Microlending in Germany

– A Case Study on DMI –

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BRI	Bank Rakyat of Indonesia
CGAP	The Consultative Group to assist the Poor
DMI	Deutsche Mikrofinanz Institut (German Microfinance Institute)
DtA	Deutsche Ausgleichsbank
e.g.	for example
e.V.	eingetragener Verein (registered association)
EU	European Union
EUR/€	Euro
GDP	Gross Domestic Product
GLS	Geben, Leihen, Schenken
GTZ	Gesellschaft für Technische Zusammenarbeit
IFF	Institut für Finanzdienstleistungen
ILO	International Labour Organization
KfW	Kreditanstalt für Wiederaufbau
MAP	Multiannual Programme
MEB	Micro Enterprise Bank
MFI	Microfinance Institution
MSME	micro, small, and medium enterprises
NABARD	National Bank for Agriculture and Rural Development
NGO	non-governmental organization
p.a.	per annum
PaR	Portfolio-at-Risk
SEEP	Small Enterprise Education and Promotion Network
SHG	Self Help Group
SME	small and medium enterprises
UK	United Kingdom
UN	United Nations
US	United States

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Introduction

2005 “the year of microfinance”. This UN announcement not only honours the past success of these financing schemes but also emphasises its increasing importance in the years to come. Organized as a means for the financially impoverished to help themselves, it does a great deal in accomplishing several of the UN Development Goals. Microfinance is considered a great success in helping alleviate poverty in developing countries. It proved that the lack of low-interest credit was not the problem of the poor, but the general access to financial services. Within the context of microfinance, new banking techniques and products were developed in order to meet the real demands of the poor, who are prepared to pay high interest rates because they were previously used to paying even higher interest rates with money lenders and because they run businesses with very high profit margins. As a result it became apparent that outreach and sustainability can be achieved simultaneously through a demand-driven approach.

Inspired by this achievement in developing and transition countries, the question was raised whether or not the success of microfinance could be replicated in developed countries, such as Germany to combat increasing problems of unemployment and social exclusion of minority-groups (such as immigrants). Government programmes to promote self-employment have not been very successful or very costly. In addition, commercial banks (including traditional “small-people” banks such as Sparkassen, Volksbanken and Raiffeisenbanken) are withdrawing from small enterprise lending because of new Basle II regulations[1] and low profits in this sector. Finally, government-owned wholesale banks focusing on small enterprise finance (such as KfW) have difficulties in finding cooperating partners in the banking sector. Therefore the German government (like many other governments in developed countries) shows an interest in the microfinance model of the South. However, this interest is only focused on a small segment of the microfinance model: the lending to start up and existing micro-enterprises.

The study looks at the present situation of Microlending in Germany and analyses the recently founded German Microfinance Institute (Deutsches Mikrofinanz Institut, DMI) as a case study. Thereby the study tries to answer the question whether microlending in Germany can be sustainable and have a substantial outreach at the same time.

The next part defines selected terms used in the study. In the third chapter gives an overview of the development of microfinance and its best practices in developing countries. Chapter 4 assesses the situation in Germany in general, whereby chapter 5 deals with the case study on the DMI in greater detail. The sixth chapter compares the findings of the previous chapters with the experience in developing countries. Finally a short conclusion is drawn in the last part of this work.

2 Definitions of selected terms

<u>Microfinance (in developing countries)</u>:

Regarding microfinance, ‘Micro’ relates to the small size of a program’s transactions while ‘finance’ to

1 “Basel II is a round of deliberations by central bankers from around the world, under the auspices of the International Bank of Settlements in Basel, Switzerland, aimed at producing uniformity in the way banks and banking regulators approach risk management across national borders.”[www.wikipedia.org] Compared to the at present valid duty of the securitization of debt with reasonable equity capital "Basel I", the securitization of debt with reasonable equity capital should be shaped in future in dependence on the creditworthiness of each individual borrower. Ratings - internal and external - become the criterion of decision. [www.investkredit.at]

the provision of safe and reliable financial services to the poor. Robinson defines microfinance more clearly as "small scale financial services – primarily credit and deposits – that are provided to people who farm or fish or herd; operate small or micro enterprises where goods are produced, recycled, repaired, or traded; provide services; work for wages or commissions; gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools; and to other individuals and local groups in developing countries, in both urban and rural areas."[2] Current trends in microfinance go beyond this definition and include micro-insurance, micro-leasing, and payment transactions on small scale basis.[3] "In addition to financial intermediation, some Microfinance Institutions (MFIs) also provide social intermediation services, such as help in group formation, the development of self-confidence, financial literacy, and other services."[4]

Micro-lending (in industrialized countries such as Germany):

Where microfinance schemes provide a broad range of financial services, micro-lending schemes only focus on the provision of micro-loans. According to the EU Multiannual Programme (MAP) for enterprise and entrepreneurship, micro-lending focuses on supplying loans up to a maximum 25,000 EUR to new and already existing micro-enterprises.[5] "The term micro-lending is used to describe a range of different … organizations, offering [micro-]loans to a broad range of clients who could not, otherwise, obtain funding through commercial banking sources. … Three main types of client tend to seek help from micro-lending organizations"[6]:

- "socially excluded people, entering marginal self-employment"[7];
  Individuals or groups whose need for social credit is satisfied as a part of support and after-care schemes.
- "people in or beyond the start-up phase with micro-credit needs"[8];
  Those people who have a good idea or already run a business, but are not bankable in commercial terms, because they (incl. their business idea) are considered too risky or existing loan products are inappropriate.
- "people running existing micro-enterprises in need of development capital"[9];
  Those who are unable to convince commercial banks that they are worthy of credit.

Microlending in this respect is different from commercial banking in terms of small loan sizes, quick and easy access, non-traditional credit worthiness evaluation, and collateral requirements.

Outreach and Sustainability:

When assessing a microfinance institution (MFI), the two long-term goals of microfinance should be considered:

- "outreach, serving those who have been consistently underserved by financial institutions (such as women, the poor, the indigenous, and rural population)"[10], and

[2] Robinson (2001), p.9.
[3] Kerer (2003), p. 9.
[4] Ledgerwood (1999), p. 268.
[5] EU-Commission (2003), p. 11.
[6] Whiley/ Kempson (2000), p. 5.
[7] Subsequent reference, p. 5
[8] Subsequent reference, p. 5.
[9] Subsequent reference, p. 5.

– "sustainability, generating enough revenue to cover the costs of providing financial services"[11]

Outreach is measured in terms of scale; the number of clients served, and depth; the poverty level of clients reached by a MFI.[12]

When talking about sustainability, it is important to distinguish between operational self-sufficiency; generating enough operating revenue to cover direct costs (operating expenses, financing costs, and provision of loan losses), and financial self-sufficiency; generating enough revenue to cover the direct and indirect costs (incl. the adjusted cost of capital)[13]. Should an MFI fail to reach operational self-sufficiency, its initial equity will be eroded by losses[14]. This means the total funds available for lending will decrease, which in turn could result in the closing down of the MFI due to a lack of capital.[15]

3 The Microfinance (R-)Evolution in Developing Countries

3.1 History of Microfinance

The financial system of a country has a central role in its developmental progress. It is responsible for the mobilization of financial resources and their productive use in generating income and employment. Efficient resource allocation is crucial in the development of markets and private sector activities. Thus a functioning financial system is a significant prerequisite in order to achieve economic growth, create employment and alleviate poverty.[16]

Following on from the experience made in the reconstruction and development of economies destroyed by World War II, the concept of financing development was based on the simple transfer of capital to developing countries. In the development policies of the 1960s and 1970s, the financial sector functioned only as a transferring and distributing channel for capital. This was demonstrated by the founding of development banks and subsidized credit programs established to improve economic conditions. However, they were rarely successful and often resulted in erosions of their capital base due to poor repayment disciplines and subsidized lending rates. Additionally it was often the financially secure that profited rather than the poor.[17]

Since the early 1970s some economists realized that the financial sector itself can be the obstacle to the developmental progress due to its limitations and the way it functions. However it was not until the late 1980s that the functioning of national financial systems and the financial institutions working within the sector started to gain interest among development policy makers.

This went beyond the previously dominant idea of capital transfer to developing countries for "financing development" but resulted in a paradigm shift to focus on "developing financing". Following this the financial system became a field on its own in development cooperation.[18]

The evolution of microfinance is closely linked to and encouraged this paradigm change. Starting in the 1970s experimental programs in Bangladesh, Brazil and few other countries started to hand out

[10] Ledgerwood (1999), p. 34.
[11] Subsequent reference, p. 34.
[12] Ledgerwood (1999), pp. 266 – 269.
[13] Maintaining the value of capital relative to inflation.
[14] Unless additional grants can be raised to cover operating shortfalls
[15] Ledgerwood (1999), pp. 215 – 217.
[16] GTZ (--), p. 2.
[17] www.cgap.org
[18] Schliwa (2003), p.1.

tiny loans to groups of poor but economically active people to invest in micro-businesses. These experiments included micro-enterprise credit programs and financial institutions organized on a self-help basis. These schemes were based on a solidarity group lending approach, in which the repayment of each member was guaranteed by all other members of the group.

At this point, recognition should be given to the piloting work of Prof. Muhammad Yunus – who is regarded as the inventor of Microfinance – in Bangladesh. Starting in 1976 his experimental loan program spread rapidly among villages and proved that the poor can serve loans. The result of which led him in 1983 to fund the now worldwide known Grameen-Bank which today serves 3.12 million borrowers in 43,682 villages through 1,195 branches.[19]

The success of his program directly influenced the emergence of other microfinance schemes and institutions specialized to serve poor throughout the 1980s and 1990s.

Numerous studies have since proved that microfinance has a significant measurable impact on developing countries.[20]

Banks rather avoid the comparatively high administrative costs associated with small amounts of money. Furthermore they consider small-scale credit transactions too risky, as the poor largely lack traditional securities, such as property, land, machinery, and other capital assets customary in banking. Thus commercial banks in developing countries serve only one fifth of the population, even if 60 % of the economically active population count into the remaining four fifths.[21]

The improved access to financial services via microfinance programs has enabled lower income groups to develop savings and take out loans. It has also been shown that savings which make clients less vulnerable to income fluctuations are far more important to poor people as the demand for savings exceeds the demand for loans many times over.[22] The access to credits on more favourable terms reduces the dependence on informal sources (e.g. money lenders). It raises entrepreneurial activities which incorporate credit financed investments. Sources of income can be diversified which lowers income volatilities. Further new jobs are created and changes in employment structure can be observed in many cases. As a result income and employment increases and standards of livings improve.[23]

Microfinance experience has changed the general wisdom about financing the poor. Not only have they proved to have excellent repayment rates among the better programs but they are also willing and able to pay interest rates which would allow Microfinance programs to (partly) cover their costs.[24]
Consequently, market related interest rates should be charged by institutions involved in credit programs for the poor. These should be between the rates charged by commercial banks at local level and the ones charged by money lenders.[25] High interest rates are useful despite the conflict between them and the poverty focus. Firstly, the subsidized rates led to a distorted allocation of resources in the past. Secondly, high interest rates can help MFIs to cover costs and grow, and to assure financial viability in the long run. The focus must lie on a sustainable development of viable institutions in a functioning financial system. Both are of course closely interlinked.

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[19] Khawari (2004), pp. 10 – 13.
[20] Schliwa (2003), p. 21.
[21] Gross (2004), S. 1.
[22] Subsequent reference, S. 1.
[23] GTZ (2004), p. 2.
[24] www.cgap.org
[25] Conroy et. al. (1995), pp. 1-2.

3.2 Characteristics and Best Practices

Successful concepts have been characterized by innovative procedures and products in order to achieve viability. Good microfinance practices comprise lending technologies[26] such as

- products (loans, savings, payment services, insurance) which are tailored to the needs of clients.[27] These include microcredits with instalments according to customer capacities (cash flow based), and growing loan sizes according to repayment performance (step-lending)[28],
- procedures which focus on the specifics of clients (e.g. contacting clients in their home by house calls, insistence on timely repayments to enhance financial discipline and future bankability),[29]
- creation of alternative kinds of collateral. These can be
    - collateral substitutes like group guarantees (using joint liability), character-based lending, frequent visits to the business by the loan officer, risk of public embarrassments, and risks of jail or legal actions, or
    - alternative collaterals like compulsory savings, assets pledged at less than the value of the loan, and personal guarantees.[30]

Successful MFIs have developed “high standard modes of operation”, which enables the lowering of transaction costs.[31]

The more advanced MFIs have even established more specialized products for micro, small, and medium enterprises (MSME) in order to concentrate on financing gap of MSME. This gap symbolizes restricted access to credit and further financial services, enhanced through inadequate lending technologies and a shortcoming of interest in MSME by financial institutions. It could be proved that products based on microlending technologies can also be used to serve MSME more effectively.[32]

In terms of development cooperation Microfinance receives great attention by donors. For instance, a systematic approach is used in German development cooperation nowadays, which combines developmental actions on the macro, meso, and micro level of the financial sector.[33] On one side support is given to financial sector reforms in order to promote corresponding constitutional and institutional surroundings. On the other technical assistance is given to financial institutions, which concentrate on the needs of the target group. In the case of financial institutions an institution-building approach has replaced methods of direct lending to specific target groups. This implies that greater attention is now given to the building up of the private sector activities, aiming at self-sustainability in the end. It focuses on the broadening and deepening[34] of the financial system. In this respect four approaches can be identified as part of the implementation of MFIs[35]:

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[26] “A credit, or lending, technology covers the entire range of activities carried out by a loan-granting institution which deal with selecting borrowers, determining the types of loans to the granted, the loan amounts and terms to maturity and the way in which loans will be secured, as well as the monitoring and recovery of loans.” [Schmidt and Zeitinger (1996) stated in Jansen (2004)].
[27] Haupt/Henrich (2004), p. 13.
[28] Seibel (2001), pp. 5-6.
[29] Gross (2004), S. 1.
[30] Ledgerwood (1999), pp. 137-138.
[31] Gross (2004), S. 1.
[32] Haupt/Henrich (2004), pp. 8-9.
[33] Kerer (2003), p. 2.
[34] Broadening is the enlargement in the range of financial products, whereas deepening is the increased outreach towards new (formerly excluded) clientele through financial institution.
[35] Haupt/Henrich (2004), pp. 9-12.

- Upgrading: The transformation of a NGO into a professionally working MFI. Market shares are increased by supporting the institutional growth of the organisation and improving the products and processes. Here problems emerge as only a few NGOs can combine this strategy with their development mission policy. In addition this commercialization of NGOs may result in a partial withdrawal from clientele due to concerns over profitability. This method has been used particularly in Central and Latin America and Africa.[36] [37] [38] A prominent example is BancoSol in Bolivia . In 1992, the only local working NGO PRODEM upgraded itself to a financially, legally and institutionally sustainable bank, shifting from social services into banking.[39]
- Downscaling: Already existing financial institutions – in particular banks – broaden their product range to make them available to poor parts of the population. This often goes together with changes in products and processes, as well as the organisation itself. Downscaled institutes are mainly found in Asia, Latin America and Eastern Europe. For instance the Bank Rakyat of Indonesia (BRI): starting in 1984 this old state-owned commercial bank went trough a downscaling process and was restructured into a Microfinance service provider. Today it is the biggest Microfinance Institution in a developing country. In 2002 it served about 28 million customers.
- Linkage Banking: This refers to banks which are linked with (existing) self help groups (SHGs)[40] or NGOs in this field. This can contribute substantially to the deepening of the financial sector and an improved territorial coverage. It has proved particularly successful in reaching very poor groups. Whereby the efficient work of both, SHGs and NGOs, make up a major component.[41] South Asia offers examples for linkage banking, the National Bank for Agriculture and Rural Development (NABARD) in India is one of them. The SHG-Bank-linkage-Program came into existence because of a pilot project implemented by NABARD in 1992. It promotes the formation of SHG (this is usually done by NGOs) and the linkage with banks in order to grant credits. Partner agencies profit from synergies by using each others' existing structures. Today more than one million SHGs have been linked with credits with nearly 16 million poor families being reached.[42]
- Greenfield: This signifies the formation of a MFI from scratch. An approach which has proved immensely successful in regions where financial services providers do not exist. This method requires high initial investments in order to build capacities and train staff. For that reason timely restricted subsidies are ingeniously if connected with transparent exit strategies. The Greenfield technique has become standard practice in transition countries of Eastern Europe and Central Asia, as well as in Southern Africa.[43] [44] [45] The Micro Enterprise Bank (MEB) in

[36] Haupt/Henrich (2004), pp. 11-12.
[37] Schliwa (2003), p. 5.
[38] Wisniwski (2004), pp. 93-96.
[39] Khawari (2004), pp. 13-15.
[40] SHG: "groups of people who have a common wish to access financial services, [It] often includes group guarantees." [Ledgerwood (1999), p. 267.]
[41] Haupt/Henrich (2004), pp. 11-12.
[42] Satish (2005), p. 1-22.
[43] Wisniwski (2004), pp. 96-101.
[44] Schliwa (2003), p. 5.
[45] Haupt/Henrich (2004), pp. 11-12.

Kosovo is such a Greenfield microfinance bank. In 2000 the MEB was the first licensed bank in war-torn Kosovo. Although it works as a universal bank, it emphasises serving micro and small enterprises. Since its first operating year it has achieved impressive net returns, which is pleasing the owners given the high investments in physical infrastructure and staff.[46]

To date none of these approaches have proved to be superior over the others.

As demonstrated microfinance institutions are diverse and exist at various levels. There are NGOs, credit unions, non-banking financial intermediaries, financial SHGs, specialized microbanks, and commercial banks all working in this sector. Many of which are still small and operate in just a few locations, serving a particular type of client. Only some have grown so heavily that they have eventually become sustainable as shown in the examples above. Their success lies in the changed wisdom that poor people can be valuable clients of financial services and serving them can be financially feasible.

Overall the advantage has been the provision of services to the poor, which often include large parts of the population and that have previously had little or no access to financial services. This has helped the poor to become independent of the exploitation of local money lenders. Instead of giving charity, microfinance promotes small enterprises by providing them with corresponding financial services.[47] This expansion of the financial sector has resulted in an increased economy's financial depth and generating more broad based economic growth.[48]

However some critics remain, as most poverty alleviation programs are subsidized. Yet, the crucial difference is it is not the loans but the actual MFI that is subsidized. These subsidies are often given only for a limited time to build up microfinance capacities. A survey in the Microbanking Bulletin in 1998 found that the revenues of MFIs which target the poorest groups can only cover about 70 % of their costs. The age or scale of an institution does not necessarily correlate with a decline in subsidy rates. Some[49] even believe that only 5 % of the MFIs will ever become self-sufficient[50]. After all they argue that the proposed win-win logic depends on manifold parameters in practice, which include the occupations of borrowers and the use of loans. For instance, if borrowers engage in activities[51] with quick turnovers and high margins, they are able to repay short-term loans with interest rates of up to 55 %. Instead high interest rates might be too costly for borrowers engaged in businesses with moderate returns over a longer period.[52] [53] Additionally the income impact is greater for 'less poor' borrowers with their increased willingness to take risks and invest in new technologies, resulting in more efficient activities and increased income flows. In contrast, extremely poor borrowers experienced even negative effects. They seldom invested in new technologies but demanded small subsistence protecting loans. In some cases these borrowers were worse off afterwards as they were pushed into further debt.[54]

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[46] Wisniwski (2004), pp. 100-101.
[47] Khawari (2004), pp. 26-27.
[48] Satayamuri/Haokip (2002), p. 1.
[49] Khawari (2004), p. 27.
[50] This speculation is primarily concerned with NGOs. Private commercial banks and credit unions are excluded.
[51] E.g. petty traders, tailor shops, or small restaurants.
[52] E.g. Lifestock, agriculture, handicrafts.
[53] Khawari (2004), p. 27.
[54] Subsequent reference, pp. 29-30.

By and large Microfinance has had a powerful impact on alleviating poverty. The question of their ability to sustain themselves should not be answered without first considering whether total benefits outweigh the costs (monetary and social aspects).

4 Status Quo in Germany

4.1 Is there a demand for microlending

Micro enterprises and their financial demand continue to gain the attention of German policy makers since the end of the 1990s. This is not surprising since these groups are by far the largest as shown in Figure 1. Micro enterprises become increasingly important for labour policy, with large-scale enterprises reducing employment on a whole, additional jobs are mainly created by micro enterprises in Germany.[55]

The EU definition of enterprises changed in January 2005. Beside the former three categories of small, medium-sized and large enterprises, it adopted a fourth called micro enterprises demonstrating its increased interest in this area.

Table 1: EU Classification Scheme for Enterprises[56]

Size of Enterprise	Number of Employees	Turnover (€/Year)	Balance sheet total (€/Year)
micro	up to 9	up to 2 Million	up to 2 Million
small	10 to 49	2 to 10 Million	2 to 10 Million
medium-sized	50 to 249	10 to 50 Million	10 to 43 Million
large	250 and more	more than 50 Million	more than 43 Million

Following this definition micro enterprises account for 88 % of the total number of enterprises in Germany. These are 2.7 million micro enterprises with less than 10 employees which have a overall of 34 % in overall employment, almost as high as large-scale enterprises. On average 4 people are employed in a micro enterprise.

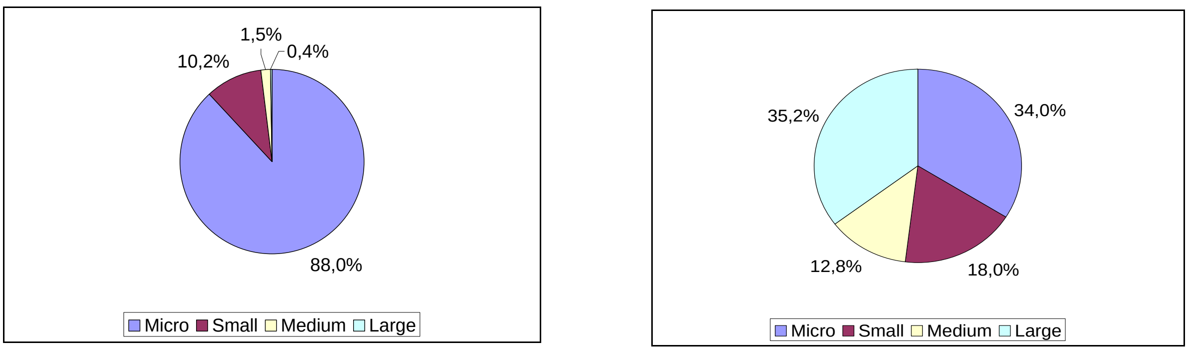

Figure 1: Enterprise Structure in Germany (2003)[57]

[55] IFF/ ILO (1999), p. 6-8
[56] Günterberg / Kayser (2004), p. 4.

Figure 2: Employment Structure in Germany (2003)[57]

Besides existing small companies, start-ups are especially hopeful prospects of labour policy. Many new self-employed provide not only work for themselves, but also for additional people either right from the start or in the cause of their work.[58] Typically (full-time) start-ups can be distinguished by being innovative, growth intensive, traditional and micro start-ups. The first are characterized by high innovative products, which carry high risk but also provide high chances of returns and growth. Usually, the financing demands are high and are best met by measures such as venture capital. This group accounts for about 1 % of all start-ups.[59] The second group has traditionally a demand for investment goods. They are portrayed as having limited risks with a limited chance of growth, if economic structures do not change substantially. Their medium financial demand is usually met by equity and traditional long-term bank financing. These represent about 10 % of all start-ups..[60] Micro start-ups are characterized by few or no investments in the beginning. Typically their work is based on skills. So, they only have a demand for current assets, they need for their ongoing work. They make up 90 % of all start-ups.[61]

This coincides with structural changes taking place on the entrepreneurial scene. On one hand necessity entrepreneurship[62] is increasing, so that the ratio stands at 1:2.10 compared to opportunity entrepreneurship[63].[64] On the other hand with raising unemployment rates more people consider self-employment as a professional alternative.[65] [66] Hereby the significant share of formerly unemployed among all entrepreneurs should only receive more attention due to its size.

In 2003 there were about 1.6 million start-ups, of which 681,000 were full-time and 974,000 on a part-time basis.[67] Almost half of the full-time and one fifth of the part-time entrepreneurs started their business out of unemployment, a development which is undoubtedly supported by politics. Programs like bridging allowance or start-up allowance (Überbrückungsgeld or “Ich-AG” Existenzgründungszuschuß, respectively) underline this.[68] In 2003, more than half of the formerly registered unemployed entrepreneurs received financial support in form of bridging allowance (Überbrückungsgeld, 43 %) or start-up allowance (“Ich-AG” Existenzgründungszuschuß, 8 %).[69]

The indicators of the Global Entrepreneurship Monitor judge basic conditions in 34 countries worldwide. Whereas start-up support policies and government subsidies receive the best grades of all countries, financing conditions are only judged on average. If compared to reference countries[70] the only lower scores belonged to Japan and Spain. Even worse the indicator shows an extreme negative development when compared to the previous years’ results and other basic conditions. Formerly good

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[57] Estimation of EIM business & Policy Research; the estimations are based on the structural business statistics and the SME data base of Eurostat. [www.kmu.unisg.ch]
[58] IFF/ ILO (1999), pp. 6-8
[59] Gross (2005), pp. 8-9.
[60] Subsequent reference, p. 9.
[61] Gross (2005), pp. 8-10.
[62] Necessity entrepreneurs start their business because of missing or unsatisfactory income situation.
[63] Opportunity entrepreneurs start their business because they want to realize a business idea.
[64] This is especially true for the Eastern part of Germany were the ratio of necessity compared to opportunity entrepreneurs is 1:1.22.
[65] More than three quarter of all start-ups were not growth-oriented.
[66] Sternberg/ Lückgen (2005), p. 14-16.
[67] Lehnert (2004), p. 4.
[68] For further details please refer to Table 2.
[69] Lehnert (2004), pp. 4-24.
[70] Reference countries have similar and comparable economic conditions.

financing opportunities do not exist anymore. This is of particular tragedy since secure financing is a fundamental prerequisite for the successful realization of a start-up.[71]

Many small and micro entrepreneurs lack sufficient equity and often cannot compensate for this lack with outside capital. In 2003, 55 % of the full-time and 40 % of the part-time entrepreneurs had a demand for capital between 1,000 and 25,000.[72]

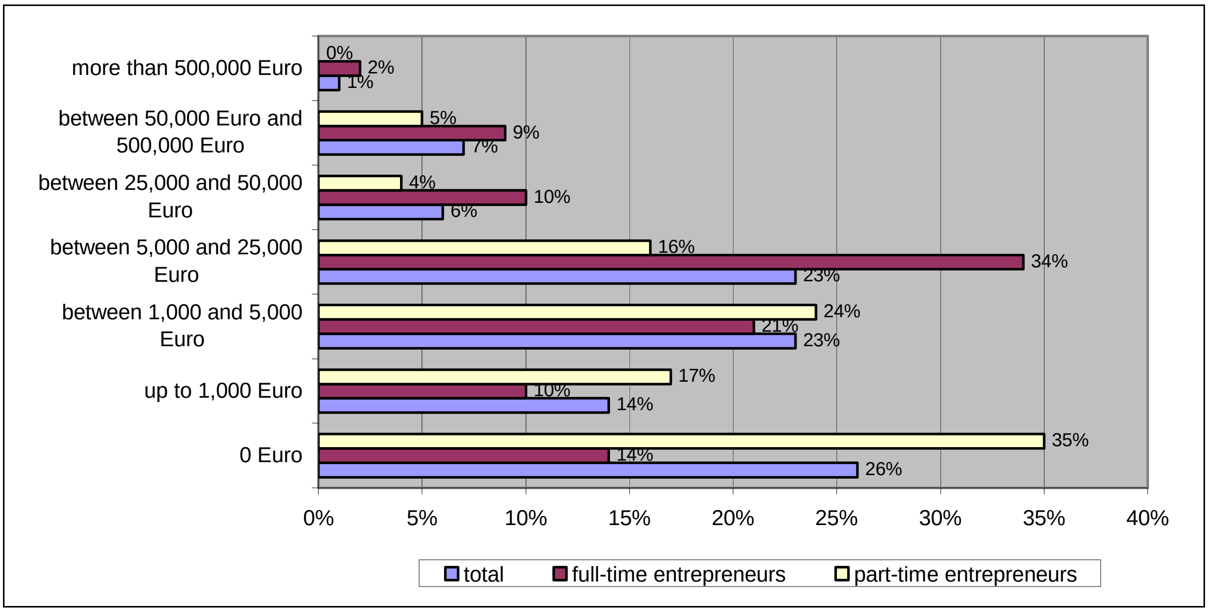

Figure 3: Financing demand[73] of full-time and part-time entrepreneurs, 2003[74]

Only 48 % of this group could cover their financing demand with equity.[75] The reverse conclusion is that 52 % or in total 397,358 entrepreneurs had a demand for outside capital. Therefore, they are among the target group of microlending programs. 23 % (175,754 entrepreneurs) had difficulty in accessing outside capital; with the inability to access bank loans being one of the most frequently mentioned reasons. The focus on the principle bank (Hausbankprinzip) as well as the caution of banks upon micro and small loans is an increasing shortcoming in financing micro entrepreneurs.[76]

Similar figures are missing for already existing micro enterprises. A recent European survey among existing companies noticed that sufficient access to capital is still a huge constraint for about 20 % of Europeans MSMEs, where smaller enterprises are more affected than medium ones.[77] Similar results can be assumed for Germany. Therefore a similar financing demand can be assumed for already existing companies compared to start-ups. Consequently, the increased interest in microlending is understandable.

4.2 Micro enterprise financing to date

Traditionally the financing of businesses and start-ups is carried out by banks in Germany. Almost all financial possibilities are offered exclusively by banks. Even public funding schemes rely on the

[71] Sternberg/ Lückgen (2005), pp. 26 – 31.
[72] Lehnert (2004), pp. 19 - 20
[73] equity and outside capital
[74] Lehnert (2004), p. 20, author's translation.
[75] Subsequent reference, p. 20.
[76] Lehnert (2004), pp. 19 – 24; Sternberg/ Lückgen (2005), pp. 27 – 29.
[77] EU-Commission (2004), pp. 3-6.

principle bank, which acts as intermediary for public authorities in actioning funding programs.[78] Traditionally, this has worked well. However, structural changes in the banking sector and the increased demand for micro loans cannot be accommodated by traditional methods and institutions. In short, two costly problems have emerged for the banks. Loan losses are expected especially; if loan terms are designed on a long-term basis. A survey conducted for the European Commission stated that 30 % of all start-ups are no longer than 3 years and 50 % are no longer than 5 years in existence.[79] This means loan losses are more likely even though an extensive (pre-)evaluation is done by the bank. Secondly, the transaction costs are very high for micro loans relative to the small amount. As a result, banks prefer to issue credit in large sums, since transaction costs are decreasing relative to the loan amount[80]. To sum it up, start-up financing is too costly and risky for banks. This was realized by public authorities who attempted to solve the problem in 1979 by supporting public funding programs. These schemes concentrate on traditional full-time entrepreneurs who have considerable demand for capital. About 20 years later the Deutsche Ausgleichsbank (DtA) reacted to the structural changes from traditional, towards knowledge-based but non capital-intensive start-ups. The DtA introduced the Startgeld and the DtA Micro loan in May 1999 and October 2002, respectively. After the merger of the DtA and Kreditanstalt für Wiederaufbau (KfW) in 2003, both programs are continued by the new KfW. Further the KfW Micro10 loan has been introduced in March 2005.[81]

The KfW Startgeld has an average loan amount of 32,434 EUR, which is outside the range of microlending (see Table 2) and as a result, will be left out of the following discussion.

The KfW Micro loan has a ceiling of 25,000 EUR and is therefore within the range of microlending. Entrepreneurs and MSMEs apply for it via their principle bank. The KfW guarantees 80 % of the loan and pays a flat processing fee of 600 EUR per loan to the bank.[82] This is in order to (partly) overcome the transaction costs, even though the actual transaction costs are estimated around 1,100 EUR.[83] Furthermore, loan losses are presumed due to the long duration of the micro loan as stated above. On average amounts in excess of 18,000 EUR demonstrates that the banks still concentrate on loans close to the ceiling even within the KfW micro loan scheme. Until September 2004, 1,063 loans had been promised exceeding 19.2 million EUR. When compared to the figures of 2003 (September 2003: 1,400 loans, 26.6 million EUR) this shows decreasing utilisation of KfW micro loans and points towards a negative trend of credit supply via this program.[84]

The KfW Micro10 is a new public funding scheme which has been introduced in March 2005. So far, it is worked as pilot program, limited until the end of the year. The conditions are based on the KfW micro loan scheme. It differs in the way that the loan size must be between 5,000 and 10,000 EUR. The application procedure has been simplified and the flat processing fee has been increased to 1,000 EUR per loan. The cooperation between banks and start-up intermediaries is encouraged in order to gain from synergy effects[85] and to aid this a guide about the cooperation between banks and start-up

[78] IFF/ ILO (1999), pp. 17-18.
[79] EU-Commission (2004), pp. 3-6.
[80] Gross (2005), pp. 12-14.
[81] Subsequent reference, pp. 12-14
[82] Stinski et. al. (2005), p. 10.
[83] EU-Commission (2003), p. 10.
[84] Gross (2005), pp. 12-14
[85] Stinski et. al., p. 10.

intermediaries[86] has been published parallel to this.[87] Concrete figures are not available for the scheme yet.

Apart from public funding schemes of the KfW, the ministry of economic affairs and employment[88] and the federal agency of employment[89] have signalled increased interest in support schemes. The federal agency of employment supports start-ups of unemployed via bridging allowance and start-up allowance since 1986 and 2003, respectively. However, both measures are only meant to secure the living expenses in the first phase after starting the business. They can or should not cover the financial demand of the actual business.[90] In order to improve (financial) promotional measures for start-ups and young micro enterprises numerous pilot projects have been supported by both authorities.[91]

The German federal system (16 Länder) as well as the federal government and the EU support promotional measures for start-ups. Many initiatives have been founded as a reaction to local and regional structural and economic problems. Often they concentrate on disadvantaged groups in society. In 1999, 3,500 different promotional programs were estimated, most of them concentrating on non-financial measures, such as information, training and coaching. However, a more detailed description of this topic exceeds the scope of this study.[92]

On the other hand financial measures have been established as a reaction to difficulties by the banks to meet financial demand in some sectors. Until 1997, only 3 programs; which included financial measures, were counted. From 1997 their number increased steadily. Till 2003, where Evers & Jung[93] conducted a study on micro loan programs. They identified 10 local (communal/regional level) and 12 regional ("länderweit") initiatives in Germany[94], where the necessary capital has been supplied by private donors, company related foundations, and local and regional public authorities.

Table 2 provides a brief overview of 19 financial initiatives, the public funding and support schemes of the KfW and the federal agency of employment explained above.

[86] „Kooperationsleitfaden für Banken und Gründerzentren"
[87] www.kfw.de
[88] Bundesministerium für Wirtschaft und Arbeit
[89] Bundesanstalt für Arbeit
[90] Gross (2005), p.16-18.
[91] For a further evaluation see Maas, Brigitte / Meißner, Heinz-Rudolf (2004) 'Praxis des Microlending in Deutschland, ein Vergleich'.
[92] IFF/ ILO (1999), p. 19.
[93] In Gross (2005), p. 17 – 26.
[94] Three of these initiatives had average loan amounts above 25,000 EUR. They are out of the range for micro-lending and therefore left out in Table 2.

Table 2: Diversity of financial support programs for micro start-ups and MSMEs in Germany[95]

	KfW-Startgeld[96]	KfW Micro25[97]	KfW Micro10[98]	Bridging allowance	Start-up allowance	Goldrausch-loans, Berlin	Start-up fund Bremen	ARP loans, Berlin	München-Fund	Start-up capital of the federal state Saarland	„Auf geht's" KIZ Offenbach
Creation	1999	10/2002	03/2005	1986	2003	1982	1984	1997	1998	n.a.	05/2002
Founder	Public bank	Public bank	Public bank	Federal agency	Federal agency	Association	Land	Public bank	Local savings bank & City	Land	Start-up center
Ownership	Public	Public	Public	Public	Public	Private	Public	PPP	PPP	Public	private
Service provided	Credits	Credits	Credits	Allowance	Allowance	Credit[99], allowance	Credit	Credit	Credit[100]	Credit, allowances[101]	Credits
Refinancing of the resources granted	Capital market, public allowances	Capital market, public allowances	Capital markets, public allowances	Social security contributions	Social security contributions	Private donations	Public allowances	EFRE resources, Public allowances	Bank credits, public allowances	Public allowances	Private Foundation
Target group	Entrepreneurs	Entrepreneurs, micro enterprises	Entrepreneurs, micro enterprises	Unemployed	Unemployed	Women with no other financial alternatives	Deprived entrepreneurs, MSMEs, women	Unemployed	Sustainable full-time entrepreneurs	Start-ups, young micro enterprises (< 3 years)	Entrepreneurs
Geographical scope	National	National	National	National	National	Regional	Regional	Regional	local	Regional	Local
Number of transactions/ year	3,595 (2003) 2,983 (up to 09/2004)	1,692 (2003) 1,063 (up to 09/2004)	n.a.	156,966 (2003)	92,819 (2003)	3 (2002) 2 (up to 06/2003)	69 (2002) 32 (up to 06/2003)	179 (2002) 102 (up to 06/2003)	14 (2002) 5 (up to 06/2003)	14 (2002) 10 (up to 06/2003)	4 (2002) 7 (up to 06/2003)
Turnover/ year	116.6 million € (2003) 96.4 million € (up to 09/2004)	32 million € (2003) 19.2 million € (up to 09/2004)	n.a.	n.a.	n.a.	9,000 € (2002) 5,300 € (up to 06/2003)	972,000 € (2002) 457,000 € (up to 06/2003)	2,759 million € (2002) 1,642 million € (up to 06/2003)	556,000 € (2002) 181,000 € (up to 06/2003)	279,000 € (2002) 163,000 € (up to 06/2003)	
Ceiling	50,000 €	25,000 €	10,000 € (min. 5,000 €)	Analogous to unemployment benefits		4,000 €	75,000 €			25,000 €	5,000 €
Duration		Max. 5 years (6 months free of repayment)	Max. 5 years (6 months free of repayment)	6 months	3 years	Max. 36 months	Max. 8 years	Max. 10 years	∅ 8 years	Max. 10 years	∅ 24 months
Average loan amount	32,434 € (2003)	18,913 € (2003) 18,062 € (up to 09/2004)	n.a.	n.a.	600 € (1^{st} year) 360 € (2^{nd} year) 240 € (3^{rd} year)	3,000 € (2002) 2,650 € (up to 06/2003)	15,000 €	15,600 €	25,000 €	13,000 €	

[95] Sources: Gross (2005), ILO (2002), KfW (2005), Stinski et. al. (2005), Wießner (2004), author's tabulation
[96] With an average loan amount above 25,000 € it is out of the range of microlending, house bank principle is used.
[97] house bank principle is used, 80 % of the loan amount is guaranteed by the KfW, flat processing fee of 600 EUR is paid to the bank for each KfW microloan given out.
[98] house bank principle is used, 80 % of the loan amount is guaranteed by the KfW, flat processing fee of 1,000 EUR is paid to the bank for each KfW microloan given out.
[99] Interest-free.
[100] Equity of 10 – 30 % required.
[101] Up to 20 % of the credit are granted if further jobs are created, house bank principle is used.

Table 2 (cont.): Diversity of financial support programs for micro start-ups and MSMEs in Germany[95]

	Enigma Siebte Säule Microlending GmbH[102], Hamburg	Feuerwehr-fonds Westerwald, WIBeN e.V.	Support of start-ups from unemployed [103], Hamburg	GÖBI-Fonds, Göttingen	Start-up Fund of the city Paderborn	Enterprise, Branden-burg	Micro Credit's Exis Junioren, Dresden	Micro lending in Mainz (MiM), MaGNet	MONEX Start-up capital for micro entrepreneurs, Baden-Württemberg	ProGES, social welfare authority Kassel	Advance money of the Freudberg Foundation, ProFi Mannheim	Loans and allowances of the city Laatzen	Emscher-Lippe micro entrepreneurs Fund
Creation	2001	1985	06/2002	1997	n.a.	07/1999	2002	2003	2002	1997	1998	2000	2003
Founder	Private bank, city, start-up center	Association[104]	Land	Association	City	Association	Association	Association	Association	Social welfare authority Kassel	Foundation	Public authorities	Association
Ownership	PPP	private	public	PPP	public	PPP	PPP	PPP	PPP	Public	PPP	Public	Private
Service provided	Credits	credits[105]	credit	credits[106]	Credits, allowances [107]	Credits[108]	Credits	Credit	Credit	Credit/ allowance [109]	Credit/ allowance	Credit[110]	Credits, partnership
Refinancing of the resources granted	Bank credits, public allowances	Monthly contributions of members	Public allowance	Bank credits	n.a.	ESF, public allowances	Bank credits, private funds	Public allowance	Public allowance, private funds	Public allowance	Private funds	Public allowance	n.a.
Target group	Unemployed	Members, entrepreneurs	Unemployed	Micro entre-preneurs	n.a.	Young disadvan-taged adults	Young entre-preneurs	Entre-preneurs who received coaching by MaGNet before	Unemployed	Recipients of social welfare, existing MSMEs	Entre-preneurs	Entrepreneurs, young micro enterprises (< 2 years)	Entrepreneurs
Geographical scope	Regional	Local	Regional	Local	Local	Regional	Regional	Local	Regional	Local	Local	Local	Local
Number of transactions/ year	15 (2002) 22 (up to 06/2003)	12 (2002) 6 (up to 06/2003)	0 (2002) 108 (up to 06/2003)	8 (2002) 4 (up to 06/2003)	n.a.	5 (2002)	16 (2002) 19 (up to 06/2003)	0 (until fall 2003)	7 (2002) 5 (up to 06/2003)	85 (2002) 145 (up to 06/2003)	5 (2002) 5 (up to 06/2003)	8 (2002) 0 (up to 06/2003)	0 (up to 06/2003)
Turnover/ year	120,000 € (2002) 270,000 € (up to 06/2003)	38,500 € (2002) 14,500 € (up to 06/2003)	1 million € (up to 06/2003)	64,000 € (2002) 38,000 € (up to 06/2003)	n.a.	n.a.	80,000 € (2002) 95,000 € (up to 06/2003)	n.a.	35,500 € (2002) 27,750 € (up to 06/03)	230,000 € (2002) 145,000 € (up to 06/2003)	38,300 (2002) 43,000 (up to 06/2003)	175,000 € (2002)	
Ceiling	12,500 €			10,225 €			5,000 €	6,000 €[111]	15,000 €[112]	10,000 €	n.a.	5,123 €	
Duration	∅ 26 months	∅ 9 months	6 years	∅ 10 years	n.a.	Max. 5 years	36 months	Max. 4 years	∅ 18 months, max. 24 months	Max. 54 months	n.a.	Max. 5 years	
Average loan amount	8,000 (2002) 12,272 (2003)	4,000 €	9,300 €	9,500 €	n.a.	n.a.	5,000 €			4,000 €	7,260 €		

[102] Enigmah = financial intermediary, Lender = city of Hamburg, Hanseatic Bank, Steplending: (5,000 € / 8,500 € / 12,500 €) Incl. Coaching.
[103] In cooperation with Lawaetz Foundation.
[104] Network of 45 local companies.
[105] Interest-free.
[106] Incl. Coaching.
[107] Mixture of credits and allowance, therefore values are missing for this program, allowances of up to 2,500 € are granted.
[108] Incl. coaching, monitoring.
[109] Interest-free.
[110] Interest-free.
[111] Minimum loan amount 2,000 €.
[112] Minimum loan amount 2,500 €.

Despite the diversity of financial support measures, the experience with credit allocation specialized in micro loans is limited. This is illustrated among other things by the very small number of transactions (outreach) in Table 2. Harshly speaking, none of the schemes described above is a microlending scheme although some of them partly meet criteria of microlending. In particular, the most important criteria of success – reducing the cost of transactions by means of large numbers of units and rapid growth (economies of scale) – are not fulfilled by the German schemes.

In view of the great variety of local and regional initiatives, their interest in exchanging experiences, and their increasing political importance, the alliance within an organisational unit gained more and more support. As a result two new organisations were founded in the beginning of 2004.[113] Initiatives who coach and support start-ups, have joined forces in the association of German start-up initiatives (Verband Deutscher Gründungsinitiaven e.V.). One of the aims is to make entrepreneurs bankable. Initiatives, who were interested or already offered financial support then founded the German Microfinance Institute (DMI). Its focus is to research into and test methodical and practical forms of microlending in Germany.[114] The DMI will be at the heart of the following analysis.

5 Replicating Microlending in Germany – A Case Study on DMI

5.1 The DMI business model

The German Microfinance Institute (Deutsches Mikrofinanz Institut, DMI) was founded on April 7, 2004. It is a registered association and has 53 members.[115] Members are mainly local NGOs, which provide training, coaching, and consultancy services to entrepreneurs, start-ups, self-employed, and micro enterprises. Their work often focuses on disadvantaged groups like unemployed or migrants. Some of the members function already as financial intermediaries on a local level. However, this can only be done via cooperation with banks, since the national law prohibits non-banks commercial lending.[116]

The DMI has two objectives. The first is the nationwide spread of microlending. The second is to research, develop and test microlending methodologies.[117] Both are intended to improve financing of start-ups and to vastly increase the number of loans issued to micro enterprises. As such, the focus is on the latter. After all, access to capital shall be simplified for micro enterprises and entrepreneurs based on a learning process which will eventually lead to the lean production of loans.

Since October 2004 any party interested in microlending was asked to express this ‘informally’ towards the DMI. Up until April 2005 only 76 are recorded as having done so.

In summer 2005 the DMI will start its actual work with a test phase of two years. To do so, loans will be given out in cooperation with and based on existing structures of local partners.[118] After being accredited by the DMI these partners will then become local microlenders[119]. Figure 4 shows the cooperation between the involved partners.

[113] Gross (2005), p. 26.
[114] § 2 of the statute of the DMI.
[115] Zientz (2005).
[116] Gross (2005), p. 12.
[117] § 2 of the statute of the DMI.
[118] Local partners will mainly be the members of the DMI. But the cooperation is possible for non-members too.
[119] Micro-lender is in the definition of the DMI anyone accredited by the DMI.

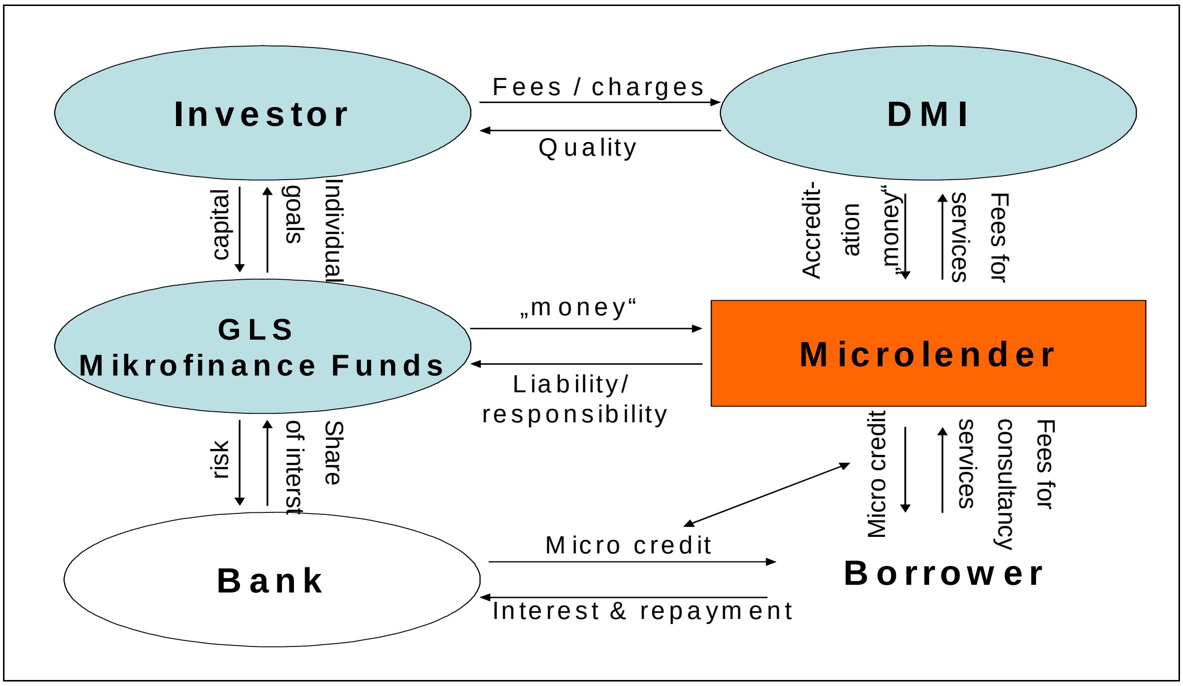

Figure 4: DMI business model[120]

Here, an investor devotes his/her money to the GLS Microfinance Fund on a long term basis where it expects a comparatively low monetary return (1.5 %). It is a silent partnership with all risks of an enterprise, where the total loss of the capital cannot be excluded. A silent partnership for the GLS micro finance fund can only be recommended to investors, who believe the social gains outweighs the risk of possibly losing their entire deposit. [121] In the following, the role of the investors will be excluded as their long-term investment cannot be withdrawn until 2014.

Following on from this, a cooperation contract is signed between the DMI, the local partner (= Microlender), the GLS Microfinance Fund[122], and a (local) bank (substituting the GLS Gemeinschaftsbank)[123]. The contract will regulate the process technically[124].

The GLS Microfinance Fund collects and administers the invested money. To date it has collected a sufficient amount of money. With this money, it provides the Microlender a fixed quota of collateral capital. The microlender can then grant micro loans to its clients up to the quota it has been provided. The Microlender is then liable to the GLS Microfinance Fund while at the same time is responsible for serving the needs of the borrower(s).[125]. The credit worthiness evaluation and the loan decision will be made by the microlender, who will also be responsible for the credit monitoring and if necessary the crisis intervention. Therefore there will be only one partner for the borrower to turn to.

The role of the bank is simply to manage the credit administration. The cooperation with a bank is necessary since German laws prohibit commercial lending for non-banks. This is also beneficial in case a sufficient number of loans cannot be reached, as only with increased loan numbers may it

[120] Förster (2005), author's translation.
[121] GLS Gemeinschaftsbank (2004), S. 2.
[122] Up to now the only fund existing is the GLS Microfinance Fund. In future the establishment of other (also local) Microfinance funds is possible.
[123] The cooperation between local Microlenders and a (local) bank is encouraged by the DMI. If no local bank can be won over, the GLS Gemeinschaftsbank will step into the position of the bank.
[124] For instance, the disclosure of the bank secrecy.
[125] This includes besides financing, coaching and training activities.

prove advantageous to establish your own back office to handle administrative aspects and make use of effects of scale. So far it is thought that the cooperation with banks, using their existing infrastructure, will minimize administrative costs and is therefore desirable. For the banks involved there are no risks.

The function of the DMI is the accreditation, continuous monitoring[126], training, and continued education of the accredited microlenders and their staff to guarantee the quality as regards the GLS Microfinance Fund. It aims at serving as quality measurer and provider for the GLS Microfinance Fund. It functions as a consulting service for both, the GLS Microfinance Fund and the microlender. Furthermore, it can and partly has already established its position as a binding agent and voice towards the surrounding environment, accomplishing for instance lobbying work at political level.

From January 1, 2005, until April 30, 2005, a test phase[127] was conducted in cooperation with 5 regional start-up centres[128] to test and optimise the technical concepts of the contracts explained above.

The official accreditation process was started on April 11, 2005. Interested parties could request the papers to apply for accreditation. Between five and ten microlenders will be accredited for the pilot phase of two years. Workshops were scheduled to take place in May and June 2005 to train the future microlender's staff to become loan officers. From July onwards, the accredited microlender can fix a quota of loan capital with the GLS Microfinance Fund and start giving out micro loans. The objective is to give out 500 micro loans with an average amount of 5,000 EUR (maximum 15,000 EUR) and duration of 24 months. The loan loss ratio is aimed at below 10 %. Special emphasis is put on high cost coverage which will be achieved by incentives (a detailed assessment of the DMI incentive system currently in discussion will be given in the next sub-chapter). After these two years a benchmarking and evaluation takes place which will provide the basis for the future work of the DMI. So far plans include the further accreditation of more members and the integration of additional fund resources.[129]

5.2 <u>Costs and Profitability</u>

During the joint meeting of the accreditation and methodology committee of the DMI on April 6, 2005, the incentives, costs, and returns were heavily discussed for each partner participating in the DMI model. The result was, that the bank as well as the GLS Microfinance Fund can make a profit on microloans.[130] The DMI can finance its work by public project measures granted by the European commission (e.g. EQUAL-Program), by the fees it receives for its quality, accreditation, training and consultancy services and by fees from members.[131] In turn the local microlenders can finance their work only through charges and fees. However the local microlender is the main interface in the actual production process and this central position is connected with a vast number of duties. Table 3 provides an overview of all expenses and duties, compared to the returns for each cooperation partner.

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[126] Sometimes this is also referred to as continuous accreditation.
[127] not to be confused with the pilot phase
[128] These included Gründernet Chemnitz (Südwestsachsen, Oberfranken, Oberpfalz), KIZ Offenbach (Hessen), Project Enterprise / IQ e.V. (Berlin, Brandenburg), ENIGMAH Gründerzentrum (Hamburg), and EXZET (Stuttgart).
[129] Förster (2005).
[130] A simplified calculation for the GLS Microfinance Fund and the GLS Gemeinschaftsbank provides Annex 1.
[131] Maas (2005).

Table 3: Comparison of expenses and returns for participants in the current DMI business model[132]

Protagonist	Expenses / duties	Returns
Socially responsible investor	– Gives risk-bearing capital to the funds for minimum of 10 years (earliest cancellation privilege is end of 2014)	– Individual goals – Return on investment (about 1.5 % p.a. according to brochure of the GLS Microfinance Fund)
GLS Microfinance Fund	– guarantees loan portfolio of bank – Assesses economic sustainability of Microlender – Is accountable towards investors – Setup and administration of a loan loss reserve (5 percentage points of the interest return will be reserved for the loan loss reserve) – Acquisition of further capital – Cost-free provision of loan capital to the Microlender – Pays commissions for repaid loans	– Returns on capital of GLS Microfinance Fund(achieved through long-term investment of capital, at present 3.5 %) – Income from processing fees transmitted from Microlender for each customer / micro loan (200 EUR)
Bank	– Loan administration (back office), risk-free volume business – Refinancing expenses	– Receives 2.5 percentage points of the interest return for loan administration expenses – 2.5 percentage points are used for refinancing expenses
DMI	– provides benchmarking and thereby continuously secures the quality of processes of Microlenders, – supports the establishment of Microlenders with training and workshops, accreditation and consecutive guidance services, methodology development, benchmarking, and tools for loan management	– income from accreditation processes – income from membership contributions – public subsidies / public sponsorship programs (e.g. EQUAL) – income from fees for services, e.g. training measures
Microlender	<u>Pre-requisites to become Microlender</u>[133] – permanent organization with economic sustainability – transparency in decision processes – regional acceptance <u>Investment costs (= establish microlending as company division in the existing organization)</u> – developmental costs of new company division – Costs of accreditation – Developmental cost of the organization and staff – Acquisition of contingency reserve (because of risk-sharing deposit into the GLS Microfinance Fund) <u>Duties within the business process</u> – credit worthiness evaluation (can judge personal loans due to previous coaching experience -> loan decision based on individual character of the borrower) – Controls loan payout – Responsible for ongoing monitoring – Secures crisis intervention	– Microlending as marketing tool – Commissions received for successful repayment of granted loans – Fees paid from borrower/entrepreneur for coaching/monitoring

[132] Source: DMI, own tabulation.

Protagonist	Expenses / duties	Returns
	– Processing fee paid for each customer / micro loan – Continued training of loan officers	
Borrower[134]	– Direct costs of financing (interest, processing fee, dunning costs etc.) – Debt repayment (in monthly annuities) – Coaching/monitoring costs (fees paid to microlender) – data preparation	– micro financing of business activities – credit/rating history – documentation of business development

As a result of the meeting on April 6, 2005, the question emerged if there are enough incentives for local partners to become accredited and to develop a company division specialized in microlending. It is this question, which is the key focus of this case study.

5.2.1 Demands on the potential Microlender

There are certain preconditions for microlenders to ensure the quality standards of the DMI. These are the (proven and henceforth expected) continuing existence of the organisation including a certain degree of 'economic' sustainability, the transparency in decision making, and the regional acceptance. Although, these conditions can not be valued in monetary terms, it is a basic rule that higher quality usually comes at a higher price. Or to formulate in a different way, the incentives for a quality institution to participate in a project must be more valuable, than the possible damage to its reputation. Additionally, there are investment expenses, which must be spent beforehand to establish microlending as a division within the existing partner institution. On one side, there are internal costs for the development of a new company division and training of staff. On the other, the external costs are directly related to the cooperation with the DMI and its partners: the costs of accreditation and the acquisition of funds for the contingency reserve. The reserve is necessary since microlenders participate with own risk-bearing funds in the GLS Microfinance Fund. This participation aims to minimize moral hazard and related problems for the GLS Microfinance Fund. Section 5.2.2 provides a more detailed assessment on this.

Last but not least there are the duties which evolve in the regular business process. Before the loan is granted, there is the financing advice to the borrower. After the loan is given out, the work consists of regular monitoring and in certain cases crisis intervention.

As stated before the microlender performs a credit worthiness evaluation. Due to its coaching experience with the borrower beforehand, it is in a far better position to judge whether or not the borrower is willing and able to fulfil the conditions of a loan contract. Its decision is based on the character of the borrower. This follows a personality-based analysis – a typical microlending tool – rather than a document-based one.

If the loan decision is approved, the microlender controls the payout process. During the repayment process it is responsible for the continuous monitoring of the borrower. In the case of a crisis situation it is expected to intervene immediately. Not only does it go along with international microfinance wisdom, but it also ensures better repayment rates. Moreover it has helped the borrower to overcome

[133] The group of institutions who will become microlenders is very heterogen.
[134] The target group of the DMI are micro enterprises and entrepreneurs. In the latter case, the focus is put on the phase after the actual founding of the company.

difficult situations. Continued training of the loan officers will be necessary to fulfil these contractual obligations.
The returns appear to be rather modest. Perhaps the most significant is the utilization of microlending as marketing tool. Although, this is controversial since the reverse effect could emerge if to many loans are turned down, resulting in bad publicity.
Otherwise, there are two monetary opportunities of return for the microlender. The commissions received for the successful repayment of granted loans and the fees[135] paid for the consulting, coaching and monitoring services provided by the microlender along-side with a loan.[136] How successful the latter can be realized, depends on the overall policy and its consequent enforcement by the microlender.

5.2.2 Risks for the Microlender

Microlenders, which are accredited by the DMI bear partly the risk for their granted loans. There are significant risks for the GLS Microfinance Fund, if the microlender does not fulfil its responsibilities sufficiently. For instance, if the microlender neglects or stops the credit monitoring. In order to avoid this from happening the microlender has to deposit a contingency reserve, which is a certain percentage[137] of his planned gross loan portfolio into the GLS Microfinance Fund. This capital will be invested in form of a silent partnership, which will be liable for credit losses of the microlender in the following way:

- Credit losses of up to 10 percent will be borne by the common assets of the GLS Microfinance Fund,
- Credit losses of more than 10 percent will be borne equally by the common assets of the GLS Microfinance Fund and the deposited share of the microlender.[138]

More incentives have been developed for the successful repayment of every single loan. These incentives are “first-loss” payments and commissions. The microlender pays for each loan application to the GLS Microfinance Fund a fee (200 EUR is currently in discussion)[139]. The GLS Microfinance Fund generates out of these payments the money for commissions.[140] After completion of the loan term, commissions are paid by the GLS Microfinance Fund for each loan repaid successfully (230 EUR). For each loan, which had difficulties during the repayment period, this is reduced (150 EUR). No commissions are paid for partly or fully written off loans. These commissions should be part of the loan officers’ salary which in return then depends on their individual success. The aim is to encourage early and personal crisis intervention by the loan officer.
The risk within the gross loan portfolio of the microlender is to be evaluated periodically against the benchmarking of the DMI. The Portfolio-at-Risk (PaR) will play a crucial role in this benchmarking process. The “PaR is the value of all loans outstanding, that have one or more instalments of principal past due more than … [15] days [or have been restructured or re-scheduled]. This includes the entire

[135] They are rather indirectly related to the microlending process.
[136] If these fees are paid diretly by the borrower or if the possibility exists of subsidizing them through public programs is neglected here.
[137] Currently, 20 percent are discussed.
[138] There are more information, an exemplary calculation, and the translation into practice in Annex 2.
[139] The negative case – the rejection of the loan application – is not planned.
[140] The GLS Microfinance Fund can support this commission system with additional capital of its own.

unpaid balance, including both the past due and future instalments, but not accrued interest."[141] The DMI aims for a PaR of below 25 percent. Microlenders, who cannot fulfil this criteria will face sanctions. First of all, their granting of loans will be prohibited. In the worst case scenario the microlenders can lose their accreditation status.
Experience has shown that first disturbances are often hints towards substantial problems in the debitor-creditor-relationship. This benchmarking process shall be another incentive for the microlender to intervene immediately in times of crisis. Furthermore it will provide the GLS Microfinance Fund with information about credit risks, before they turn into loan losses.

5.2.3 Financing of the Microlender

The classic structure of start-up and entrepreneurial sponsorship, such as business promotion and business chambers are built with the traditional type of entrepreneur concept. Apart from these structures there exists no certain planning for start-up centres or intermediaries who work in the remaining supportive field of entrepreneurial activities.[142] They are usually funded by limited support measures of certain projects or central invitations to bid. Both of which are often publicly funded. These defined short-term measures frequently do not allow for the lasting sustained work of the sponsored institutions.
The microlending institutions will receive charges and fees for coaching and consultancy services from their clients. The microlender will be benchmarked by the DMI according to its economic efficiency, e.g. the use of economies of scale, cost-effective processes, and microlending technologies.[143] Still, it is doubtful that these payments will cover the costs of the microlender.
The first accredited microlenders have already acquired the necessary funds to build up and carry out microlending.[144] Additional financing will be made available in form of capital funds for pioneers and processing fees in connection with the KfW Mikro10 loan.
The DMI was set up by organisations which wished to grant microloans. Some of these organisations are unable to acquire the necessary funds for the contingency reserve in the short-term.[145] However, these organisations are very important to the DMI due to their experience and commitment as pioneers. Therefore the capital will be provided for them.[146] The accredited microlender can apply for an allowance[147] of up to 20 percent of the planned gross loan portfolio which equals the contingency reserve requirements of the GLS Microfinance Fund. This allowance can only be paid to non-profit organisations. These can either be accredited microlenders or an associated non-profit organisation of the microlender.
Furthermore the GLS Gemeinschaftsbank will grant loans between 5,000 and 10,000 EUR in form of KfW Mikro10 loans. The bank receives a processing fee of 1,000 EUR from the KfW for each Mikro10 loan it hands out. Out of this revenue 600 EUR will be shifted into an extra Fund. Microlenders will

[141] SEEP (2002), p. 5.
[142] DMI (2005), p. 16.
[143] subsequent reference, p. 18.
[144] This often within cooperation in their regional context.
[145] DMI (2005), p. 14.
[146] This capital is made available from donor institutions related to the GLS Gemeinschaftsbank, such as Gemeinnützige Treuhandstelle e.V., Bochum, and Evidenz, Dornach. [Protokoll, p. 15]
[147] The allowance functions like a "private" subsidy or grant, which does not have to be repaid by the microlender.

receive quarterly payments out of the extra Fund for each microloan granted. An exemplary calculation is given in Annex 3 for this procedure.[148]

So far this option is only available for 2005[149] since the KfW Mikro10 loan program is limited until the end of the year. It is not known at this point of time if the program will be prolonged after this.

Organisations which are interested in microlending and therefore strive for a cooperation with the DMI must acquire the necessary funds for developing a microlending division by themselves. The DMI can only provide training, handbooks, and tools to carry out microlending practically. The internal and external costs have to be borne fully by the microlender and could amount to as much as 10,000 to 30,000 EUR.[150]

The DMI currently tries to organise a regular access to public funds such as measures of business promotion, labour market policies, and social policies.

5.2.4 Cost and profitability calculation for the Microlender

Are the above mentioned criteria incentives enough for local partners to engage into microlending? Table 4 provides a calculation of the contribution margin[151] for potential microlenders. In this calculation start-up centres act as local partners of the DMI (= microlender). To use start-up centres here is useful since they are the typical partner for the DMI at present. Start-up centres play a double role with regards to the DMI. Firstly, they were very important one year ago, when the DMI has been founded and the majority of the members are still start-up centres or similar locally working institutions. Secondly, the members of the DMI; the start-up centres; are an important target group of the DMI. It is obvious that members will be preferably recruited as microlenders by the DMI. They will in return execute the sales of loan products as DMI microlenders. The DMI business model as explained above does not emphasise on a direct provision of DMI loans to their customers, but instead will use partnerships with local institutions like start-up centres.

The calculation shown in Table 4 is based on the following assumptions[152]:

- planned gross loan portfolio 100,000.00 EUR
- contingency reserve 20 % of the planned gross loan portfolio
- interest rate 10 %
- hourly wage of loan officer 35.00 EUR
- actual gross loan portfolio in percentage points of planned gross loan portfolio 100 %
- average amount of loans 5,000.00 EUR
- average loan term 2 years (= 24 months)

The planned gross loan portfolio equals the amount of collateral capital provided by the GLS Microfinance Fund to the Microlender. It is the maximum amount the microlender can grant.

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[148] DMI (2005), pp. 14-15.

[149] And only if the GLS Gemeinschaftbank is the cooperating bank. Arrangements with local banks have to be negotiated individually.

[150] DMI (2005), pp. 17-18.

[151] Deckungsbeitragsrechnung

[152] The assumptions are based on interviews and discussion rounds with experts and information provided by the DMI. Detailed descriptions of all items and figures used in the calculation illustrates Table 7 in the Annex.

The costs of becoming a microlender are demonstrated as accreditation costs. They are equivalent to the accreditation fee paid to the DMI; 7,000.00 EUR for members and 7,250.00 EUR for non-members. Microlending trainings are included and for simplicity reasons, it is assumed that all developmental costs will be covered by the accreditation fee.

A microlender needs a minimum of 6 to 8 hours for the credit worthiness evaluation (an average of 7 hours are used in the calculation). However, synergy effects can emerge if the borrower is known so that the processing time can then be reduced.

An application fee of 200.00 EUR is transferred to the GLS Microfinance Fund by the microlender for each loan application. It is assumed that the fee will be collected from the borrower and can be increased by an extra fee of the Microlender (here 50.00 EUR).[153]

Monthly monitoring is emphasized, with an expected average of 2 hours per month. It is assumed that the borrower will pay fees and charges, which will cover these costs. A service fee could be claimed from the borrower even easier if this is combined with coaching services. Additional work and expenditures are expected for ailing loans and are assumed to be 2 hours extra per loan per year.

After the completion of the loan-term, commissions[154] are paid by the GLS Microfinance Fund for each loan repaid successfully (230.00 EUR) and repaid completely but with difficulties (150.00 EUR). No commissions are paid for partly or fully written off loans.

The GLS Microfinance Fund expects a return on investment of 1.5 % according to its brochure[155] for which it will pay an equal return on the contingency reserve of the microlender. As explained in subchapter 5.2.3 the microlender will receive payments for each microloan given out in 2005. These payments are connected with the share of processing fees paid by the KfW to the GLS Gemeinschaftsbank. This figure greatly depends on the work of other accredited microlenders. It can only be indirectly influenced by the microlender. It is assumed that 50 percent of all loans granted will be in the range of and granted as KfW Mikro10 loans.

The inflation rate has been ignored in the calculation below. It is assumed that the normal proceeds such as fees and charges as well as loan sizes will increase with increasing costs.

[153] Therefore the option application fee is listed twice in the calculation. They cannot be substituted one for the other, they are rather complementary.
[154] Commissions are generated out of the previously paid application fees.
[155] GLS Gemeinschaftsbank (2004), p. 2.

Table 4: Calculation of the contribution margin for a microlender[156]

Business year			1	2	3	4	5	6	7	8	9	10
year			2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
	Number of loans in the Gross Loan Portfolio (#)		20 €	29 €	24 €	27 €	25 €	26 €	26 €	26 €	26 €	26 €
Revenue items	Application fee of the Microlender (EUR)	50,00 €	1.000,00 €	450,00 €	750,00 €	600,00 €	650,00 €	650,00 €	650,00 €	650,00 €	650,00 €	650,00 €
	Application fee of the GLS Microfinance Fund (EUR)	200,00 €	4.000,00 €	1.800,00 €	3.000,00 €	2.400,00 €	2.600,00 €	2.600,00 €	2.600,00 €	2.600,00 €	2.600,00 €	2.600,00 €
	Commissions for successfully repaid loans (230,- EUR)	65%			2.990,00 €	1.345,50 €	2.242,50 €	1.794,00 €	1.943,50 €	1.943,50 €	1.943,50 €	1.943,50 €
	Commissions for loans repaid but with difficulties (counted into the PaR) (150,- EUR)	25%			750,00 €	337,50 €	562,50 €	450,00 €	487,50 €	487,50 €	487,50 €	487,50 €
	Commissions for (partly) written off loans (counted into the loan loss rate) (0,- EUR)	10%			- €	- €	- €	- €	- €	- €	- €	- €
	Fees/Charges for monthly monitoring services (h)	2	16.800,00 €	24.360,00 €	20.160,00 €	22.680,00 €	21.000,00 €	21.840,00 €	21.840,00 €	21.840,00 €	21.840,00 €	21.840,00 €
	Share of KfW Micro10 loans/ Gross loan portfolio (processing fee 600,- EUR)	50%	6.000,00 €	- €								
	participation on interest returns of Microlender's Gross Loan Portfolio (%)	0,00%	- €	- €	- €	- €	- €	- €	- €	- €	- €	- €
	dividend income on contingency reserve (EUR)	1,5%	300,00 €	300,00 €	300,00 €	300,00 €	300,00 €	300,00 €	300,00 €	300,00 €	300,00 €	300,00 €
Total Revenue			28.100,00 €	26.910,00 €	27.950,00 €	27.663,00 €	27.355,00 €	27.634,00 €	27.821,00 €	27.821,00 €	27.821,00 €	27.821,00 €
Inflation rate		0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Costs / expenditures	Accreditation costs (EUR)	7.000,00 €	- 7.000,00 €									
	Cost of current accreditation (EUR)											
	Membership contribution to DMI (EUR)	240,00 €	- 240,00 €	- 240,00 €	- 240,00 €	- 240,00 €	- 240,00 €	- 240,00 €	- 240,00 €	- 240,00 €	- 240,00 €	- 240,00 €
	Application work (h)	7	- 4.900,00 €	- 2.205,00 €	- 3.675,00 €	- 2.940,00 €	- 3.185,00 €	- 3.185,00 €	- 3.185,00 €	- 3.185,00 €	- 3.185,00 €	- 3.185,00 €
	Cost/ expenditures for monthly monitoring services (h)	2	- 16.800,00 €	- 24.360,00 €	- 20.160,00 €	- 22.680,00 €	- 21.000,00 €	- 21.840,00 €	- 21.840,00 €	- 21.840,00 €	- 21.840,00 €	- 21.840,00 €
	Application fee of the GLS Microfinance Fund (EUR)	200,00 €	- 4.000,00 €	- 1.800,00 €	- 3.000,00 €	- 2.400,00 €	- 2.600,00 €	- 2.600,00 €	- 2.600,00 €	- 2.600,00 €	- 2.600,00 €	- 2.600,00 €
	additional expenditures for risky loans p.a. (h)	2	- 490,00 €	- 710,50 €	- 588,00 €	- 661,50 €	- 612,50 €	- 637,00 €	- 637,00 €	- 637,00 €	- 637,00 €	- 637,00 €
	Contractual liability for loan losses above the loan loss rate of 10 %	50%	- €	- €	- €	- €	- €	- €	- €	- €	- €	- €
Total Expenditures			- 33.430,00 €	- 29.315,50 €	- 27.663,00 €	- 28.921,50 €	- 27.637,50 €	- 28.502,00 €	- 28.502,00 €	- 28.502,00 €	- 28.502,00 €	- 28.502,00 €
Contribution Margin			**- 5.330,00 €**	**- 2.405,50 €**	**287,00 €**	**- 1.258,50 €**	**- 282,50 €**	**- 868,00 €**	**- 681,00 €**	**- 681,00 €**	**- 681,00 €**	**- 681,00 €**
accumulated contribution margins			- 5.330,00 €	- 7.735,50 €	- 7.448,50 €	- 8.707,00 €	- 8.989,50 €	- 9.857,50 €	- 10.538,50 €	- 11.219,50 €	- 11.900,50 €	- 12.581,50 €
+ costs for application work	if there are synergy effects considered please insert 1, if not leave it blank	1	4.900,00 €	2.205,00 €	3.675,00 €	2.940,00 €	3.185,00 €	3.185,00 €	3.185,00 €	3.185,00 €	3.185,00 €	3.185,00 €
Cash Flow			**- 430,00 €**	**- 200,50 €**	**3.962,00 €**	**1.681,50 €**	**2.902,50 €**	**2.317,00 €**	**2.504,00 €**	**2.504,00 €**	**2.504,00 €**	**2.504,00 €**
Liquidity at end of the year			- 430,00 €	- 630,50 €	3.331,50 €	5.013,00 €	7.915,50 €	10.232,50 €	12.736,50 €	15.240,50 €	17.744,50 €	20.248,50 €

Table 5: Expenditures of the borrower (corresponding to Table 4)

From the borrower's view		1.	2.	monthly annuity (interests and debt repayment)	monthly costs incl. annuity, monitoring costs (with interest participation of Microlender)	monthly costs incl. monthly annuity and monitoring costs (without interest participation of Microlender)	effective interest rate (a)
loan amount	5.000,00 €						
interest rate	10%						
Application fees	250,00 €	250,00 €					
Fees/Charges for monthly monitoring services (2 h)		840,00 €	840,00 €				
Annuity (a)	2.880,95 €	2.880,95 €	2.880,95 €	240,08 €	310,08 €	310,08 €	24,03%
costs p.a.		3.970,95 €	3.720,95 €				
total amount to be (re-)paid by the borrower	7.691,90 €						

[156] Figures and assumptions are based on interviews and discussion rounds with experts and information made available by the DMI. Detailed descriptions of all items and figures used in the calculation provides Table 7 in Annex 4.

5.3 Assessment of the DMI Project

It is a positive move on behalf of the DMI and its cooperation partners to have decided on a careful entrance strategy into the market for the first phase.[157] During the pilot phase only a few selected and highly motivated partners will start to grant micro-loans. The emphasis is to be put on the development of innovations and pilot measures, which have to be tailored to the clients needs. Later this knowledge will be spread by the DMI and via more cooperation partners, in particular more microlenders. A division of labour exists between the development and spread of microlending. This laboratory approach has several advantages for the cooperating institutions too. Not only do they become easier to control, but it also enables them to keep a better overview concerning costs and benefits.

However, it derives from the above calculation that the DMI model is unlikely to produce sustainability and outreach – the two long-term goals of microfinance.[158]

Several points are critical within the calculation:

1. There are no expenditures included in the calculation for material goods such as offices material, rents, telephone and internet costs and so on.
2. The costs of accreditation will not be 7,000 EUR, but are estimated between 10,000 and 30,000 EUR depending on the partner organisation.[159] For simplicity, only the accreditation fee of the DMI has been assumed here. Marketing costs, travelling expenditures for staff, internal process costs have to be considered too.
3. No costs are included for a continued accreditation by the DMI. Most probably the DMI will charge fees for continued services connected with a continued accreditation process.
4. The costs for loan applicants who do not pass the selection criteria for a loan are not included in the calculation. During the test phase from January until April 2005 only 10 percent of all inquiries received a positive credit rating by the testing microlenders. Inquiries which are rejected waste staff time and therefore create additional expenditure.
5. No (opportunity) costs are assumed for the contingency reserve of the microlender. These, however, can emerge, if the money could be invested with higher returns. Or if the microlender has to accept a cooperation in order to acquire the needed funds, which in return could cause additional duties for the microlender.
6. The assumption that the borrower will bear the cost for the monitoring is very vague. It will increase his monthly rate by 70 EUR. Table 5 illustrates that the effective interest rate would be 24.03 % for an average loan of 5,000.00 EUR. If the loan amount decreases the effective interest rate increases. However, the microlender has no other opportunity to cover the cost for monitoring or similar expenditures.

There are only two opportunities for the microlender to become more cost effective in his work. He either has to decrease his expenditures, mainly the transaction costs, or increase his returns or in the best case both.

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[157] Kerer (2003), p. 7
[158] for further details please refer to Chapter 2.
[159] DMI (2005), p. 18.

Almost all costs are variable costs.[160] From this it follows that cost reductions will not be reached by an increased outreach as there is no incentive for increased output so far. Cost-effective processes must be developed. If for example the time for application work could be halved (all other parameters being equal), positive results can be expected following the third year in operation. Some experts call for processing times of one hour. Only then, borrowers formally unknown to the microlender would become profitable. Otherwise microlending will become profitable for the microlender in the long run only if synergy effects can be realized before granting the loan.[161] Synergy effects emerge if the microlender already knows the borrower(s) and can use this knowledge to rate their credit worthiness which therefore reduces the processing time. This is possible for instance if the borrower has visited coaching seminars before. Here, however, arises the risk that the whole initiative is in danger of resulting in another solely distributing scheme[162], as many subsidized programs have before. There are few incentives for local partners (= microlender) to promote microlending actively. Perhaps, the most significant is the utilization of microlending as marketing tool. Some local partners have already expressed their intention to provide microloans only to existing customers in order to keep transactions costs on a manageable level. This can be compared to loans provided by car sellers. Clients will only receive loans, if they purchase a car in return. Or to put in other words, only clients who buy other services of the microlender will be able to apply for microloans.[163] This development is counter-productive to the goal of increasing scale of outreach.

The monitoring costs are the biggest cost factor in the calculation. Even better results can be achieved if the monitoring time can be diminished i.e. via innovative monitoring techniques. In addition those reduced costs can also be passed on to the borrowers, making the product more attractive. Currently the various transaction costs of the microlender are at an undesirable level.

More revenue can be realized through several parameters. First of all, it is strongly recommended that the microlender collects the application fee for the GLS Microfinance Fund (and charges an extra fee) from each loan application of borrowers.[164] Application fees could go up in price, however, this seems unlikely as outreach numbers will then suffer. If the loan amount decreases the flat application fees result in an increased effective interest rate for the borrower. The same is true, if the charges for monitoring services are increased. Both arguments will be hard to sell to potential customers.

Another way is to improve the quality of the gross loan portfolio. There are incentives given by the GLS Microfinance Fund, which aim at this. For example, commissions which increase for microlenders as soon as the PaR or the loan loss rate or both are reduced.

If the PaR is halved (all other parameters being equal) returns increase by 130 EUR p.a. in the long run[165]. Additionally 149.50 EUR p.a. can be realized in the long run if the number of loans written off can be reduced by half. Both of these figures symbolize the increased returns on the total gross loan

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[160] Table 8 in Annex 5 illustrates this by assuming a dynamic growth of the Gross Loan Portfolio of 10 %. The increasing costs can not be diminished significantly by the raised revenue.

[161] According to the Cash Flow in the calculation: it is assumed that no extra time is needed for the credit worthiness evaluation since the borrower is known and therefore can be rated right away. The expenditures for application work can be withdrawn from the financial result (contribution margin).

[162] The granting of loans is not actively promoted as a product and there exist "exclusion" criteria for certain potential clients. As a result loans are not actively "sold" but rather passively "handed out".

[163] DMI (2005), S. 6

[164] This has also been assumed in the calculation of Table 4.

[165] This figures evolves from the 7th year of operation on. In the years before there are smaller deviations from this figure due to deviations in the gross loan portfolio.

portfolio. If both rates could be halved at the same time it still leads to a negative contribution margin of 83 EUR. It is doubtful that these figures present any incentive. At present, the commissions paid by the GLS Microfinance Fund after the loan term are less than the application fee collected before the loan term, if the PaR and the loan loss rate are at their maximum, 25 and 10 percent, respectively. If the microlender does not collect the application fees from the borrower and can not improve the reference values of PaR and loan loss rate, he will even lose money.

So far, the microlender does not receive returns from interest paid by the borrower. It is questionable why the microlender must bear the risks when the profit-sharing is limited. In contrast, the bank faces limited risks and accumulates profits from interest payments. If the microlenders would receive a share of the interest paid by the borrower(s), their returns would increase substantially. For instance, if the interest rate is raised by 2 percent to a total of 12 percent (all other parameters being constant), this increases the revenue of the microlender by 1,782.86 EUR p.a. in the long run.[166] The microlender could achieve positive results from the third year in operation onwards. At the same time the monthly rate of the borrower increases by less than 7 EUR, the effective interest rate by only 1.25 percentage points.

Right now, there are two conflicts of interests:

- The microlender has incentives to grant small amounts of loans. This is because all returns are flat and do not depend on the loan size. In contrast the borrower has an incentive to apply for high amounts of loans. This is because the effective interest rate decreases with increasing loan sizes.
- Microlending itself will only become economically attractive to local partners, if as many costs as possible can be passed on to the borrowers. Overall this includes service charges of the microlender. In contrast the loan product itself becomes unattractive to borrowers with high or increasing costs.

The DMI is not willing or able to organize its sales by itself (as illustrated in subchapter 5.1). Consequently it emphasises on a linkage banking approach (as defined in Chapter 3). Here the DMI in connection with the GLS Microfinance Fund will not directly provide loans to their customers but instead will use intermediaries such as start-up centres, their existing infrastructure and knowledge as inter-linkage.

The German Gesellschaft für Technische Zusammenarbeit (GTZ) has extensive experience in linkage banking internationally. Due to its knowledge it distinguishes between three linkage banking models:

- <u>Direct financial linkage</u>: Banks and SHGs are directly linked. NGOs are responsible for establishing and assisting SHGs.
- <u>Indirect financial linkage</u>: NGOs have the above functions and on top act as financial intermediary. On the one side there is the financial linkage between the bank and NGO, and on the other between the NGO and SHG.
- <u>Direct linkage</u>: Banks and SHGs are directly linked to each other without any NGOs involved. The bank takes over the functions of the NGO. Besides financial services it is responsible for establishing and assisting SHG.

[166] As illustrated by Table 9 and Table 10 in Annex 6.

If this is transferred into the German context, the DMI business model goes in line with the indirect financial linkage approach. Of course, there do not exist any SHG here. Instead individual borrowers will step in this position. The local microlender which provides assisting services to borrowers is the local partner NGO (as described above) and acts as financial intermediary. However, the experience of the GTZ has shown that the indirect financial linkage approach to be least successful.[167]

As long as there is no access to public funding, cross subsidies are necessary from other business divisions of the Microlenders. Also, mixing credit delivery and assisting services, as well as the funding of both proves to be problematic. In order to build financially viable, sustainable institutions both activities and their funding have to be separated. Otherwise, subsidies could be used to cover losses of badly designed and managed credit schemes.[168] Whereas business support will always depend on external funding (e.g. grants, subsidies, fees), credit delivery should not rely on subsidies but aim for self-sufficiency. Experience suggests to either focus on financial or non-financial assistance services. Attempting to provide both holds a risk of not providing either service properly. In any case an institution that provides both has to separate responsibilities, incomes, and costs.[169]

To summarize, only very favourable conditions will lead to positive a contribution margin in the long-run. The incentives given by the GLS Microfinance Fund and the DMI are limited and insufficient. They certainly won't be enough to engage seriously in microlending.

6 Microlending in Germany vs. Microfinance in developing countries – a tentative comparison

Microfinance represents one of the tools to alleviate poverty. In developing countries this is concerned with absolute poverty often faced by large parts of the population. Due to an extensive safety net[170] virtually nobody in Germany faces absolute poverty, but relative poverty exists. The latter stands for social exclusion of poorer sections of the population.

Just like in developing countries, microfinance is used as a tool for creating self-employment in Germany. However, while the reasons in the former are high underemployment and economic depression, in Germany they are relief of social security systems and an answer to the change in employment structures.

Microfinance in developing countries and microlending in Germany have common goals; both emphasise the provision of financial services for the poor and formerly excluded people. But whereas in less developed countries the majority of the population is financially depressed, in Germany typical low-income households have access to safe and liquid deposit services in principle. Access to loans exist for the majority of the population to some degree, too. Anyone with a wage and a clean credit record will usually get a consumption loan or credit on their current account. If access to loans is constrained then it is usually due to a lack of collateral or because the bank judges a client as to risky or both. This shows another similarity between less developed countries and Germany. Though for Germany, it applies only to certain disadvantaged market segments, such as unemployed, migrants,

[167] Schliwa (2003), p. 14-15
[168] Evers et. al. (2000), p. 14.
[169] Subsequent reference, p. 21.
[170] This is still true despite the current reforms going on in this sector, if compared to developing countries.

and single parents. From this it follows that the main objective here is only the provision of loans to these groups, compared to the wide range of financial services as it is done in developing countries. The following table compares conditions which MFIs face in developing and developed countries like Germany.

Table 6: Comparison of Microfiance in developing and developed countries[171]

	Developing Countries	Developed Countries
Objectives	Provision of financial services to the poor on a sustainable basis	Provision of credit (and training) to assist certain disadvantaged market segments (e.g., unemployed, immigrants, single parents)
Market Size	Majority of the population—between 60 and 80 percent of the households	Small minority of the population
Visibility	Large, visible demand for credit	Hidden demand: market needs to be explored first.
Market Density	Concentrated. Fifty or more borrowers can be found at one marketplace	Dispersed. Clients are expensive to identify, select and reach
Access to Financial Services	Extremely limited	Generally the financial sector is competitive and accessible; market failure in certain areas and for certain segments
Income Alternatives for microentrepreneurs	Few. No or poorly developed welfare and social security system. High underemployment and few formal sector jobs.	Welfare and social security systems provide some safety net. Predominant formal sector employment.
Regulations for MFIs	Less defined. Generally less constraining.	Complex. Lots of bureaucracy, often not favorable to MF alongside banking.
Regulations for microentrepreneurs	Large, dynamic informal sector, few MSMEs are formally registered or pay taxes, regulations are largely absent	Complex, lots of bureaucracy, chief regulatory constrains are taxes, licenses, regulations, welfare rules
Barriers to Entry for self employed	Few	Many: competition from already existing small businesses and their lobbies; consumer protection rules; low profit margins
Competition in microenterprise sector	Shopkeepers and street vendors compete against each other, Households spend majority of budget on products from micro enterprises	Competition from large retailers and service providers, micro enterprises are only competitive in small niches Households do not spend large shares of budget on output of micro enterprises
Competition from commercial lenders	MFI competes with money lenders and other informal finance	MFI competes with private consumption credits, credits on current accounts and credit cards, though measures are designed for wage employed, access is lesser but available for microentrepreneurs
Microfinance operational costs	Manageable (staff costs can often be reduced by volunteer labour and externalisation of client screening, i.e. group liability)	Relatively high—especially wages and rent; limited scope for use of volunteer labour; practically no scope for use of cost-reducing delivery techniques
Loan amounts	Nominally small but relatively large—in general about GDP per capita	Nominally and relatively small—often less than 5 percent of GDP per capita

[171] Sources: ILO (2005); Schreiner/ Morduch (2001); own tabulation.

Interest rates	Generally between 30 and 60 percent per annum	Generally below 24 percent per annum; possible clash with effectively monitored anti-usury laws[172]
Economies of scale	Substantial in many areas in the South	Very difficult to achieve because of heterogeneity of clients.
Potential for full cost-recovery	Exists, even though generally the path towards financial self sufficiency is longer than originally expected. Over 60 MFIs worldwide are profitable.	Highly unlikely, particularly as most microfinance mechanisms are embedded in larger enterpreneurship promotion programmes.

Many of the microlending technologies built up in developing countries can not be replicated in Germany. For instance, the potential of joint liability groups seems to be low in Germany as the poor people are usually not tied to a plot of land or village and are less concerned about the maintenance of an unblemished reputation.

One of the important tasks of German microlenders will be to judge the risks of self-employed borrowers with bad credit records. Probably most of them are willing and able to repay loans and so will cease to be a bad risks. The challenge will be to differentiate between those and the ones who still remain a bad risk. US microfinance programs have used business plans and course work as indirect tools to screen for risks. This has proved to be inefficient too. Recent approaches include credit scoring, use of landlord references, savings records, and proof of bill payments.[173]

The focus on microlending combined with training is in sharp contrast to the experience in developing countries. There the main constraint is the access to financial services. In Germany it is believed that missing skills are a constraining factor too. Due to a highly regulated market, entrepreneurs must excel in many tasks besides their core business, e.g. keeping accounts. These skills decide decisively over success and failure of the company.

Developing countries have few lessons to offer on the combination of training and financial measures. Hence, one is that the provision of financial services has proved to be critical if done by the same institution designed to encourage business development of micro-enterprises. Institutions which do so face the following risks:

- The demand for business development services only emerges because the clients want to get access to (micro)loans. Distorted capital allocation may be the result.
- Conflicts of interest can arise within the institution if the decision of the micro-lending division is contrary to the one of the business development service. Whereas the first is concerned with high quality standards, the second acts as advocate of the micro enterprises.

Consequently it is not advisable to supply financial and non-financial services by the same institution.[174]

However, non-financial services play a decisive role in industrialized countries. Copisarow, who has extensive microfinance experience in developing as well as developed countries, points out that the situation faced by the poor in developing countries is not an exception but rather the norm. The social networks within communities and families are much stronger. As a result poor micro-enterprises suffer

[172] In Germany “interest rates levels are limited by an usury law that forbids charging more than double the average interest rate in the sector (e.g. real estate, loans), or exceeding the average interest rate in the sector by 12 percentage points or more.”[Evers et. al. (2005), part 4, p. 19.]
[173] Schreiner/ Morduch (2001), S. 49.
[174] Kerer (2003), p. 5-11.

relatively less from lack of self-esteem and confidences, but rather from missing access to financial services. In comparison, in industrialized countries the target group of micro enterprises and micro entrepreneurs represents an 'invisible' minority, which is socially excluded and individually isolated from traditional support patterns, such as families. In this respect, the role of community organisations is to rebuild and reinforce support schemes via institutional settings. Only if this pre-requisite has been re-established, sustainable financial services for this market can be created. Overall it is concluded that this difference is the reason why microfinance programs in developing countries have reached large numbers of borrowers without additional social or skill-building services, whereas this is not the case for developed countries countries. From her UK experiences, Copisarow no longer believes that a sustainable organisation can be created by only offering microloans in a developed country. [175]

Chapter 5 illustrated that there is a sufficient number of organisations during the pilot phase which are interested in becoming local DMI-microlender. They are willing to invest their own capital into the development of a microlending division. The above findings however suggest that this will be a money-losing business for them. International experience demonstrates it is challenging to become profitable in a developing country but even more in an industrialized one. Setting up financial institutions particularly in this field acquires high institutional costs. In developing countries these costs are often subsidized for MFIs which have prospects of long-term viability. Those subsidies should be designed degressively, and only be paid over a limited-term. In general, long-term subsidies are considered unsuitable. No interest subsidies - in particular when they diverge from market conditions - should be granted for final borrowers.[176] Microlending schemes in Germany often focus on minorities such as the unemployed. The fiscal cost of unemployment in Germany exceed the ones in developing countries many times over. In 2003, the federal agency for employment stated that the average expenditures per unemployed were 18,900 EUR.[177] Studies estimate that the potential for entrepreneurs who start out of unemployment is between 3 and 5 percent.[178] This figure is relatively small and demonstrate that self-employment is an employment-opportunity for only a small group of unemployed. However in absolute numbers, this made up for about a quarter of a million entrepreneurs in 2003.[179] If microlending supports self-employment of formerly unemployed, the results are the relief of social security systems and public budgets. Subsidies might be justifiable for microlending schemes in Germany, if total benefits – including social benefits – outweigh total expenditures. For the DMI model explained in Chapter 4, such a subsidy could be designed like the flat processing fee paid by the KfW for each micro10 loan.[180] Currently, an allowance of about 1,200 EUR per loan would have to be paid in order to enable the microlender to make a small profit, while the effective interest rate of the borrower would be reduced to 15 percent at the same time.[181] With expenditures well above revenues, microlending schemes, which continually rely on donors, have to

[175] Copisarow (2005), p. 20-38.
[176] Haupt/ Henrich (2004), p. 18-19.
[177] Federal Agency of Employment (2005).
[178] Wießner (2004), p. 67.
[179] Subsequent reference, p. 65.
[180] For further information, please refer to Table 2 in Chapter 4.2.
[181] By using the scheme in Table 4, this number can be calculated.

permanently justify their existence among other supported programs in this field. Cost-effectiveness analyses must be enforced on a serious and regular basis.[182]

7 Conclusion

The case study has shown that replicating microfinance in Germany is not that easy. This is due to the political, economic, and social settings differing tremendously from the ones found in developing countries. However, these conditions play an important role in the designing of a microfinance program. Best practices might not be as successful in a different surrounding and setting of variables.[183]

In Germany, microlending is gradually becoming established. At present its scale is still relatively small. The challenge is to find a place between and distinguish itself from the social security systems, providing support for the livelihood of the poor, and the established banking sector, providing loans on commercial terms to the established business community. Its role must be to facilitate access to credits and enable target groups to undertake self-determined employment and income opportunities.[184]

Compared to developing countries, the focus of German microlending schemes is often socially determined. They concentrate on minorities i.e. unemployed, migrants, which are especially hard to reach. Yet, mixing social intentions with business needs in lending is an obstacle to outreach and even more to sustainability.[185] This is reflected by the DMI model too. Especially, the setting of and within the cooperating institutions and the lack of sufficient incentives have been found critical. The success of microfinance in other countries however is based on a chain of incentives for each partner involved. Only if there is a self-interested reason to make it work it will work. Concluding from this more (financial) incentives have to be developed in order to achieve outreach and sustainability in the long run. Along this line the reduction of costs is necessary too. There are three possibilities of doing it; reducing operational expenses, loan losses, and costs of funds. For the first two technological improvements are needed. Innovations such as joint liability groups have been successful in developing countries to better judge the risks of loans to poor and enforce high repayment rates. Appropriate tools have to be developed for the German context too. This is important since microlending symbolizes an innovation. But innovations not only develop due to scientific research. Often they emerge by accident in form of solutions to practical problems. In this respect, the work and intention of the DMI should not be discredited right from the beginning. Often programs itself can become brokers of innovation in their ongoing development.

Furthermore, close attention must be paid to the design of suitable, demand-driven products. For this purpose the target group of German microfinance has to be defined more clearly. A decisive analysis of potential clients and their needs would have exceeded the scope of this study and is currently missing.

Although there are some lessons to learn from developing countries, microlending can not be replicated simply. Many of the problems have to be solved within the German context.

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[182] Schreiner/ Morduch (2001), p. 6.
[183] Khawari (2004), p. 32.
[184] Evers et. al. (2000), p. 43.
[185] Subsequent reference, p. 14.

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Annex

Annex 1: Diversion of interest income among GLS Microfinance Fund and GLS Gemeinschaftsbank

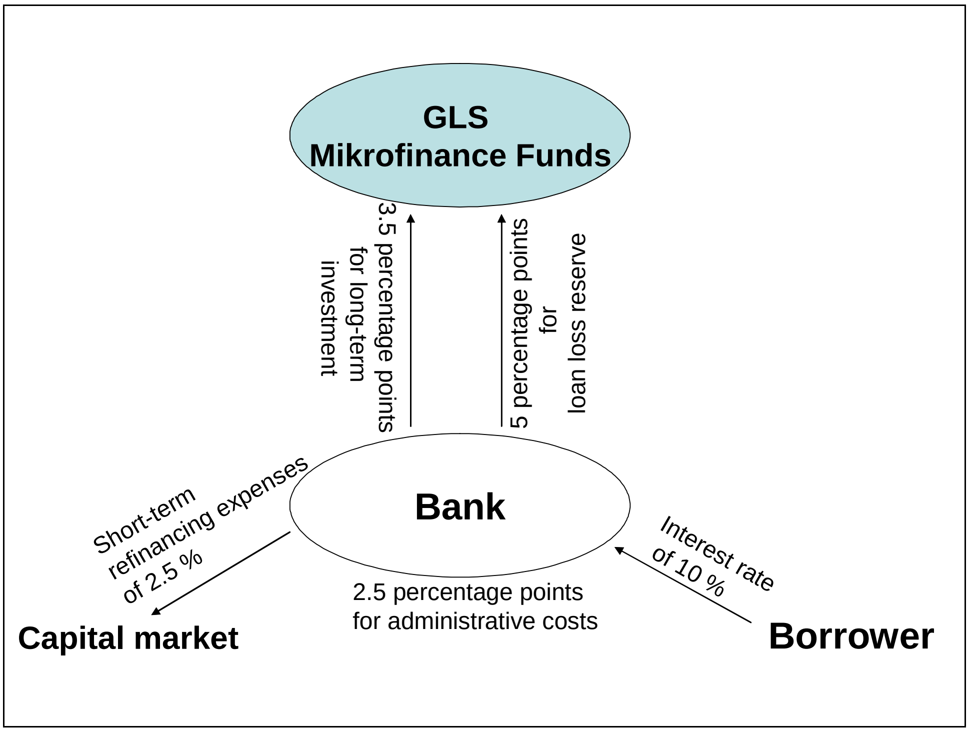

Figure 5: Diversion of interest income

The GLS Microfinance Fund receives a long-term interest-rate, whereby the micro loans are refinanced by the bank via the capital market on a short-term basis.

Annex 2: Risk of the microlender[186]

Example 1 (no depreciation):

Gross loan portfolio	100,000.00 EUR
Contingency reserve of microlender X	20,000.00 EUR
Written off loans of microlender X	10,000.00 EUR (= 10 %)
Repayment of the contingency reserve	20,000.00 EUR
Dividend	1.5 % p.a. (est. by the GLS Microfinance Fund)

Example 2 (depreciation):

Gross loan portfolio	100,000.00 EUR
Contingency reserve of microlender X	20,000.00 EUR
Written off loans of microlender X	16,000.00 EUR (= 16 %)
Loan losses above 10 %	6,000.00 EUR
Loan losses charged to microlender's contingency reserve (50 %)	3,000.00 EUR
Repayment of the contingency reserve	17,000.00 EUR
Dividend	1.5 % p.a. (est. by the GLS Microfinance Fund)

Translation into practice:

- The contingency reserve of the microlender must cover 20 percent of its gross loan portfolio at anytime, at least however 20 percent of the newly grantable amount arranged in the newest cooperation contract with the GLS Microfinance Fund.
- In the participation contract as well as through a guarantee in the annex it is indicated for which the Microlender priority liability of its contingency reserve is applicable. The participations can be drawn by the Microlender and also of its surroundings.
- In each case to the 31.01. and to the 31.07. if the fund checks whether the coverage of 20 percent is given. If this is not the case, the credit award is discontinued until a coverage exists again. (self-regulation with hard sanction)
- The participation is terminable for the first time after three years with a deadline of one year. Prerequisite for the disbursement is the necessary coverage of 20 percent
- Example for the calculation of the loan loss rate:

gross loan portfolio on January 31,2006	234,567.00 EUR
gross loan portfolio on July 31, 2006	345,678.00 EUR
capital means in 2006	290,122.50 EUR
written off loans in 2006 (paid by the GLS Microfinance Fund)	23,456,78 EUR
loan loss rate	8,08 %

  The participation will not be devalued in this case, (rate <10 percent).
- Possible devaluations of participations well be deducted on December 31.

[186] DMI (2005), pp. 12-13.

Annex 3: Exemplary calculation for the commissions paid in connection with processing fee of the KfW Mikro10 loan[187]

The GLS Gemeinschaftsbank eG will grant DMI credits between 5,000 and 10,000 EUR normally as KfW-Mikro10 loans. It will make 600 EUR of the processing fee paid available for each credit into an extra Fund. Out of this Fund a reimbursement per DMI credit gets out to the Microlender four times a year at the end of each quarter. A quarter settlement could look, as follows:

DMI credits (total)	= 90
From which are … KfW Micro10 loans	= 60
60 loans x 600 EUR	= 36,000 EUR
reimbursement per DMI credit	= 36,000 EUR / 90 DMI credits = 400 EUR

If a Mikrofinanzierer arranged 10 credits in this quarter, he therefore gets 4,000 EUR.

Annex 4:Definitions of items used in the calculation and underlying assumptions.

Table 7: Items, their definition and underlying assumptions of the calculation

Item	Definitions / underlying assumptions
1. General Items	
Planned gross loan portfolio (EUR)	The Planned Gross Loan Portfolio is the loan capital provided by the GLS Microfinance Fund to the Microlender. The Microlender fixes a quota with the GLS Microfinance Fund before and then can grant loans as high as the fixed quota.
Contingency reserve (EUR)	The microlender has to deposit a contingency reserve as high as 20 % of the planned gross loan portfolio into the Fund. The Fund is entitled to claim 50 % of loan losses which are above the aimed loan loss rate.
Interest rate (%)	Planned interest rate of the DMI, at present 10 %
Hourly wage of loan officer (EUR)	average hourly wage rate of 35.00 EUR
Average loan size (EUR)	Reference figure of DMI; 5,000.00 EUR
Average loan term (a)	Reference figure of DMI; 24 months
Real Gross Loan Portfolio/ Planned Gross Loan Portfolio (%)	all loans, which have been granted by the microlender (in % of planned gross loan portfolio
Dynamic growth of Gross Loan Portfolio (%)	Microlender increase outreach, constant growth of the Gross Loan Portfolio (e.g. 10 %)
Gross Loan Portfolio Outstanding (EUR)	Real gross loan portfolio on average
Loan payouts (EUR)	Yearly payouts of loans
Remaining loan stock at the end of the year (EUR)	Share of loans granted in previous years not yet fully amortized (remaining loan stock at the end of Period 1)
Received payments on loans (EUR)	Amortization of the real gross loan portfolio during the year
Grantable loans during the following year (#)	Number of loans, which can be granted in the following year out of the received payments on loans in this year
Number of loans in the Gross Loan Portfolio (#)	Number of loans which have been granted but are not yet fully amortized
2. revenue items	
Application fee of the Microlender (EUR)	extra application fee for the Microlender (50 EUR assumed here) to be paid by the borrower to the Microlender

[187] DMI (2005), p. 14.

Application fee of the GLS Microfinance Fund (EUR)	Fixed application fee of 200 EUR has to be paid to the GLS Microfinance Fund for each loan application, Here it is assumed that this fee is paid by the borrower to the Microlender and transferred from the Microlender to the GLS Microfinance Fund (see expenditures)
Commissions for successfully repaid loans (EUR)	A commission is paid by the Fund for each successful repaid loan, which did not face disturbances during its term, of 230 EUR.
Commissions for loans repaid but had difficulties (= counted into the PaR) (EUR)	– PaR is the value of all loans outstanding, that have one or more instalments of principal past due more than … [15] days. This … includes the entire unpaid principal balacen, including both the past due and future instalments, but not accrued interest.[188] – A commission is paid by the Fund for each successful repaid loan, but which were encountered in the PaR, of 150 EUR – The DMI aims at a PaR ratio of below 25 %. Microlenders, who cannot fulfil this criteria will face sanctions, in the worst case lose their accreditation status
Commissions for (partly) written off loans (counted into the loan loss rate) (EUR)	– Loan loss ratio represents the percentage of loans that have been removed from the balance of the real gross loan portfolio, because they are unlikely to be repaid.[189] – No commission is paid by the Fund for loans which had to or partly had to be written off. – The DMI aims at a loan loss ratio of below 10 %. Microlenders, who cannot fulfil this criteria will have to participate with their deposited security reserve on the loan losses.
Fees/Charges for monthly monitoring services (h)	Processing fees for monthly coaching and monitoring paid by the borrower. A minimum of 2 hours per month is assumed from expert interviews. (see also expenditures)
Share of KfW Micro10 loans/ Gross loan portfolio	The GLS Gemeinschaftsbank will grant loans of 5,000 to 10,000 EUR in form of KfW Mikro10 loans. (a more detailed assessment gives Annex 3). The KfW Micro10 loan program is limited until December 05.
participation on interest returns of Microlender's Gross Loan Portfolio (%)	Potential share in the interest revenue of the Gross Loan Portfolio received by the microlender. The reference value of the DMI is at present 0.
dividend income on contingency reserve (EUR)	The GLS Microfinance Fund will pay a dividend on its capital stock, estimated are 1.5 %
3. costs / expenditures	

Accreditation cost (EUR)	– Costs of accreditation by the DMI: 7,000 EUR for members / 7,250 EUR for non-members
	– Subscription costs are included for 2 people for the DMI-trainings within the scope of accreditation:
	  – Training 1: products, target groups, calculation
	  – Training 2: implementation, procedures, benchmarking, monitoring
	  – Training 3: adjustment process, exchange of experiences (taking place after accreditation)
	– For simplicity reasons, it is assumed that all developmental costs for the organization and staff will be covered by the accreditation costs of the DMI.

Cost of current accreditation (EUR)	Most probably the DMI will charge fees for continued services connected with a continued accreditation process. Up to now there are no reference figures for costs available.
Membership contribution to DMI (EUR)	Members have to pay a yearly contribution, at present of EUR 240.00.

[188] SEEP (2002), p. 14.
[189] SEEP (2002), p. 15.

Application work / credit worthiness evaluation (h)	– Between 6 and 8 hours are needed for credit decision according to expert interviews. – However synergy effects can emerge if the borrower has been known by the loan officer (coach), for instance during a start-up seminar visited by the borrower beforehand. This can reduce the time of the evaluation process. This is important for the cash flow calculating. – For simplicity reasons, an average of 7 hours is assumed.
Cost/ expenditures for monthly monitoring services (h)	Expenditures for monthly coaching and monitoring of borrowers. It is suggested that the borrower will bear these costs. A minimum of 2 hours per month is assumed from expert interviews. (see revenue items)
Application fee of the GLS Microfinance Fund (EUR)	Fixed application fee of 200 EUR has to be paid to the GLS Microfinance Fund for each loan application, Here it is assumed that this fee is paid by the borrower to the Microlender and transferred from the Microlender to the GLS Microfinance Fund (see revenue items)
Additional expenditure for risky loans (h, EUR)	– Additional working time is needed for risky loans. Risky loans are all loans of the PaR and loan loss rate. – 2 hours per loan are assumed yearly.
Contractual liability for loan losses above the loan loss rate of 10 % (%)	– Credit losses of up to 10 % will be borne by the common assets of the GLS Microfinance Fund – Credit losses of more than 10 % will be borne equally by the common assets of the GLS Microfinance Fund and the contingency reserve of the microlender
4. other items	
+ costs for application work	Synergy effects can emerge during application work, because time can be saved if the borrower is known to the Microlender beforehand (e.g. because trainings of other business divisions have been visited by the borrower before). It is assumed that the loan officer does the credit worthiness evaluation during his normal work. Additional costs do not emerge for the Microlender then. If real costs emerge, this field will be left blank.

Annex 5: Calculation of the contribution margin including a dynamic growth of 10 %

Table 8: Contribution margin's calculation incl. 10 % annual growth of the Gross Loan Portfolio

Business year			1	2	3	4	5	6	7	8	9	10
year			2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
	Dynamic growth of Gross Loan Portfolio (%)	10%										
	Gross Loan Portfolio outstanding (EUR)		- €	102.380,95 €	111.190,48 €	114.523,81 €	126.666,67 €	132.142,86 €	144.523,81 €	152.380,95 €	162.380,95 €	172.619,05 €
	Number of loans in the Gross Loan Portfolio (#)		20 €	30 €	27 €	31 €	32 €	35 €	37 €	40 €	42 €	45 €
Revenue items	Application fee of the Microlender (EUR)	50,00 €	1.000,00 €	500,00 €	850,00 €	700,00 €	900,00 €	850,00 €	1.000,00 €	1.000,00 €	1.100,00 €	1.150,00 €
	Application fee of the GLS Microfinance Fund (EUR)	200,00 €	4.000,00 €	2.000,00 €	3.400,00 €	2.800,00 €	3.600,00 €	3.400,00 €	4.000,00 €	4.000,00 €	4.400,00 €	4.600,00 €
	Commissions for successfully repaid loans (230,- EUR)	65%			2.990,00 €	1.495,00 €	2.541,50 €	2.093,00 €	2.691,00 €	2.541,50 €	2.990,00 €	2.990,00 €
	Commissions for loans repaid but with difficulties (counted into the PaR) (150,- EUR)	25%			750,00 €	375,00 €	637,50 €	525,00 €	675,00 €	637,50 €	750,00 €	750,00 €
	Commissions for (partly) written off loans (counted into the loan loss rate) (0,- EUR)	10%			- €	- €	- €	- €	- €	- €	- €	- €
	Fees/Charges for monthly monitoring services (h)	2	16.800,00 €	25.200,00 €	22.680,00 €	26.040,00 €	26.880,00 €	29.400,00 €	31.080,00 €	33.600,00 €	35.280,00 €	37.800,00 €
	Share of KfW Micro10 loans/ Gross loan portfolio (processing fee 600,- EUR)	50%	6.000,00 €	- €								
	participation on interest returns of Microlender's Gross Loan Portfolio (%)	0,00%	- €	- €	- €	- €	- €	- €	- €	- €	- €	- €
	dividend income on contingency reserve (EUR)	1,5%	300,00 €	300,00 €	300,00 €	300,00 €	300,00 €	300,00 €	300,00 €	300,00 €	300,00 €	300,00 €
Total Revenue			28.100,00 €	28.000,00 €	30.970,00 €	31.710,00 €	34.859,00 €	36.568,00 €	39.746,00 €	42.079,00 €	44.820,00 €	47.590,00 €
Inflation rate		0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Costs / expenditures	Accreditation costs (EUR)	7.000,00 €	- 7.000,00 €									
	Cost of current accreditation (EUR)											
	Membership contribution to DMI (EUR)	240,00 €	- 240,00 €	- 240,00 €	- 240,00 €	- 240,00 €	- 240,00 €	- 240,00 €	- 240,00 €	- 240,00 €	- 240,00 €	- 240,00 €
	Application work (h)	7	- 4.900,00 €	- 2.450,00 €	- 4.165,00 €	- 3.430,00 €	- 4.410,00 €	- 4.165,00 €	- 4.900,00 €	- 4.900,00 €	- 5.390,00 €	- 5.635,00 €
	Cost/ expenditures for monthly monitoring services (h)	2	- 16.800,00 €	- 25.200,00 €	- 22.680,00 €	- 26.040,00 €	- 26.880,00 €	- 29.400,00 €	- 31.080,00 €	- 33.600,00 €	- 35.280,00 €	- 37.800,00 €
	Application fee of the GLS Microfinance Fund (EUR)	200,00 €	- 4.000,00 €	- 2.000,00 €	- 3.400,00 €	- 2.800,00 €	- 3.600,00 €	- 3.400,00 €	- 4.000,00 €	- 4.000,00 €	- 4.400,00 €	- 4.600,00 €
	additional expenditures for risky loans p.a. (h)	2	- 490,00 €	- 735,00 €	- 661,50 €	- 759,50 €	- 784,00 €	- 857,50 €	- 906,50 €	- 980,00 €	- 1.029,00 €	- 1.102,50 €
	Contractual liability for loan losses above the loan loss rate of 10 %	50%	- €	- €	- €	- €	- €	- €	- €	- €	- €	- €
Total Expenditures			- 33.430,00 €	- 30.625,00 €	- 31.146,50 €	- 33.269,50 €	- 35.914,00 €	- 38.062,50 €	- 41.126,50 €	- 43.720,00 €	- 46.339,00 €	- 49.377,50 €
Contribution Margin			**- 5.330,00 €**	**- 2.625,00 €**	**- 176,50 €**	**- 1.559,50 €**	**- 1.055,00 €**	**- 1.494,50 €**	**- 1.380,50 €**	**- 1.641,00 €**	**- 1.519,00 €**	**- 1.787,50 €**
accumulated contribution margins			- 5.330,00 €	- 7.955,00 €	- 8.131,50 €	- 9.691,00 €	- 10.746,00 €	- 12.240,50 €	- 13.621,00 €	- 15.262,00 €	- 16.781,00 €	- 18.568,50 €
+ costs for application work	if there are synergy effects considered please insert 1, if not leave it blank	1	4.900,00 €	2.450,00 €	4.165,00 €	3.430,00 €	4.410,00 €	4.165,00 €	4.900,00 €	4.900,00 €	5.390,00 €	5.635,00 €
Cash Flow			**- 430,00 €**	**- 175,00 €**	**3.988,50 €**	**1.870,50 €**	**3.355,00 €**	**2.670,50 €**	**3.519,50 €**	**3.259,00 €**	**3.871,00 €**	**3.847,50 €**
Liquidity at end of the year			- 430,00 €	- 605,00 €	3.383,50 €	5.254,00 €	8.609,00 €	11.279,50 €	14.799,00 €	18.058,00 €	21.929,00 €	25.776,50 €

Annex 6: Calculation of the contribution margin including a share of interest revenue (2 %) for the microlender

Table 9: Contribution margin's calculation incl. interest share for the microlender

Business year			1	2	3	4	5	6	7	8	9	10
year			2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
	Number of loans in the Gross Loan Portfolio (#)		20 €	29 €	24 €	27 €	25 €	26 €	26 €	26 €	26 €	26 €
Revenue items	Application fee of the Microlender (EUR)	50,00 €	1.000,00 €	450,00 €	750,00 €	600,00 €	650,00 €	650,00 €	650,00 €	650,00 €	650,00 €	650,00 €
	Application fee of the GLS Microfinance Fund (EUR)	200,00 €	4.000,00 €	1.800,00 €	3.000,00 €	2.400,00 €	2.600,00 €	2.600,00 €	2.600,00 €	2.600,00 €	2.600,00 €	2.600,00 €
	Commissions for successfully repaid loans (230,- EUR)	65%			2.990,00 €	1.345,50 €	2.242,50 €	1.794,00 €	1.943,50 €	1.943,50 €	1.943,50 €	1.943,50 €
	Commissions for loans repaid but with difficulties (counted into the PaR) (150,- EUR)	25%			750,00 €	337,50 €	562,50 €	450,00 €	487,50 €	487,50 €	487,50 €	487,50 €
	Commissions for (partly) written off loans (counted into the loan loss rate) (0,- EUR)	10%			- €	- €	- €	- €	- €	- €	- €	- €
	Fees/Charges for monthly monitoring services (h)	2	16.800,00 €	24.360,00 €	20.160,00 €	22.680,00 €	21.000,00 €	21.840,00 €	21.840,00 €	21.840,00 €	21.840,00 €	21.840,00 €
	Share of KfW Micro10 loans/ Gross loan portfolio (processing fee 600,- EUR)	50%	6.000,00 €	- €								
	participation on interest returns of Microlender's Gross Loan Portfolio (%)	2,00%	1.800,00 €	1.752,86 €	1.774,29 €	1.787,14 €	1.735,71 €	1.782,86 €	1.782,86 €	1.782,86 €	1.782,86 €	1.782,86 €
	dividend income on contingency reserve (EUR)	1,5%	300,00 €	300,00 €	300,00 €	300,00 €	300,00 €	300,00 €	300,00 €	300,00 €	300,00 €	300,00 €
Total Revenue			29.900,00 €	28.662,86 €	29.724,29 €	29.450,14 €	29.090,71 €	29.416,86 €	29.603,86 €	29.603,86 €	29.603,86 €	29.603,86 €
Inflation rate		0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Costs / expenditures	Accreditation costs (EUR)	7.000,00 €	- 7.000,00 €									
	Cost of current accreditation (EUR)											
	Membership contribution to DMI (EUR)	240,00 €	- 240,00 €	- 240,00 €	- 240,00 €	- 240,00 €	- 240,00 €	- 240,00 €	- 240,00 €	- 240,00 €	- 240,00 €	- 240,00 €
	Application work (h)	7	- 4.900,00 €	- 2.205,00 €	- 3.675,00 €	- 2.940,00 €	- 3.185,00 €	- 3.185,00 €	- 3.185,00 €	- 3.185,00 €	- 3.185,00 €	- 3.185,00 €
	Cost/ expenditures for monthly monitoring services (h)	2	- 16.800,00 €	- 24.360,00 €	- 20.160,00 €	- 22.680,00 €	- 21.000,00 €	- 21.840,00 €	- 21.840,00 €	- 21.840,00 €	- 21.840,00 €	- 21.840,00 €
	Application fee of the GLS Microfinance Fund (EUR)	200,00 €	- 4.000,00 €	- 1.800,00 €	- 3.000,00 €	- 2.400,00 €	- 2.600,00 €	- 2.600,00 €	- 2.600,00 €	- 2.600,00 €	- 2.600,00 €	- 2.600,00 €
	additional expenditures for risky loans p.a. (h)	2	- 490,00 €	- 710,50 €	- 588,00 €	- 661,50 €	- 612,50 €	- 637,00 €	- 637,00 €	- 637,00 €	- 637,00 €	- 637,00 €
	Contractual liability for loan losses above the loan loss rate of 10 %	50%	- €	- €	- €	- €	- €	- €	- €	- €	- €	- €
Total Expenditures			- 33.430,00 €	- 29.315,50 €	- 27.663,00 €	- 28.921,50 €	- 27.637,50 €	- 28.502,00 €	- 28.502,00 €	- 28.502,00 €	- 28.502,00 €	- 28.502,00 €
Contribution Margin			**- 3.530,00 €**	**- 652,64 €**	**2.061,29 €**	**528,64 €**	**1.453,21 €**	**914,86 €**	**1.101,86 €**	**1.101,86 €**	**1.101,86 €**	**1.101,86 €**
accumulated contribution margins			- 3.530,00 €	- 4.182,64 €	- 2.121,36 €	- 1.592,71 €	- 139,50 €	775,36 €	1.877,21 €	2.979,07 €	4.080,93 €	5.182,79 €
+ costs for application work	if there are synergy effects considered please insert 1, if not leave it blank	1	4.900,00 €	2.205,00 €	3.675,00 €	2.940,00 €	3.185,00 €	3.185,00 €	3.185,00 €	3.185,00 €	3.185,00 €	3.185,00 €
Cash Flow			**1.370,00 €**	**1.552,36 €**	**5.736,29 €**	**3.468,64 €**	**4.638,21 €**	**4.099,86 €**	**4.286,86 €**	**4.286,86 €**	**4.286,86 €**	**4.286,86 €**
Liquidity at end of the year			1.370,00 €	2.922,36 €	8.658,64 €	12.127,29 €	16.765,50 €	20.865,36 €	25.152,21 €	29.439,07 €	33.725,93 €	38.012,79 €

Table 10: Expenditures of the borrower (corresponding to Table 9)

From the borrower's view		1.	2.	monthly annuity (interests and debt repayment)	monthly costs incl. annuity, monitoring costs (with interest participation of Microlender)	monthly costs incl. monthly annuity and monitoring costs (without interest participation of Microlender)	effective interest rate (a)
loan amount	5.000,00 €						
interest rate	12%						
Application fees	250,00 €	250,00 €					
Fees/Charges for monthly monitoring services (2 h)		840,00 €	840,00 €				
Annuity (a)	2.958,49 €	2.958,49 €	2.958,49 €	246,54 €	316,54 €	310,08 €	25,28%
costs p.a.		4.048,49 €	3.798,49 €				
total amount to be (re-)paid by the borrower	7.846,98 €						