**2011 Global Microcredit Summit**
***Commissioned Workshop Paper***
***November 14-17, 2011 – Valladolid, Spain***

# Implementing effective partnerships between MFIs and financial institutions: The case of France and Europe

***Changing the mindset and strengthening the capacity of financial institutions, governments, MFIs and other stakeholders, to carry out effective microfinance programs***


**Written by:**

**Maria Nowak**, *President & Founder*, L'Association pour le droit à l'initiative économique (ADIE), *Co-founder*, Microfinance Center and the European Microfinance Network, France

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*Summary*

The paper's first section describes the experience of Adie in France. Created in 1988 by three volunteers with no capital, with the support of the French Association of Banks Adie obtained an amendment to the Banking law, allowing associations to borrow and on-lend. This amendment allowed Adie to develop partnerships with almost all French banks.

The second section presents the experience of the two European microfinance networks and describes how microcredit was introduced in the European Commission, the European Parliament and the European Investment Bank.

The third section draws lessons from these experiences and identifies remaining obstacles to the development of microcredit in Europe.

## Introduction

If in developing countries microcredit developed outside the banks, which had little interest in its target clientele, in Europe the organisation of the banking sector and the much stricter application of banking regulation made such a development considerably more difficult, in the face of a much smaller demand.

Moreover, the implantation of microcredit in Europe has taken much longer and its development is far from complete. In Central and Western Europe, it has been helped by the dismantling of the central command economy and its transition towards the market economy. From one day to the next, almost the entire labor force found itself unemployed and had no choice but to create an enterprise or develop some other income-generating activity. The support of aid agencies and international NGOs, which provided both the financing and technical assistance needed to create microfinance institutions out of nothing, in a rapidly changing institutional environment, facilitated the emergence of a microcredit sector. This was helped by a lower density of banks, which were, moreover, not always adapted to this type of financing.

In Western Europe, introduction of microcredit was more difficult insofar as circumstances did not make it essential. Wage-paid labor was always the rule, and the welfare state took care of those whom the market economy left behind.

In both cases the development of microcredit was only possible in the framework of a profound evolution of public opinion, to which the sector itself contributed.

In the framework of the World Bank, the author of this paper launched the first microcredit projects in Eastern Eastern Europe, particularly in the Balkans. Working as a volunteer, she applied this experience, together with that acquired previously in Africa through the Agence Française de Développement, by creating in France the Association pour le Droit à l'Initiative Economique (Adie), and by working to develop microcredit in the European Union.

## 1. The development of microcredit in France

### 11. Origins

The idea of implementing microcredit in France arose from a successful transfer of the Grameen Bank experience into Africa. In 1988, welfare payments (known as Revenu Minimum d'Insertion) had just been introduced in France, and I had the idea that one way to integrate jobless people in the economy could be the development of self-employment and creation of microenterprises. I contacted several NGOs engaged in anti-poverty work, offering to help them launch a pilot project, but none of them believed in it. The response was always the same: »It's a good idea for poor countries, but not for a developed country such as ours. » Thus I had no choice but to set up myself, with two friends, an association with the three-fold object of:

- Financing projects of people who were jobless or on welfare and desired to create an enterprise ;

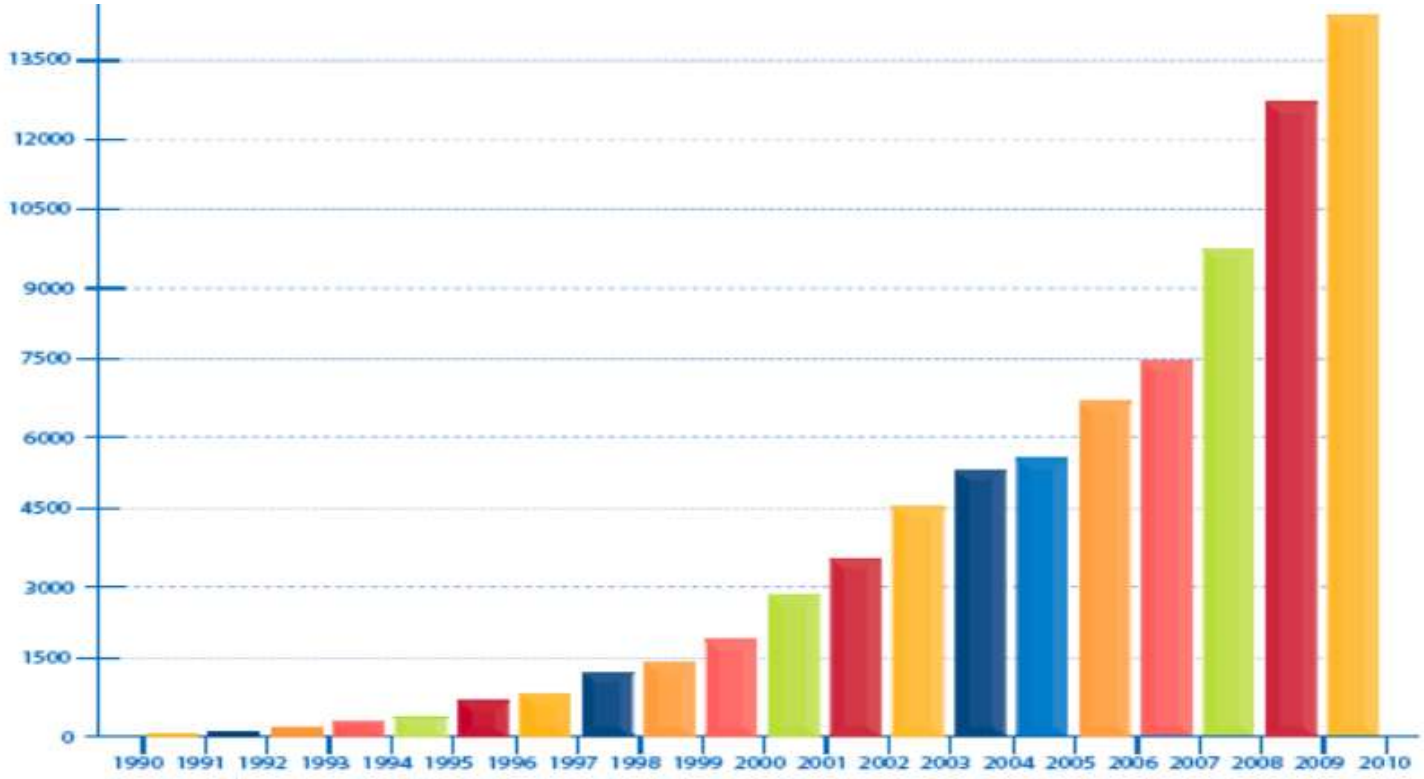
- Help them to regain their autonomy and succeed in their project, by providing them business development services;

- Draw lessons from this action on a large scale to change public opinion and a regulatory framework that were adapted to an economy based on large enterprises, wage labor and the welfare state.

**12. Results**

Over 22 years Adie has made close to 100,000 loans, with a loss rate below 3% ; a two-year survival rate of 68% for the enterprises created, close to the national average; and an 80% rate of integration of clients in the economy. Its network covers the entire territory of France, including overseas territories. Its active clients currently number more than 27,000 persons.

Number of microcredits granted since Adie's inception




Moreover, the Association has obtained major advances in reforming the institutional framework. The principal measures are presented below:

*Legislative advances in the field of microcredit*

- 2001: amendment of the Banking law, allowing microcredit associations to borrow and on-lend
- 2005: removal of interest rate caps on loans to individual enterprises
- 2008: extension of the authorisation for borrowing and onlending to foundations + extension of the target group to microenterprises with less than three employees + consumer credit to persons lacking access to banks. Access to records of the Banque de France.

*Legislative advances in regard to Microenterprises*

- 2005: recognition of enterprise creation as a way to economic integration and reduction of social security charges for low-income entrepreneurs
- 2007: social shield
- 2008 : creation of the status of auto-entrepreneur

As of now, we still have three major battles to win :

- <u>access of jobless persons creating enterprises to vocational training funds</u>, which are legally available to them since 2005.

- <u>removal of constraints applicable to trades not requiring lengthy training</u>. Regulation in France is based on sector of activity. Whether you want to be an auto mechanic or bicycle repairman, you need three years of training and a diploma in order to carry on your trade. Following three years of unsuccessful efforts to change the law, we have appealed to the « Conseil d'Etat », on the basis of non respect of the fundamental right to undertake economic activity. Our appeal has been transmitted to the « Conseil Constitutionnel ». Given its negative decision, it will be submitted again to the « Conseil d'Etat ».

- <u>establishment of a system for providing equity capital to jobseekers creating enterprises</u>. This is needed because, contrary to the situation in countries of the South, they do not develop informal income generating activities , but registered enterprises in an environment that is infinitely more complex. The problem is that all the public facilities that used to provide equity or quasi-equity capital to young people, low-income districts or welfare recipients have been recently abolished, *due to fiscal deficit.*

## 2. Development of microcredit in Europe

### 21. Origins

If Adie was the first institution to transfer the new approach to microcredit to Europe, this was not a new idea there. Small-scale informal credit already existed in the Middle Ages. The Mounts of Piety were created in Italy in the 16th century to serve the poor, at the same time as credit for large-scale commerce was being developed. In the 19th century, savings and loan cooperatives established by Raiffeisen in Germany offered peasants an alternative to usury. These gave rise to mutualist banks in most European countries.

### 22. Diversity of institutional models

The economic evolution linked to the industrial revolution, rural-urban migration, and the development of wage-paid labor, was accompanied by the growth of banks serving more accessible clients and using procedures based less on client contact than on statistical evaluation. This development , ***as well as the implementation of the banking régulations,*** left behind those who could only borrow small amounts of money and lacked collateral.

At the end of the 20th century, the idea that the poor also needed access to credit reappeared through the inspiration, notably, of Bangladesh's Grameen Bank. Long-standing institutions such as savings banks or Credit Unions began increasingly to provide microcredit to small enterprises. Some commercial banks opened special windows. NGOs created nonbank MFIs.

*Examples of institutions developing microcredit*

- Partnership between Government, public bank, and MFIs, acting as agents, in Germany
- Savings banks in Spain, before the crisis
- Partnership between banks and MFIs in France, Belgium
- Older models of credit unions: Ireland, Poland, Bulgaria, Romania

### 23. Birth of the MFC/EMN networks

Starting in 1990, the collapse of the central command economy in Central and Eastern Europe brought about massive unemployment in the entire region. The major international aid agencies, the World Bank, USAID and international NGOs looked towards introducing microcredit in the post-communist countries. Parallel to the financial flows, the new microfinance insitutions, which had no idea how to proceed, needed training and technical assistance. It was in 1996 that three practitioners of microcredit, Rosalind Copisarow, Ken Van Der Weld and myself established the

Microfinance Centre for Central and Eastern Europe and the MIS Countries (MFC), which was installed in Warsaw to provide all the region's microfinance institutions with the services of training, technical assistance and research that they needed.

Since the MFC was scarcely interested in Western Europe, where microcredit was very little developed, in 2003 La Nef, Evers&Jung and Adie created the European Microfinance Network (EMN), covering the 21 member countries with more or less the same objectives as the MFC. When the European Union took in eight Eastern European countries in 2004, the geographical coverage of the two networks overlapped in part, and the division of labor became more difficult. The EMN plays more of a role of representation before the European Commission, while the MFC remains largely a center of research and services. Having been the first president of both networks, I have been able to strengthen relations with the European Commission, which has made it possible to advance the cause of microcredit in the Union.

**23. Evolution of European institutions**

Due to an intensive advocacy in Brussels, the European institutions have become progressively convinced of the suitability and importance of microcredit in industrialized countries. The major steps are listed below:

*European Commission*

- DG Empl finances Adie's pilot phase (1989) as well as business development services for micro-entrepreneurs.

- DG Enterprises organises the first European conference on microcredit (2003) as well as expert groups on market shortcomings and regulation of microcredit.

- Ecfin and DG Enterprises establish a system of guarantees for microcredit

It finances studies on inclusion of jobless people in the economy through creation of enterprises.

- Following lengthy discussion among several Directorates, organized by DG Regio, in 2007 the Commission publishes «the Initiative for the Development of Microcredit in favor of Growth and Employment», promoting four strands of activity:

    - Improvement of the legal and institutional environment of microcredit in the Member States
    - Further improvement of the climate in favour of entrepreneurship
    - Promoting the spread of best practices
    - Providing additional financial capital for new and nonbank MFIs

At this point, the last two strands have been implemented:

A technical assistance facility called « Jasmine » provides technical assistance to the European MFIs and a financial facility called « the European Microfinance Progress Facility » (EMPF) provides them with equity and loan capital. Now the main challenge is to improve the legal environment of microcredit and microenterprises, which is the responsibility of the Member States. While it has significantly changed in some countries, in many others the banks' monopoly, the cap on the interest rates, the difficulty of bridging the gap between self-employment and the welfare system, the weight of social charges and the overall complexity of the legal system for microenterprises, hamper the development of microcredit and microenterprises.

*The European Parliament*

In recent years, expansion of microcredit has been supported by the EU Parliament, which has organized meetings and financed pilot projects .

The European Investment Bank

The EIB, mainly oriented towards large investments, has revised its policy and now participates in financing MFIs. The European Investment Fund, a member of the group, is in charge of managing the guarantee fund as well as the EMPF.

## 3. Lessons from experience and future prospects

### 31. What have we learned in 20 years?

During the last 20 years, a number of lessons have been learned.

- The first lesson is that entrepreneurship never dies and that microcredit is also relevant in developed countries. A few examples show it: In the transition countries, where economic initiative was prohibited for 40 years, the collapse of the public sector made people entrepreneurs, from one day to the next. In France, adoption of a law simplifying self-employment created 700,000 enterprises in two years. Last but not least, default rates in Europe are low, as is the case of the countries of the South.

- The second lesson is that the potential market is large but not immediately accessible. Besides the microenterprises, which represent 92 % of the total number of existing enterprises, there is a pool of activity and employment at the base of the pyramid.

- The total population below the poverty line amounts to about 80 million, or 16% of the European population. Among the active population are registered jobseekers, but also those affected by hidden unemployment, especially in rural areas, low-income workers, and welfare recipients . A part of them come from the most vulnerable groups: single-parent families, the elderly, immigrants, Romas, etc.

  In order to be operational, the microcredit market requires social marketing. In the end it is supply that creates demand.

- The third lesson is that economic models are very different as between Eastern and Western Europe

  A comparison between France and Romania shows a higher social performance in France and a better financial performance in Romania. These caracteristics are related among other factors to :

-the different target groups : vulnerable people creating their own job in France ; existing small and microenterprises in Romania. While in France the average loan amount corresponds to 10% of per capita GDP, the ratio in Romania is 70% ;

-the density and role of banks in the two régions ;

- higher costs, and a more developped welfare system in Western Europe ;

-higher interest rate in Romania versus France.

In both cases, however, microcredit creates the market's cheapest jobs, generating savings for the government budget as well as high economic and social returns.

**32. Prospects for development**

Looking beyond the impact of the current economic crisis - decline of demand and increase in risk, which has slowed down microlending - the development of microcredit seems inevitable in the medium term. The main reasons are the following :

- Disindustrialisation, the growth of services and new technologies favor the creation of small production units, possibly linked in networks,
- Ageing of the population and inevitable reform of the welfare state require more active employment policies,
- Unemployment, poverty, and fiscal deficits require a policy of trust in the citizenry, while making it responsible,
- Globalization, irreversible as it is, must also encompass the base of the economic pyramid and be complemented by local development.

For all these reasons, microcredit is becoming the financial instrument of the post-industrial period.

Comparative evolution of the number of employees in industry and services between 1970 and 2009

**33. Actions to be taken**

Because the development of microcredit has economic, social and financial implications and effects, it requires the collaboration of European institutions, Member State governments, the regions and the banks.

Several actions should be undetaken in this respect:

*Regarding the institutional framework :*

The preparation by the European Ccommission (EC) of the Single Market Act, to be published at the end of the year, provides an opportunity to improve the legal and institutional framework of microcredit.

- Under the patronage of the Polish Presidency and the European Parliament, DG Markt can encourage the Member State financial regulatory authorities to improve the regulatory framework of microfinance by organizing a policy forum on this subject.

- DG Empl, Dg Enterprises and DG Markt can develop exchanges among European countries in regard to removing legal and regulatory obstacles to the development of self-employment and microenterprises, as well as economic inclusion policies based on self-employment.

*In regard to financing,*

- With the support of the EC, the microfinance networks can develop communication among European Member States and citizens on the impact of microcredit and use of the structural funds to finance business development services and microcredit ;
- New partnerships should be developed among banks, the European Investment Fund and MFIs in order to launch new microcredit programs along the lines of microStart in Belgium[1].

*Regarding technical assistance*

- The challenge is to extend best practices with the support of Jasmine and greater collaboration between the two microfinance networks.

**Conclusion**

Microcredit can facilitate the current economic evolution in its capacity as a:

- Tool serving the development of microenterprises and employment of vulnerable population groups
- Instrument of economic democratisation, allowing citizens to take charge of their destiny
- Source of social links contributing to Europe's social cohesion
- Instrument of trust in the future, contributing to Europe's dynamism in the face of globalization.

***[1] MicroStart est une société coopérative créée avec la participation de BNP Paribas Fortis, EIF et l'Adie avec pour objectif de développer le microcrédit aux personnes démunies dans deux quartiers pauvres de Bruxelles, puis, en fonction de la réussite de l'opération, de l'étendre en Belique.***