



Fondazione Giordano Dell'Amore



*Fondazione Europea
Guido Venosta
dal profit al nonprofit*

Microfinance in the European Union

Excerpt

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Foreword

This study is a joint project of Giordano Dell'Amore Foundation and the European Foundation Guido Venosta.

Giordano Dell'Amore Foundation has been involved for more than 30 years in research, training and technical assistance on the topic of development finance: during these years, the Foundation organised several courses and masters for the specialisation of students coming from all over the world and conducted many studies concerning financial issues, with a specific interest in developing countries. The European Foundation G. Venosta, born in 2000, has been working on management techniques for not for profit organisations and focuses on this topic through research activities. The research was made possible thanks to the contribution of Pirelli S.p.A.

The study was conducted by a group of six researchers, graduated in 2002 from a Master Programme on microfinance offered by Giordano Dell'Amore Foundation, CIPSI and sponsored by the Italian Ministry of Foreign Affairs; the study was supervised and co-ordinated by Laura Viganò, professor at the University of Bergamo, specialised in microfinance.

The aim of this work was to explore the existing microfinance experiences in the countries of the EU; its aim was to produce a document showing that microfinance products can be very effective to foster development also in the European context and to show how some European players are using it successfully, constituting important examples for other institutions. Before examining the existing European programmes, the study in its first part considers the factors that contributed to the development and success of microfinance in the last 20 years in LDCs.

The work is organised into four chapters. The first one offers a background through a theoretical apparatus supporting the conclusions later reached in the empirical analysis; some of the main issues related to the development of microfinance, such as the problem of asymmetric information and other distortions existing in financial markets

and the related credit rationing, are explored, to demonstrate that they could be partially overcome by the innovative introduction of microfinance. After analysing the different approaches and methodologies used to provide microfinance services, the first chapter concludes with the presentation of some significant examples of MFI's operating in LDCs. In fact, the main theories developed until now, are based on the experience of developing economies, where microfinance is now quite widespread in its different forms.

The second chapter analyses the European context; at first the historical experiences of microfinance were considered: the Reiffeisen Bank in Germany, the lending Charities in England and the Cooperative model of "Casse rurali" in Italy are some examples which demonstrate that microfinance is strongly rooted in Europe. The research found out that even if the distortions characterising LDCs financial system are smoothed in the EU countries, financial exclusion still constitutes a problem for some European citizens. Financial exclusion in Europe is mainly concentrated among those people suffering from poverty and social exclusion. In Europe, as well, since the core of the European economic system is characterised by the important role played by micro and small enterprises, the capacity of the banking system to reach and serve the very small entities is crucial to the achievement of a general socio-economic improvement. However, this capacity is not fully exploited. In fact, exclusion from banking services often constitutes an obstacle to the start-up of new business activities, which could be very interesting in terms of expected cash flow but are not taken into consideration by financial entities because they lack guarantees and information usually required by traditional banking system standards.

In this context, the development of microfinance services, either by banks or other intermediaries seems appropriate to fill the gap. The various types of microfinance intermediaries, as well as the threats and opportunities generated by the existing banking regulation were taken into consideration. To conclude, the EU countries were singularly analysed with a particular focus to poverty, unemployment and financial systems.

The main goal of this work was, on one side, to state that also in Europe there is a market which has not been covered by the banking system yet and, on the other side, to show that when using the appropriate methodology this market can be served in a sustainable and effective way.

In the third chapter, a sample of institutions operating in the European microfinance sector was analysed in order to understand which approaches have been chosen by different institutions, and among them, identify those that better fit the European context. The study of the institutions was conducted through the distribution of questionnaires on the main aspects of an MFI management: the institutional background and organisation structure, the clientele, the financial sources, products and services offered, terms and conditions, the quantitative indicators of the institution. The data collected were then used in aggregate terms to conduct a cross-analysis of the institutions interviewed. This analysis is described in the following paper which constitutes chapter 3 of the research.

The information collected were used to elaborate some institutional *fiches* explaining how each MFI functions, which are presented in chapter 4.

The whole research is now being reviewed by some scholars of Giordano Dell'Amore Foundation and will soon be published by the two Foundations. This excerpt is made available for the meeting of Alfa Project in Bolivia for discussion and comments.

Chapter 3

The empirical study

Introduction

In the previous chapters, after reviewing the history and most recent evolution of the microfinance (MF) phenomenon, we have described some of its outstanding features, and outlined MF state of the art in the European Union (EU), which was the main object of our research.

As the research group did not wish to confine to mere theory, but to carry out an empirical verification of the proposed theories and considerations, we have examined the reality of MF in the 15 EU member countries. To do so, we have circulated a questionnaire conceived to describe existing MF experiences exhaustively, have contacted a number of microfinance institutions (MFIs) by telephone and e-mail, and have personally met the representatives of some of them.

The objective was to verify some working hypotheses and collect concrete evidence of success or failure, in the innovatory and evolving world of European microfinance.

The result is a complex and many-dimensional collection of data, which, just like the world of microfinance, it is hard to circumscribe and interpret univocally.

Our effort was directed to provide some keys to reading a phenomenon that materializes under very different forms, to support our statements statistically, but avoiding the pitfall of considering MF as a transparent universe of linearly comparable entities.

After a short description of the methodology used for empirical verification, this chapter will provide a descriptive analysis of the data, which aims at giving a summary and synthetic, albeit not exhaustive, picture of the collected information that can be a starting point for concrete reflections on the evolution of MF in Europe.

The last section is devoted to an analysis of some aspects which are of a strategic importance for MF development, through an aimed cross use of available data.

The ensuing conclusions can be considered as a first step towards gaining a better insight into that complex phenomenon.

3.1 Description of the methodology and origin of the data

Empirical analysis involved the study of some MFIs operating in the EU. MFIs were identified through the Internet and the study of literature and documentation on MF in Europe. The Authors also made use of the experience of all those who contributed to the study and of their personal contacts with MFIs operating in Europe.

Initially they identified some hundred institutions in EU member countries, and then weeded out those less representative of microfinance activity. In order to obtain the information necessary to achieve the research objectives, each MFI was asked to fill a questionnaire drafted for this purpose. In drafting the questionnaire the following conditions were considered:

1. *Simplicity of the interview*: it refers to the number of questions asked to get the necessary information. Four areas of interest were identified with a total of 21 “qualitative” questions plus a grid of “quantitative” questions. Qualitative questions (Part A) were of the multiple choice or open type and required a greater effort to interpret the text before answering. The quantitative grid (Part B) requested information on numerical data, drawn from the financial statements or internal regulations and information brochures on the institution’s products. For clarity’s sake, the grid was divided into two sections, one concerning the institution and one concerning the products, which was in turn sub-divided by lending products, savings products, payment services and insurance services.
2. *Usability of information*: it refers to how information was systemized to serve the research purposes. Consideration was also given to whether system development needed extraordinary activity or the support of external advisors, or could be done by the existing staff. The data were treated in an electronic sheet, and then analyzed with the use of a statistic software directly by the staff who had drafted the questionnaire and collected the data.
3. *Cost of system development*: it refers to the time and effort necessary to achieve system development. The research staff, composed of six researchers and one co-ordinator, worked on this research phase for approximately six months. Considering the time set for research completion, this phase required a considerable effort.
4. *Quality of data*: it refers to system accuracy in the collection of information. Collected data were manually entered in the system, checked and, when necessary, corrected after contacting the concerned institution by telephone.
5. *Reality of data*: it refers to the risk of data being “forged”. It was not possible to quantify the risk of “forgery” or misinterpretation of data by the person making out the questionnaire, which might probably be expected for the answers to some of the questions (due to the fact that the question was difficult, the person was possibly willing to provide unreal information, or the information was of a confidential nature). The questions which were deemed to be more risky from this standpoint were treated with more caution in multi-dimensional analysis.

As mentioned earlier, the questionnaire is composed of two parts. The first part (A) concerns some qualitative features of the institutions, while the second part (B) refers to financial and quantitative information considered to be of interest for the research purposes.

- a) *The first part* contains information on the institutional features and operational characteristics of the respondents as well as information on the categories of clients, types of services and sources of funds. This part was made out by the person in charge of each institution who was best fit to provide this kind of information.
- b) *The second part* mainly contains quantitative information. The questions concerned mainly information on credit and savings products (amounts, interest rates, expiry, securities, repayment rate, standard time of issuance, documentation requirements ...) and general information on the institution (No. of clients, No. of members, total credit portfolio, No. of staff, working hours for the public ...).

Before using the system of data analysis, tests were performed in order to improve the questions and the questionnaire efficiency.

No visit to concerned MFI was made, and the questionnaires were sent by e-mail or fax. After the questionnaires were returned and checked, the information were systemized¹. A case apart is Italy, where the questionnaire was often made out directly by the staff of an institution together with one of the researchers, and the flow of information by telephone was more detailed.

Collected data were used for the analyses describe below (sections 3.2, 3.3, 3.4, and 3.5) and mainly treated as aggregates², trying to highlight the main features of respondent MFIs, also based on the theoretical framework and the analysis of the major characteristics of the microfinance industry in the European Union (described in the full text of the research). It is worth underlining that MF organizations were selected among those operating in each EU member country based on the information available to the research staff and the organizations' willingness to co-operate in the research.

Moreover, the number of MFIs varies over countries, but not in connection with the presence or spread of MF in each country. In the descriptive analysis, the Authors used 32 of the respondent institutions (31 in the multi-dimensional analysis section): 8 located in Italy, 8 in Spain, 5 in the United Kingdom, 3 in Ireland, 2 in France, Belgium and Germany respectively, 1 in Finland and 1 in Portugal (as shown in detail in Table 3.1).

This is the reason why the analysis is not meant to be reflective of the full reality of microfinance in EU member countries. Yet, the selected sample may well be used to test some theoretical assumptions, and give the reader a good general overview of the present state of the microfinance context.

¹ It was often necessary to sent the questionnaire several times to the same institution before obtaining correct answers and reliable data.

² The full text of this research presents detailed information on individual respondent institutions.

Table 3.1 – The investigated institutions

MEMBER COUNTRY	INSTITUTION
Sweden	Almi
Sweden	Swedish Jobs and Society
Ireland	Aspire
Ireland	Western Development Commission (WDC)
Ireland	First Step
Spain	Fundacion La General para el Desarrollo Solidario Granada
Spain	Acció solidaria contra l'atur (Barcellona)
Spain	Fundacion Un sol mon (caixa catalunya)
Spain	Fundacion Laboral WWB en España (FLWWBE)
Spain	Instituto Municipal de Formacion y Empleo-IMFE (GRANADA)
Spain	Fidem
Spain	ICO (Instituto de Credito Oficial)
Spain	Associazione Reas net
Spain	COOP57
Belgium	Brusco
Belgium	Credal
Belgium	Netwerk Vlaanderen
Finland	Finnvera plc
Italy	Fondazione Antiusura S. Maria del Soccorso
Italy	Fondazione San Carlo
Italy	CGM Finance
Italy	MAG2 Finance
Italy	Banca Popolare Etica (progetto Caritas Treviso)
Italy	Banca Popolare Etica (Sede centrale Padova)
Italy	MAG_Verona
Italy	MAG 4 Piemonte
Italy	Regione_Toscana
Italy	MAG_Venezia
Germany	Lawaetz
Germany	Enigma
Germany	Investitions Bank Berlin
Germania	Projekt Enterprise
United Kingdom	Salford MoneyLine
United Kingdom	Art
United Kingdom	Weetu
United Kingdom	Street UK
United Kingdom	OneLondon
France	Socodem
France	Adie
France	Paris Love and Money
Portugal	Andc
<p><i>Note:</i> The institutions written in bold types were not included in the descriptive and multi-dimensional analyses. Banca Popolare Etica (Caritas Treviso project) was included only in the descriptive analysis.</p>	

3.2 The sample descriptive analysis

The data collected from the questionnaire have allowed the Authors to analyze the institutional and credit characteristics of 32 MFIs operating in 9 EU member countries in depth. The rate of returned questionnaires was 31 per cent, as many institutions (or projects) that were initially contacted were later considered unfit to be included in the sample (e.g. because they had provided incomplete data, or because they did not strictly operate in microfinance, or because, although being based in a EU member country, their microfinance project was being developed outside the EU, etc.).

In this section, we report a descriptive analysis highlighting the characteristics of the investigated sample³.

Fifty-six per cent of respondent institutions provides microfinance products and/or services directly and exclusively. The remaining 44 per cent provides credit as well as non-financial services such as assistance in the preparation of credit applications or the provision of collateral to third parties, training, technical assistance and advisory services (especially for the drafting of projects).

The MFIs in the sample belong to a wide and diverse range of institutional types (Table 3.2). Only nine per cent of them is established and operates as a financial institution with bank statutes, while NGO, associations and foundations account for over 46 per cent. Non-bank financial institutions and co-operative organizations account for the remaining 45 per cent.

Table 3.2 – Institutional types

<i>Banks</i>	<i>Non-bank financial institutions</i>	NGOs	Foundations	Associations	Co-operatives	Others
2	5	3	8	3	3	8

Over 40 per cent of the institutions under investigation operates at a regional level, 25 per cent at the national level and 22 per cent at a local level. As to the areas where they provide their services, 53 per cent of the institutions operates at the urban level exclusively, while the remaining part does so at both the urban and rural level.

It is interesting to note (Table 3.3) that these MFIs establish formal close relationships with both financial institutions and public entities (over 68 per cent) and non-profit organizations and entities.

Table 3.3 – Relationships with other organizations

Type of	Financial	Universities	Public entities	International	Non-profit
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³ In the section about methodology, mention was made of the sample used for the empirical analysis not being statistical insignificant.

relationship	Institutions	and research centres		organizations	organizations
Formal	22	10	22	11	19
Informal	4	12	3	5	8
Permanent	18	2	12	11	17
Occasional	8	20	13	5	10
Total	26	22	25	16	27

As shown in Table 3.4, they service a diverse range of clients, and over one third of respondent MFIs appears to have no specific client targeting strategy.

It will be interesting to see in the analysis reported in the following section (section 3.3) whether and how the use of client targeting affects the performance of the institution.

Women do not appear to be among priority targets contrary to what happens in LDCs, where, as mentioned earlier, (chapter 1, section 1.5.2), they play a very active role in microfinance programmes, as many donor agencies rank gender empowerment among their top priorities.

Table 3.4 – Types of clients

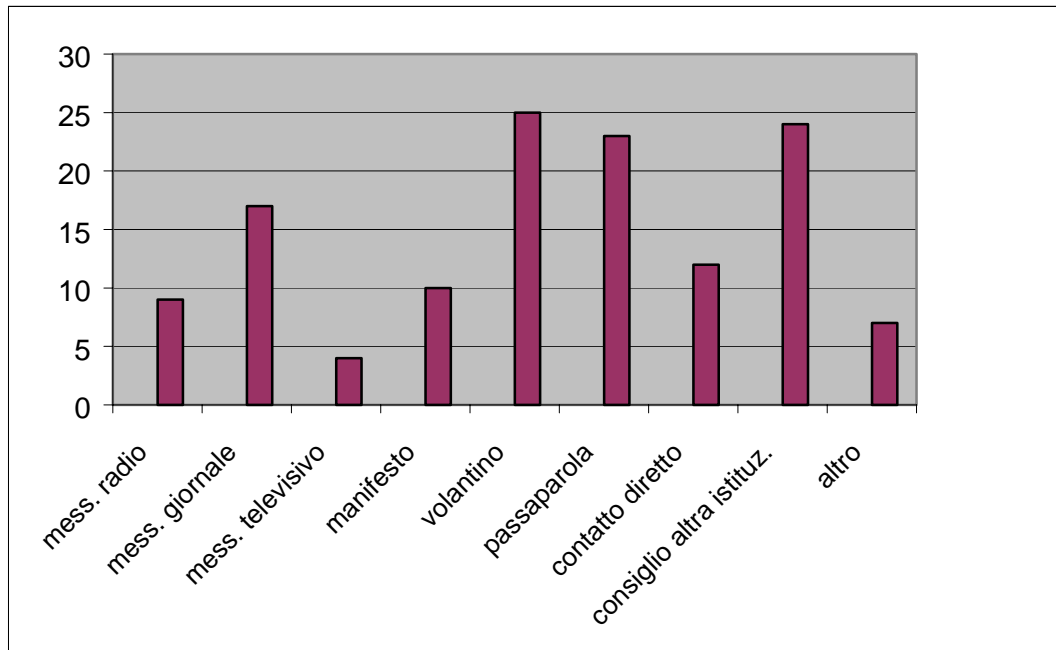
	Prisoners	Immigrants	Homeless	Handicapped	Households	Students	Youth under 30	Old people	Indistinct	Co-operatives	Women	Sundry
No. MFIs	4	11	1	5	4	4	6	3	12	3	3	14
% MFIs	12%	34%	3%	16%	12%	12%	19%	9%	37%	9%	9%	44%

The working category receiving MFIs' greatest attention is that of the unemployed (34 per cent). By legal status, MFIs' clients are mostly individuals (served by 69 per cent of them), followed by co-operatives (56 per cent) and non-profit organizations (50 per cent).

By industry, MFIs services are equally distributed over trade and services to individuals and enterprises, while the agricultural sector is underrepresented (9 per cent of industry total).

As to the information channels used by MFIs to communicate and publicize their products it is interesting to observe that 75 per cent of them uses person-to-person oral informal communication channels through their clients and other institutions operating in the industry (development and employment agencies, other financial institutions).

As to traditional advertising channels, the most widely used are leaflets and newspaper advertisements, which are used by 78 per cent and 53 per cent of institutions respectively. Advertising through the radio and television is used only in 28 per cent and 12 per cent of cases respectively.

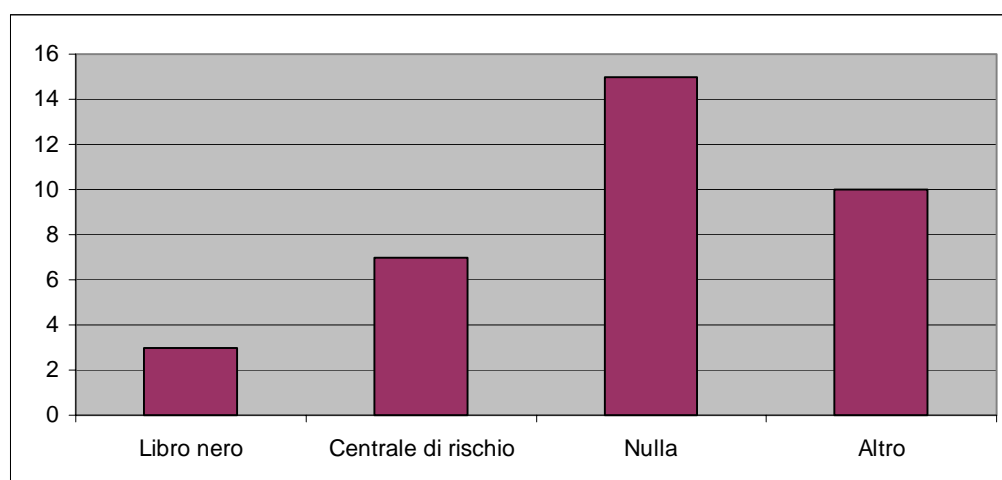
Chart 3.1 – Information channels used to publicize MFIs' products (percentage over total institutions)

radio; newspapers; TV; posters; leaflets; oral communication; direct contact; other inst. advice; sundry

Over 56 per cent of MFIs has a well-defined marketing strategy. In section 3.3, we shall consider how this aspect may affect some performance-related variables, such as the number of clients and repayment rate.

We shall also consider whether and to what extent applying no structured system of inquiry on clients' creditworthiness (46 per cent of sample MFIs) affects the institution performance (see Chart 3.2).

The questionnaire has allowed researchers to identify the sources of funds of respondent institutions. Approximately 34 per cent of them uses only private funding, 56 per cent makes use of mixed (private and public) funding and a mere 6 per cent is supported by public funding alone.

Chart 3.2 – Collection of information on risky clients (number of institutions)

black book; centralized credit rating agency; nothing; other

Table 3.7 clearly shows that households and financial institutions are among the major contributors to MFIs' funding, the nature of their contributions being mainly donations and lending at market rates. As to public financing, funding equally spreads over the European Union, national governments and regional governments, most of the funds being provided under the form of grants.

Table 3.7 – Classification of the sources of funds

PRIVATE FUNDING	Individuals Households	Companies	Financial institutions	Associations Foundations	Others	TOTAL
Market rate	2	0	5	1	5	13
Subsidized rate	2	1	4	2	0	9
Zero rate	3	1	2	2	0	8
Own capital	4	1	1	3	2	11
Donations	5	2	4	5	2	18
TOTAL	14	5	14	11	9	
PUBLIC FUNDING	European Union	Government funds	Regional funds	Local funds	Other	TOTAL
Market rate	0	1	0	0	1	2
Subsidized rate	0	2	0	1	1	4
Zero rate	1	1	0	0	1	3
Own capital	1	0	0	0	1	2
Donations	8	8	7	5	2	30
TOTAL	10	11	7	6	2	

All institutions offer 1.7 credit products on average, 5 also offer savings products, only 2 offer insurance products, and 1 offers payment services.

Moreover, 75 per cent of MFIs also provides non-financial services, such as assistance in drawing up business plans, and assistance and advisory services at large (see Table 3.8).

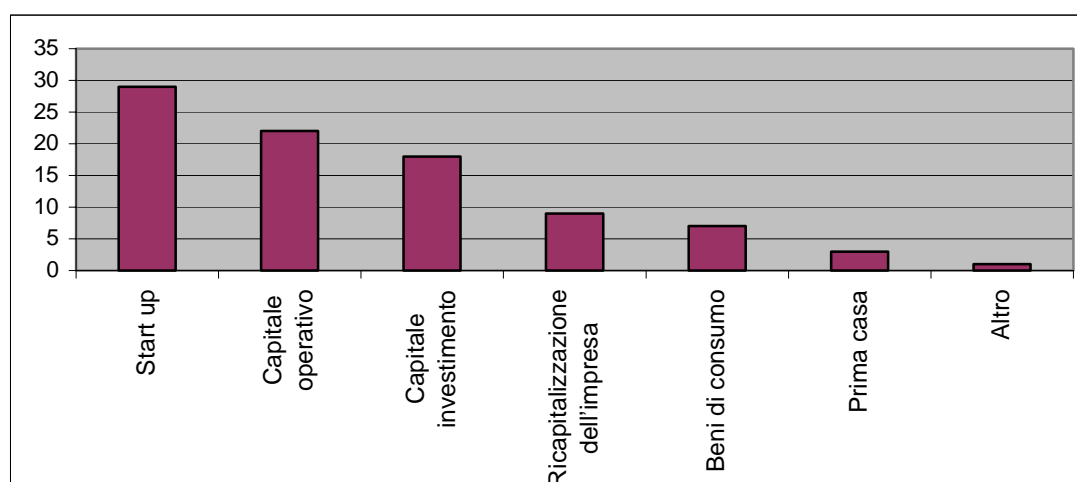
Table 3.8 – MFIs' non-financial services

	Assistance for business plan preparation	Assistance to clients in accessing financial institutions	Legal aid	Technical assistance	Training	Sundry
MFI No.	14	15	9	15	8	4
% MFI	43%	47%	28%	47%	25%	12%

Almost all MFIs provides credit to business start-ups (over 90 per cent), while approximately 25 per cent of loans goes to consumption. (see Chart 3.3).

Over 69 per cent of MFIs in the sample grants personal credit, only 9 per cent makes group lending, while 12 per cent makes both. If in some cases, no security collateral is required (59 per cent) against loans, in others MFIs require personal (approximately 35 per cent) or real (9 per cent) securities.

Chart 3.3 – Destination of loans (percentage over total institutions)



start up; operating assets; investment capital; recapitalization; consumer goods; housing; sundry

Loan disbursement takes 29 days (from submission of application to actual disbursement), and the borrower must submit a number of documents, among which a business plan (required by 87 per cent of MFIs), the borrower's tax declaration and employment contract (required by 46 per cent and 40 per cent of institutions respectively). Over 50 per cent of sample MFIs also requires and evaluates information on the borrower's behaviour in connection with loans he/she was granted in the past by other credit institutions.

3.3 Multi-dimensional analysis

The analysis reported in this section was carried out in the aim to highlight the outstanding characteristics of the sample under investigation, differently from what had been done in descriptive analysis (section 3.2).

The MFIs in the sample were initially divided into three different institutional groups. Then, we identified the dimensions through which we would observe the characteristics of the defined groups, and selected some complementary variable to the given dimensions in order to get a deeper insight into the dynamics characterizing the MFIs under investigation.

Finally, we outlined the MFIs institutional profiles with reference to the notions of sustainability and outreach, and used the above-mentioned dimensions to determine them.

In this section, we are going to describe the group identification criteria, and specify the analysis keys (sustainability and outreach). Then we shall report the results of the empirical study carried out on the sample of respondent MFIs, and make some concluding remarks.

3.3.1 The identified types of MFIs

The 31 MFIs in the sample used for the following analyses (see Table 3.1) were grouped primarily by institutional form, based on the respondent institutions' own declarations. By institutional form we mean the legal-statutory form of the institution as outlined in the answer to Question 5 in the questionnaire.

Moreover, as the sample included organizations with a mixed institutional form, three more aspects were considered in the group selection process, viz. (a) the main types of clients serviced (question 11), as this might be the result of an institutional orientation having obvious repercussions on the organization of the institution's activities and services, (b) the nature of the institution's sources of funds (question 17), as an *a priori* choice of the sources of funds is expressive of the institution's philosophy and *a posteriori* affects the institution's management, (c) the institution's supply of non-financial services (question 19), which usually indicates an institution's willingness to assist the client in the use of the loan and management of the business, and consequently affects the institution's management costs and complexity of the service offered.

Based on the answers obtained, 3 macro-categories were defined, viz.

- *MFIs that are financial institutions (FIs)*⁴: the group includes the institutions that, while often lacking the legal status of a “bank”, are mainly oriented to financial intermediation and provide their (in 22 per cent of cases only financial) services to individuals and enterprises by using essentially mixed funds (in 99 per cent on cases), i.e. both public and private funds (answers 1 and 2 to question 5). Nine institutions in the sample belong in this category.

⁴ The group consists of 8 “non-bank” and 1 “bank” financial institutions.

- *MFIs that are co-operative societies (COOP)*: the group includes the institutions having the legal form of a “co-operative society” (answer 6 to question 5). They offer their services primarily to other co-operatives or associations (90 per cent), by using private funds almost exclusively (80 per cent) collected from among their members. A large number of co-operatives (40 per cent) only provides services of a financial nature. In analyzing this group, it is important to consider that the number of final loan or service beneficiaries is very often much larger than the number of formal beneficiaries. In fact, a loan formally granted to a co-operative has an economic and social impact on all the individuals working in the beneficiary organization. Moreover, it is worth stressing that, in the cases under investigation, the borrowers are often different from depositors. Such situation defines the institutions in this group as financial intermediaries matching the supply and demand of different units rather than as mutual assistance centres. Ten institutions are grouped under this category.
- *MFIs that are NGOs, associations or foundations (NAF)*: the group includes non-governmental organizations, associations and foundations (answers 3 and 4 to question 5). Their legal status is testified by the nature of their sources of funds, characterized by a substantial share of both public and private donations. Generally (92 per cent of cases), NAF offer non-financial services (legal aid, technical assistance, training and advisory services). Twelve institutions are grouped under this category.

3.3.2 The dimensions of analysis and complementary variables

Considering the system used for the collection of information and the quality of the latter, it was decided to treat the notions of sustainability and outreach based on some dimensions that would indirectly allow the researchers to achieve a measurement of these two characteristics for each group. As to a possible proxy of *sustainability*, conceived as the MFIs' ability to generate enough profits to cover operating and financial costs (see section 1.5), the following variables were considered:

- the interest rate
- the repayment rate
- the average number of clients handled by one staff member.

Outreach was viewed as the social value generated by the MFI's action relative to some of the dimensions characterizing it (see Chapter 1, Box 1.4), viz.

- the number of clients
- the number of products
- the longevity of the MFI programme
- the depth of the action (average loan size/per-head GDP)

The variables further considered in the following section are some of the complementary aspects that were deemed to be most interesting, and ensuring a better insight into the institutional dynamics of the sample groups of MFIs, in terms of sustainability and outreach.

The selected complementary variables are

- whether the institution has a focus on the clients they serve,

- whether they have a structured system of information collection to hedge against credit risk (e.g. black book, joining a centralized credit rating agency, monitoring of clients, etc.),
- whether they have a marketing strategy,
- whether they lend based on collateral.

The purpose of the analysis is to highlight the characteristics of the MFI types that have been defined, while identifying trade-offs, if any, between the dimensions expressive of sustainability and outreach.

At first, we are going to provide a mere statistical description (see Table 3.10 below) for every variable used in the definition of dimensions (i.e. repayment rate, interest rate, etc.); then, we shall attempt an interpretation of the findings based on the relationships existing among the dimensions at issue, using the complementary variables whenever possible, in order to provide a clearer interpretation of the operating trends of the MFIs under investigation.

Table 3.10 – Dimensions and complementary variables: the institutional profiles of MFI groups

PARAMETERS	Cooperatives (COOP)	Financial institutions (FIs)	NGO, Associations, Fondations (NAF)	SAMPLE MEAN
SUSTAINABILITY (Dimensions of analysis)				
<i>Repayment rate</i>	96,1%	89,8%	83,3%	89,7%
<i>Average interest rate</i>	6%	6,6%	4,5%	5,5%
<i>Private sources of funds</i>	98,1%	44%	69%	71%
<i>Public sources of funds</i>	1,9%	56%	31%	29%
OUTREACH (Dimensions of analysis)				
<i>No. clients</i>	91	738	532	437
<i>No. products offered</i>	1,3	2,1	1,7	1,6
<i>Depth</i>	1,18	0,29	0,30	0.58
<i>Longevity of MF programme</i>	159	63	65	95
COMPLEMENTARY VARIABLES				
<i>There is a focus on clients</i>	90%	34%	67%	63%
<i>There is a system of information collection on risky clients</i>	40%	89%	34%	52%
<i>There is a marketing strategy</i>	40%	89%	50%	56%
<i>No. of clients handled by one general staff member</i>	24	28	48	34,5
<i>Real securities</i>	10%	0%	16%	9%
<i>Personal securities</i>	80%	33%	0%	34%
<i>No collateral</i>	20%	67%	84%	59%

▪ **The rate of repayment**

The rate of repayment is one of the most simple, yet significant measures of the financial performance and success of a microfinance programme. If, in the sample under consideration, the average rate of repayment is 89.7 per cent, with a minimum value of 50 per cent and a maximum of 100 per cent, then its distribution is very interesting.

- 11 per cent of the sample reports repayment rates below 70 per cent,
- 7.4 per cent of the sample reaches repayment rates ranging from 70 to 80 per cent,
- 22 per cent of the sample reports repayment rates ranging from 81 to 90 per cent,
- 50 per cent of the sample boasts repayment rates over 90 per cent.

The repayment rate is very high for co-operatives (96.1 percent), and decreases gradually for financial institutions (FI) and the group of NGO, associations and foundations (NAF) (89.5 per cent and 83.3 per cent respectively).

As mentioned earlier with reference to co-operatives, rather than being related to depositors-borrowers matching (which does not exist), the high repayment rate financial institutions report may be connected with the auxiliary services they provide to assist their borrowers and the socio-economic milieu where their clients operate. The latter are, in fact, most often backed by a strong relational network, tied to a geographical area.

▪ **The rate of interest applied by MFIs**

The rate of interest is the remuneration earned by an MFI on lending, and should be such as to cover financial and operating costs, and also consider portfolio riskiness and inflation.

Besides being affected by the lender's ability to reduce relevant costs (efficiency ability), the rate of interest might also be influenced by the lender's special "mission" (often described in the institution's "statutes").

Hence, it is worth stressing as from now that an MFI's low interest rate may be due to both its efficient cost reduction policy and an *ex-ante* decision based on the lender's particular social and political choice rather than economic efficiency-related reasoning. When a low interest rate is associated with a high repayment rate, we can say we are in the first case, while low interest rates associated with low repayment rates might be reflective of the second hypothesis.

In our sample, the interest rate average value is 5.5 per cent, while minimum and maximum values range from 0 per cent (hence, free loans) to 19.5 per cent (in Europe, market interest rates on loans in the period of the analysis vary from 8 per cent to 12 per cent).

Moreover, in our sample, interest rate distribution is as follows:

- 19 per cent of MFIs applies rates below 3 per cent,
- 16 per cent of MFIs applies rates ranging from 3.1 per cent to 4.9 per cent,
- 29 per cent of MFIs applies an interest rate of 5 per cent,
- 26 per cent of MFIs applies rates ranging from 5.5 per cent to 9.5 per cent,
- 10 per cent of MFIs applies an interest rate exceeding 10 per cent.

Hence, 64 per cent of the MFIs in our sample applies a rate of interest lower than 5.5 per cent. The lower average interest rate, viz. 4.5 per cent, is applied by the NAF group, while co-operatives and financial institutions apply rates of 6 per cent and 6.6 per cent respectively. In particular, it can be noted that there is no defined trade-off between interest rate and repayment rate, and that there is a high variability of repayment rates associated with rates of interest below 5 per cent, while for higher interest rates, this performance indicator never falls below 88 per cent. This observation indicates that the institutions lending at subsidized rates achieve less satisfactory results on average than those adopting a more sustainability-oriented approach. In the following sections, we shall discuss the linkage between the search for sustainability and the interest rate level.

▪ **The number of clients handled by one staff member**

This indicator defines the number of clients handled yearly by each staff member working with the MFI. It provides an indication of staff productivity and institution efficiency. The higher its value the lower the cost incurred by the MFI in handling each client. Saving on this cost may affect the MFI's ability to recover its management costs, and, hence, improve its financial sustainability in the long run.

For the whole sample, the average value of staff productivity is 34 clients, with a maximum value of 312. At the aggregate level, distribution is as follows:

- 50 per cent of MFIs reports a productivity of less than 20 clients by staff member,
- 36 per cent of MFIs reports a productivity ranging from 21 to 50 clients by staff member,
- 14 per cent of MFI boasts a productivity of over 50 clients by staff member.

The best productivity of general staff members is reported in the NAF group, whose employees handle approximately 48 clients each, while financial institutions' employees handle 28 clients each on average. The productivity of individual co-operative staff members is only 24 clients (co-operatives).

It is important to stress here that MFIs lower productivity as compared to financial institutions non operating in microfinance is partly linked to the limited longevity of many institutions (and, hence, the fact that they are still working at an experimental stage) and partly to the types of auxiliary services they provide to meet their clients' needs and to serve the purposes pertaining to the social mission of a large number of them. The high repayment rate mentioned earlier may be partly related to MFIs' willingness to establish strong personal relationships with their clients. This is not often the case with traditional financial institutions, but is often reported by MFIs, and obviously involves a lower productivity of their staff.

▪ **Number of clients (breadth of outreach)**

This variable refers to the average number of clients serviced by the institution during a year's activity. The average number of clients serviced for the whole sample is 437, with the following distribution:

- 50 per cent of MFIs services less than 100 clients,
- 40 per cent of MFIs services from 101 to 340 clients,
- 10 per cent of MFIs services over 2000 clients.

Financial institutions service 738 clients on average, the NAF group provide their services to approximately 532 clients. In both cases, the institutions provide much more specific and careful assistance to clients than traditional credit institutions, due to the deficiencies and disadvantages characterizing their target clients. This indicator falls considerably when considering co-operatives that service but 91 clients on average (which, however, are legal persons, i.e. associations and co-operatives, in 90 per cent of cases).

▪ **Number of products offered (scope of outreach)**

This variable indicates the degree of diversification of the MFIs' product range. On average, the value for the whole sample is 1.7, with a minimum value of 1 and a maximum value of 4. At an aggregate level:

- 54 per cent of MFIs offers 1 credit product only,
- 25 per cent of MFIs offers 2 credit products,
- 16 per cent of MFIs offers 3 credit products,
- 4 per cent of MFIs offers 4 credit products.

The highest value is reported for financial institutions, which offer 2.1 credit products on average, while the figure reduces to 1.7 for the NAF group and falls to a minimum 1.3 for co-operatives. In many cases, instead of standardizing several product models, MFIs prefer to define one or two products which are then remodelled to suit individual clients' needs, due to potential clients' diversity in the market niches where they operate. If, as it is argued, this strategic choice of closeness to clients would entail satisfactory repayment rates, especially when the number of clients is not so large, it might as well produce low profitability due to the high costs implied in diversifying the service.

▪ **Longevity of the microfinance programme (length of outreach)**

The indicator measures the number of months the microfinance programme offered by the institution has been running. The variable shows an average value of 95 months, varying from a minimum of 12 to a maximum of 429 months. Distribution is as follows:

- 32 per cent of programmes has been running for less than 36 months,
- 19.3 per cent of programmes has been running for 36 to 60 months,
- 22.5 per cent of programmes has been running for 61 to 120 months,
- 24.5 per cent of programmes has been running for over 120 months.

The longer programmes are those registered under the form of co-operatives (159 months on average), testifying to the long-established presence of those institutions in the European context (see section 2.1). On the contrary, the average longevity of programmes for the NAF and FI groups is considerably shorter (65 months and 63 months on average respectively). It is worth stressing that one third of MFIs is less than 3 year old and over half of them is only 5 year old. These data confirm that the industry of microfinance is very "young" and still at an experimental and development stage, which partly explains some of the findings mentioned above (small number of clients, low productivity), typical of infant financial institutions.

▪ **Depth of outreach**

The indicator is given by the ratio of the MFI's average loan value to the average per-head GDP of the country where the MFI operates. The lower the indicator value, the more likely is the MFI to reach the poorest and those shunned by traditional bankers. The indicator shows values varying from a minimum .3 per cent and a maximum 290 per cent, which means that in the former case the loans granted are equivalent to .3 per cent of per-head GDP, while in the latter they are approximately three times the value of per-head GDP. The indicator average value is 58 per cent, with the following distribution over the sample:

- 28.5 per cent of institutions has a depth lower than 20 per cent of per head GDP,
- 29 per cent of institutions has a depth varying from 21 per cent to 49 per cent of per head GDP,
- 25.8 per cent of institutions has a depth varying from 50 per cent to 100 per cent of per head GDP,
- 19.3 per cent of institutions has a depth of over 101 per cent of per head GDP.

It is hard to make a consistent comparison of the three types of MFIs. As might be expected, the depth of outreach of the FI and NAF groups (.29 and .30 respectively) is much greater than co-operatives' depth. It should not be forgotten, however, that co-operatives almost always lend to legal persons, and, hence, the impact of their lending is much stronger than shown by the indicator.

1.3.1 Relationships among variables

In order to give a consistent in-depth interpretation of the MF phenomenon, in the light of the above mentioned variables, it may be interesting to cross-analyze the data listed above in order to highlight the relationships among variables and make some relevant considerations.

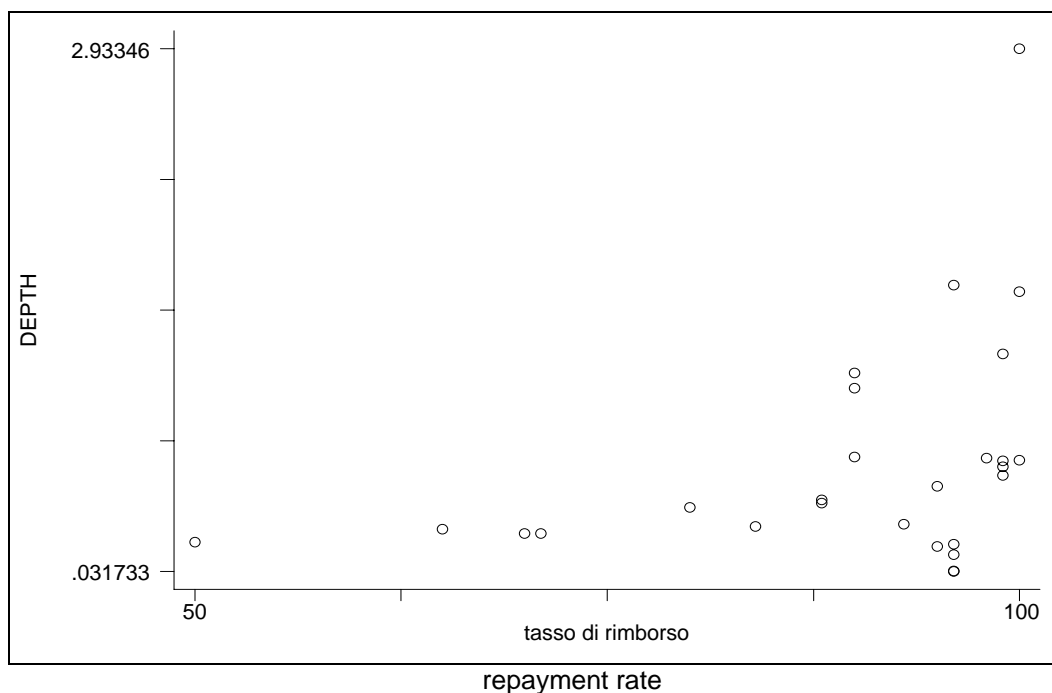
The **repayment rate** might be affected by the MFI's programme longevity. One can expect that in the early stages of a microfinance project, an institution is ready to accept low repayment rates as a result of an aggressive market policy, but as the programme continues and strengthens, those rates should reach satisfactory levels in order to ensure the programme full sustainability. Hence, it is worth considering the microfinance programme temporal dimension. "Younger" programmes, i.e. those promoted by FIs and NAF, show lower repayment rates than co-operatives (a group boasting the "oldest" MF programmes), while the NAF group shows repayment rates even lower than sample average. It is also worth stressing that, in the case of co-operatives, the repayment rate is also positively affected by their clients taking the status of "members". While they are not usually the co-operative main depositors or majority members, they are obliged by law to participate in it.

At the same time, it is also interesting to focus on the relationship existing between the repayment rate and the depth of outreach calculated for sample institutions, in order to see whether their performance depends on their ability to reach a marginal clientele or not.

Chart 3.4 compares the proxy of sustainability, i.e. the repayment rate, which, as mentioned earlier, depicts the ability of an institution to survive over time fairly accurately, as a high repayment rate is associated with a minimum loss on loans and a lower credit risk level, with the proxy of the institution's depth of outreach (as defined above).

In particular, the COOP group, which boasts the highest repayment rate, is also the sample group with the lowest depth indicator. The finding might be related to their offering their services to a well-defined target group of clients, i.e other co-operatives and associations in 90 per cent of cases, which are generally also members of the lending institution.

Chart 3.4 – The relationship between depth and repayment rate



For this reason, the depth of their outreach is lower, as it is calculated based on the amount of credit and the number of serviced clients, be they individuals or legal persons. Hence, as mentioned earlier, the value of the depth indicator for the COOP group would have been very different if the number of members of each client co-operative and association had been considered⁵. As to the other two sample groups (FI and NAF), which show a lesser propensity to focus on specified target client categories (34 per cent and 67 per cent respectively), and mainly service all those who are excluded from traditional financial services indiscriminately (small and micro-businesses, individuals), they achieve greater depth of outreach, but lower repayment rates.

⁵ Considering a loan of 100 granted to 1 association of 10 members, the corresponding value of the depth indicator, as calculated in our analysis, would be: 100/per-head GDP.

Should we consider depth based on the number of members of the client association, then depth would be: 10/per-head GDP.

There is an apparent negative correlation between the depth of MFIs action and its sustainability. Although, as mentioned earlier, such relation is distorted by lack of homogeneity among groups, it reveals a difficulty in achieving high degrees of depth while at the same time ensuring sustainability.

It can also be observed that the institutions showing greater depth (FI and NAF groups) are also characterized by having a larger number of clients.

However, the major difference between COOP and other types of MFIs lies not only in the legal nature of their clientele (natural and artificial persons)⁶ and in their focusing on a given client category, but also in the use of peculiar **marketing strategies**. FIs very frequently (89 percent) using a well defined marketing strategy have a larger number of clients (738) on average than NAF (532), where only 50 per cent of institutions makes use of marketing tools. In the case of the COOP group, the number of entities using marketing strategies is still smaller (40 per cent). Yet, the relationship between the number of clients and the use of marketing strategies is still fuzzy. As it is, this relationship might be interpreted in both directions, i.e. it is unclear whether a more aggressive marketing strategy would favour an increase in the number of clients, or whether the MFI's growth would promote the organization rationalization and opening through studied ad hoc strategies, also made possible by larger amounts of available resources.

At the same time, it is also interesting to note that, depth being equal, the variability of the repayment rate would appear to be affected also by the use or non-use of a **structured system of information collection** on risky clients. Leaving aside the COOP group, due to their peculiar client relationship which was mentioned earlier, the findings seem to confirm the above hypothesis. We can observe that the MFIs in the FI group, which report a 7 per cent higher repayment rate than NAF, are also those most often using a structured information system (88 per cent) and a well defined marketing strategy. Whereas the low repayment rate reported for the NAF group, besides being possibly related to the special nature of their sources of funds, their governance structure or their social and political orientation (mission), might also be affected by their still infrequent use of those management tools.

Considering sample MFIs, one can also note that a maximalist orientation⁷, which especially characterizes the NAF group, generally implies a very low (4.5 per cent) **interest rate** as compared to those applied by the remaining two groups, which tend to mainly offer only financial services (6.02 per cent and 6.58 per cent respectively for COOP and FIs). It is worth stressing that the NAF group, characterized by lower-than-average repayment rates and the supply of auxiliary non-financial services (advisory services, legal aid, training), are in a position to apply lower interest rates only thanks to the substantial share of donations and subsidized financing in their sources of funds (70 per cent). Moreover, their maximalist policy might as well generate cross-subsidization effects, i.e. non-financial services subsidizing financial services.

It is also interesting to note that the number and type of clients vary in proportion to the **number of lending products** offered by the institution. In fact, FIs, which offer a wider range of products (2.1 products), aim at meeting the financial needs of a more diverse

⁶ In general, co-operatives do not necessarily have a lesser outreach by way of their lending policy to other co-operatives.

⁷ Financial services are often associated with non-financial assistance in order to further strengthen the relationship between the institution and the beneficiaries of the project.

range of clients than COOP (1.3 products), which, as mentioned earlier, offer their services primarily to other co-operatives and associations.

As to sustainability, the different distribution of the **collateral** securities required to back loans might affect repayment rates and interest rates alike. Considering that credit risk can be suitably hedged by introducing loan contract innovations and, hence, structuring the loans based on the clients' characteristics, it appears that the groups of institutions less frequently requesting real securities (COOP and FI) are those reporting higher repayment rates as well as higher interest rates. Parallel to the lending schemes based on no collateral securities offered by all sample MFIs (83 per cent of lending for NAF, 67 per cent for FIs, 20 per cent for COOP) a growing number of schemes envisages the supply of personal securities (33 per cent for FIs, 80 per cent for COOP, and 0 per cent for NAF), which points to a search for continuing innovation aimed at identifying the contract pattern that can better meet the client's financial needs.

3.4 Conclusions and suggestions

The analyses discussed above have aimed at highlighting the relationships, if any, between sustainability and outreach, in respect of the European context. In general, and mainly with reference to LDCs, it can be said that, in these latest years, the MF programmes reporting significant progress in terms of outreach as well as sustainability are few (Yaron, 1994; Christen *et al.*, 1995; Schreiner and Yaron, 2001). Moreover, the programmes showing the best results in terms of outreach seem to also be those tending to achieve the best results in terms of sustainability (Gonzalez-Vega *et al.*, 1997).

The ever-evolving market of microfinance seems to be moving towards gradual commercialization⁸ of the industry, especially in some LDCs (Bolivia and Bangladesh) characterized by great dynamism and strong competitiveness. But the major difficulty encountered in developing these programmes, and especially those aiming at reaching the poorest of the poor, is the achievement of financial sustainability. Also the most renowned (e.g. the Grameen Bank) do not achieve full sustainability and succeed in recovering approximately 70 per cent of their total costs (Murdoch, 1999).

In Europe, although MF has different origins (see section 2.1) and takes peculiar institutional forms, the industry trend does not appear to be very different. The analyses performed in this chapter have somehow confirmed that independently of the poverty lending approach or sustainability approach, MFIs' efforts should be aimed at maximizing the difference between the costs and benefits derived from MF, through the use of financial technologies that should allow them to reach the identified market segment, in a long-run perspective, minimizing the costs implied in the supply of their services and at the same time maximizing the benefits their clients draw from those services. Yet, experimenting on this, and introducing new tools is problematic due to the trade-off between the cost and quality of the services. In their attempt to service a given potential market niche, MFIs should find an efficient risk-evaluation measure at a lower cost than the benefit that might be derived from it (Schreiner, 2000).

The models developed in LDCs and their success have given the microfinance industry in Europe a new boost, rekindling the interest and attention of both private and public entities, and paving the way to significant development and continuing applied

⁸ Commercialization here means the process of approximating MFIs management practices to market logic, characterized by full (both operating and financial) cost recovery.

research. In the course of our analysis, three prevailing institutional forms (COOP, NAF, FI) were identified, which have different orientations as to the supply of microfinance services.

As described earlier, the MFIs in the three groups differ not only in terms of institutional set-up, but also in terms of the characteristics of their products, sources of funds and serviced clients.

There seem to emerge different MF markets serviced by organizations differing in structure and objectives: *Co-operative societies (COOP)*, which somehow represent the historical roots of the MF phenomenon in Europe (see section 2.1). They primarily service other co-operatives and associations (90 per cent), almost exclusively using funds of a private nature (80 per cent) mainly collected from among members. A large share of these organizations tends to focus (40 per cent) on the supply of financial services only, contrary to what observed for *associations, foundations* or *NGOs* in the NAF group. The latter tend to provide also auxiliary non-financial services (92 per cent), and regard credit as only a marginal component of their activities. Their legal status and governance structure are also connected with the nature of their sources of funds, characterized by a substantial component (approximately 70 per cent on average) of public and private donations. This is among the reasons why those MFIs can provide their services at a lower cost, even though their repayment rates are below average (and lower than those reported for the remaining two groups of COOP and FIs).

While it is clear that the better performance of co-operatives is primarily due to their nature and the "member" status generally assumed by their clients, for the organizations included in the FI group the same seems to be also linked to the application of structured systems of information collection on risky clients and the adoption of marketing strategies. Even when these organizations do not have the status of a "bank", they are primarily oriented to financial intermediation, and provide their services (only of the financial type in 22 per cent of cases) to individuals and businesses, using essentially mixed funds (in 99 per cent of cases), i.e. both public and private, which yet include a subsidized share also in this case, although to a lesser extent.

Despite this aspect, which however concerns all European MFIs to a different extent, the FI group of MFIs appears to be the one more oriented to the commercialization and innovation process characterizing many of the MFIs operating in LDCs and examined earlier (Chapter 1, section 1.5.2).

Generally, MF commercialization mirrors the institutions' orientation towards full sustainability, which is often the necessary condition to be granted permission to operate in a market regulated and supervised by a central authority (Christen, 2000). Competition among the institutions operating in the same industry will stimulate innovation which, as mentioned earlier, is the springboard for performance improvement in terms of outreach and sustainability.

Yet, it is too often apparent that many MFIs have given up searching for new "solutions", and confine themselves to replicating one single scheme of action with growing uniformity (Hulme and Mosley, 1996). In so doing, they forget that the true strength of microfinance lies in its ability to penetrate a given social texture, and exploit its peculiar potential (see section 1.1 and 1.5).

The main difficulty in providing this type of financial services seems nowadays to lie in the choice of an organizational design with the appropriate incentive structure

and definite administration structure linked to a clear definition of the organization governance mechanism (Gonzalez-Vega, 1998).

3.5 Lessons learned

In the course of the present research, some key aspects have emerged, which make it possible to outline a number of choices that can be regarded as “winning” for the establishment and management of an MFI. Yet, it is clear that, although some of the indications are amenable to, and valid for almost all realities in the European context, it is the organization’s sensitivity and purposes that can only ensure their successful application at an operational level. It should not be forgotten that the true strength of microfinance lies in its ability to get embedded in the local context, exploiting existing synergies and peculiarities and using resources that were so far neglected or not taken into consideration by traditional credit institutions. Hence, the statements below far from being expressive of specific certainties, are meant to be only general indications.

The analysis carried out so far, and the authoritative opinion of some distinguished microfinance scholars, induce us to state, with the due and necessary caution, that a winning microfinance institution is specialized, commercial and minimalist (Von Pischke, 2002). This type of institution

- (a) tends to specialization, in order to benefit from the economies of scale characterizing large scale services.
- (b) It mainly uses an individual lending technology, but also considers the possibility of using group lending, in order to service its target clients at best. If and when necessary and convenient, it also provides technical assistance (which is also important to improve the client’s loan management ability and responsibility, and, hence, to improve loan repayment), but always in a minimalist perspective.
- (c) It defines the price of the financial services it provides (rate of interest) in such a way as to cover operating and financial costs (financial sustainability) and ensure the organization growth in the long run.
- (d) It generally uses subsidized funds only in the medium run, in the attempt to become self-sufficient in the long run, through a full financial sustainability-oriented commercialization process. In general, subsidized resources are considered to be a costly and unstable source of funding. The activity of a subsidized institution would not enjoy autonomy, as in the first place it should pursue the purposes established by those providing the funds, and only in the second place the objectives fixed by its managing board.
- (e) It considers innovation a crucial element for institutional development, without ever losing sight of the trade-off between the quality of its services and the costs incurred in designing and providing them.

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