK** is an outlier in this discussion because there is no microcredit model. Although the Community Development Finance Institutions (CDFIs) do not officially have microfinance operations they are considered the chief microfinance lender by default because of the similarity between their operations and the stated guidelines for micro-enterprise lending at the European level. While a variety of CDFIs exist, the majority are non-profits and officially non-bank in terms of their legal charter. There historical purpose has been to fund entrepreneurs who have otherwise not qualified for credit from the highly consolidated and centralised British banking system. In terms of their overall loan portfolio, operations considered to fall into the microcredit category represent only 28% (13.42 million Euros in volume).

Western Europe - Main issues

The target of microcredit in these four markets varies. Micro-enterprise lending exists in all four markets, being the focus in the UK. In Germany, a greater volume of microcredit is focused on micro-enterprise lending; however, there are considerably more social lending focused institutions. In Italy, targeting is somewhat more evenly balanced, and the immigrant community is increasingly becoming a focus for social lending programmes. In Spain, lending is decidedly social in nature. In general, all four markets have grown significantly since their beginnings and potential demand is considered to be substantial. However, **performance was specifically hard to track** in these four markets due to a number of issues. In many cases, institutions were not forth-coming with performance data from their loan portfolios. In other cases it was apparent that some of the smaller non-profits that proliferate in these markets lacked the capacity due to **weak information management and or the lack of human expertise**.

The current size of the markets is hard to measure exactly as well, due to the **unavailability of reliable data** regarding cumulative number of loans and total loan value. Overall, the supply and demand findings from the country reports were based on surveys run by this study's research teams, in-depth analysis of more macro data, and info provided by industry associations. The following table is an attempt to compile the best data available and place each market in its national context.

	GDP in millions Euros (2008)^^	Unem-ployment Rate (2008)^^	At risk of poverty rate** after social transfers (2007)^^	Number of loans disbursed (2007)	Total value of loans disbursed (mill. Euro) (2007)	Average Loan Size (2007)	Average Interest Rate	Percent of loans to women°°	Percent of loans to immigrants°°	Percent of loans to Young people°°
Germany	2,492,000	7.3	15	4,620(est.)		11303	6.92	39%	NA	NA
Italy	1,572,243	6.7	20	682-3,223	2.7-43.7	6,966-13,558	5.8 (not-weighted)	27%	21%	11%
Spain	1,095,163	11.3	20	3348	38.1	9943	5	67%	47%	33%
UK	1,814,819	5.6	19	1252	13.42	11200	13.4	55%	14%	16%

^^: Data retrieved from Eurostat (2009-18-3) and ISTAT

°°: Comprehensive data was not available for this study. These results are based on the findings of the 2006/07 EU Microcredit Overview Survey conducted by Fundación Nantik Lum.

**: At-risk-of-poverty rate after social transfers by gender: The share of persons with an equivalised disposable income below the risk-of-poverty threshold, which is set at 60 % of the national median equivalised disposable income (after social transfers).

Western European markets are **over-crowded with social support organisations**. This is a result of the young markets' lack of consolidation and coordination. In Italy and Spain, a plethora of public and non-profit actors populate the market and operate with little interaction and no cohesive strategy. In Germany too, it was noted that the market was comprised of a large number of institutions granting a very small number of loans. In Germany and Italy, national level efforts have been made to form some level of coordination (the RITMI in Italy and DMI in Germany), but in Spain, there has been no such progress. In Germany, Italy and Spain, the diversity of these institutional groupings and **lack of consolidation behind well guided regulatory measures** are seen as potential challenges to market development. Further difficulty results from the fact that the social support organisations are highly dependent on subsidies from public and private donors. There is thus **little movement toward commercial viability**. This lack of commercialisation in many cases has reinforced a lack of professionalisation (due to lower wages and less training capacity). On the other hand, despite the problems they currently confront, it is felt that these social support organisations and their Business Development Services and or loan support services are essential in the Western European markets.

Regarding information in these markets, all of the countries reported a **lack of information regarding potential demand**. This was in part due to the markets' own lack of capacity to conduct intensive analysis as well as the lack of sufficient marketing programmes that might help gauge the breadth of demand.

Traditional **financial institution licensing** is a limiting factor for most aspiring microfinance institutions as it confines these new institutions and their innovative products within the rules applied to the traditional, profit-driven financial system. Apart from the expenses of legal incorporation and compliance, aspiring microfinance institutions in these countries must operate within the range of acceptable interest rates outlined by national usury laws (this does not apply to the UK). The **high operating costs** inherent in microfinance, the **inability to take savings** and the **non-existence of economies of scale** due to limited demand mean that auto-sustainability in this sector will not be achieved in the foreseeable future.

Another serious concern for the future in all the country markets was the **future effects of the mounting economic crisis**. It is very unclear whether donors will continue to support microfinance as substantially, and whether demand will rise with unemployment and poverty rates, or will demand be tempered by risk aversion behaviour on the part of the potential entrepreneurs.

CEE - Summary (Romania, Bulgaria, Czech Republic, Slovakia)

CEE - Main findings

Microfinance is perceived in the region as an effective tool in fighting social and financial exclusion and poverty and has proved to be efficient in providing sustainable development in Eastern and Central Europe. However, in spite of the fact that the four countries are located in the same region and share a common recent history, the studies revealed a diversity of approaches, methodologies, instruments and institutions engaged in providing as well as facilitating access to financial services to underserved entrepreneurs, micro enterprises and individuals.

Eastern Europe

Microcredit is mainly provided by Non Bank Financial Institutions, evolved from NGOs. The innovative models developed have proven to be sustainable and replicable at larger scale in Romania and in Bulgaria.

In **Bulgaria**, within the last five years, the banks started offering special products penetrating down to increasingly lower segments of the market, and today the micro-credit sector in Bulgaria has unquestionably carved its place within the lending industry. It involves a growing range of commercial banks and a well established group of microfinance institutions (MFIs) that pioneered a variety of micro-credit products and built credibility for their target clientele, notably micro enterprises, small entrepreneurs, business start-ups and disadvantaged borrowers. The main challenge is to further broaden and deepen the outreach of microfinance to particular at-risk groups which may be more difficult to reach.

In **Romania**, beside the specialised SMEs banks targeting mainly small and medium enterprises, a well established and sustainable micro finance sector covers the gap left by the commercial banks in financing micro enterprises, individual entrepreneurs, family based business and small private farms. The non-bank financial sector is growing faster since an enabling legal framework is in place, reaching almost a third from the financial services granted to the economy. The biggest challenge of the Romanian microcredit sector amidst the current liquidity crisis is servicing the 700 million Euros of estimated uncovered demand (2007) within the micro enterprises sector, underserved by the formal financial sector.

Central Europe

In Central European countries, as in Western Europe, specialised State-owned banks and the commercial banking sector are the main suppliers of financial services for the SME sector. However, the lack of specialised institutions and little institutional focus on microenterprise development mean that microfinance is undeveloped, although the demand seems to be growing.

In **Slovakia**, the microfinance market remains undeveloped. The microfinance program within the National Agency for SMEs operates on a very small scale and the State-owned SZRB bank is the only significant provider of credits and guarantees for small business, and it provides only a low volume of microcredits.

Furthermore, there are no formal MFIs for which microfinance is a core activity, and the three organisations that have or continue offering micro loan products do so as a side activity. There remain some significant policy barriers to the development of a sustainable microfinance for enterprise industry in Slovakia, and it would almost certainly require a significant level of new capital to launch a dedicated and formal MFI.

Banks in general remain unwilling to enter this market without guarantees from the State or EU. However, the strong and growing demand for consumer credit products indicate that there remains a demand for enterprise microfinance. In the **Czech Republic** there are no specific microfinance institutions. Micro enterprises do not have a clear legal definition and are mostly included into the SME segment. Only a few state owned banks such as Moravian Guarantee or the Development Bank provide guarantees, guaranteed loans and technical assistance programmes for SMEs. Some microenterprises obtain financing from mainstream financial institutions, but they often use consumer, mortgage or credit card lending to finance their operations.

CEE - Main issues

An overarching problem is the **lack of definition of microcredit**. The EU definition of loans of under EUR 25,000 may not be adapted to countries still well under average EU per-capita-GDP levels. With no clear definition of players, tools, offer and demand, it is **very difficult to gather reliable data and build statistics**.

Another issue is the **legal and regulatory background**. It is sometimes nonexisting, as in the Czech Republic or in Slovenia. It is insufficient or not adapted, as in Bulgaria, where a financial institution must have share capital. In Romania, after an initial good law in 2005, the Microfinance Companies Law, some recent regulatory changes have brought in difficult obligations for smaller microfinance institutions. Some countries, mainly in Central Europe, prioritise **large company growth rather than small business development**. In parallel, little is done to develop financial institutions, projects or products geared towards small and very small companies.

Although mainly workforce exporters, Central and Eastern European countries do see part of their population, mainly the Roma, face exclusion problems. They have set up programmes and actions to face the issue, but **microfinance, which is a tool for financial and therefore social inclusion, is seldom considered as a priority**.

The micro and small **entrepreneurs tend to use the fast-developing consumer credit products** as a default answer to their financing needs. This is counterproductive for the entrepreneur, who gets expensive financing and no counselling or training, and on the long term for the financial sector.

ANNEX 5 "OVERVIEW OF THE MICROCREDIT SECTOR IN THE EUROPEAN UNION 2006-2007" EXTRACT FROM THE EMN[29] WORKING PAPER (JULY 2008)

In 2007, Adie[30]/EMN, MFC[31], Pentor Polska/MFC and SEON/EMN carried out Microfinance Market Studies in France, Hungary, the Netherlands and Poland on behalf of the European Investment Fund (EIF) within the framework of the JEREMIE programme. These studies analyse the demand and supply side of microcredit differentiating between the non-bankable demand (less than EUR15,000) and the bankable demand (between EUR15,000 and EUR30,000). However, in order to estimate the supply of bank microcredit, the studies had to rely on statistics concerning access to bank loans as most often banks do not provide specific information on microloans.

Adie estimates the demand for bank microcredit in France at 211,000 loans per year for new and established enterprises while only about 111,000 microloans are offered by banks. With regard to non-bank microcredit, 10,000 loans are provided by Adie while between 90,000 and 140,000 loans are needed every year (depending on the methodology of calculation used[32]). Thus, the demand for microcredit in France is largely unmet, with 100,000 microloans from banks and between 80,000 and 130,000 loans from non-bank microcredit providers lacking.

In Hungary an estimated 280,000 microenterprises are in need of credit, of which 70% constitute the smallest enterprises with 0-1 employees. However, only 13% (90,000) of microenterprises use microcredit either from a bank or a savings and credit cooperative. Thus, an estimated gap of 190,000 exists in the microcredit market. Owing to strict regulations and structural shortcomings of the State microfinance programme, microcredit expansion has been limited. Microenterprises seeking very small loans also remain excluded from the formal banking system, despite bank downscaling.

Banks serve the largest number of microenterprises in Poland, with almost 40% of microfirms having access to a credit line and 20% claiming to use working capital loans. However, the intervention of banks is limited to mature microenterprises, which is only a small fraction of the total market. Credit unions and non-bank microloan providers have much lower outreach – credit unions being primarily engaged in consumer lending while non-bank providers serve relatively small numbers of clients due to lack of sufficient funding to enable them to grow.

In the Netherlands only 200 microloans are provided by NGOs and another 2000 under a governmental programme. With the exception of Fortis Bank and municipal credit banks, banks do not engage in microcredit, but simply provide overdraft facilities. Dutch society has a well developed welfare system, but this does not explain the poor provision of microcredit. The study reveals a total potential demand for microloans of 43,500 persons out of which 60% are considered non-bankable.

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29 European Micro-finance Network.

30 Adie: "Association pour le droit à l'initiative économique".

31 MFC: Micro Finance Centre http://www.mfc.org.pl/

32 Calculations based on the number of existing enterprises or on the number of potential micro-enterprises, i.e. the number of low-income persons wishing to set up a business.