Università
Ca'Foscari
Venezia

Master's Degree in

Comparative International Relations

Final Thesis

The Ways of Microfinance in Europe: An Overview of Actors and Practices

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Academic Year
2019/2020

Abstract

The European microfinance sector is young, fragmented and relatively under-researched. It is young as modern initiatives have gained momentum in the 1990s in eastern Europe with the fall of planned economic systems and in the 2000s in western Europe, when the European Union launched its multiannual programme for business and entrepreneurship support. It is fragmented as national regulations, economic contexts and priorities differ considerably from one country to another. It is relatively under-researched compared to global microfinance, a field where large international NGOs manage large amounts of donor funding, who demand an account of its impact - even using expensive tools such as randomised controlled trials.

Contemporary European microfinance differs from that practised in developing countries in several aspects. Although both broadly operate in a market economy, the former is combined with welfare policies aimed at increasing social inclusion, while the latter emphasises poverty alleviation, often through the implementation of rural microfinance programmes supported by international humanitarian agencies.

This paper presents an overview of microfinance actors and practices in Europe over two decades (2000-2020), covering both general topics such as the nature of microfinance, the historical and conceptual context, and more specific topics, such as the role of the main players, a snapshot of the phenomenon from a quantitative point of view, some references to national legislations, a more in-depth view of the Italian way to microfinance together with some examples of good practices. Particular attention has been given to the selection of the bibliography, allowing the reader to explore the topic independently.

Despite the lack of systematic comparative studies on the subject, the hope is that we have been able to grasp from the overview some distinctive elements that characterise microfinance in European countries vis-a-vis global microfinance, so that they can be object of mutual stimulus.

Abstract (Italian)

Il settore europeo della microfinanza è giovane, frammentato e relativamente poco studiato. È giovane perché le iniziative moderne hanno preso slancio negli anni '90 in Europa orientale, con la caduta dei sistemi economici pianificati, e negli anni 2000 in Europa occidentale, quando l'Unione Europea ha lanciato il suo programma pluriennale per il sostegno alle imprese e all'imprenditorialità. È frammentato perché le legislazioni nazionali, i contesti economici e le priorità differiscono considerevolmente da un Paese all'altro. È peraltro poco studiato se paragonato alla microfinanza mondiale, terreno dove le grandi ONG internazionali gestiscono ingenti finanziamenti di donatori, i quali chiedono contezza sul loro impatto - anche utilizzando strumenti costosi come gli studi controllati randomizzati.

La microfinanza europea contemporanea differisce da quella praticata nei Paesi in via di sviluppo per alcune peculiarità. Sebbene entrambe operino in linea di massima in un'economia di mercato, la prima si coniuga con politiche di welfare volte ad aumentare l'inclusione sociale, mentre la seconda pone l'enfasi sull'alleviamento della povertà, sovente mediante l'attuazione di programmi di microfinanza rurale supportati da agenzie umanitarie internazionali.

Questo scritto presenta una panoramica sugli attori e sulle pratiche della microfinanza in Europa nell'arco di due decenni (2000-2020), coprendo sia temi generali quali la natura della microfinanza, il suo contesto storico e concettuale, che argomenti più specifici, come il ruolo dei *player* principali, un'istantanea del fenomeno dal punto di vista quantitativo, alcuni cenni alle legislazioni nazionali, una visione più approfondita della via italiana alla microfinanza insieme ad alcuni esempi di buone prassi. Particolare attenzione è stata data alla selezione della bibliografia, che consente al lettore di esplorare l'argomento in autonomia.

Nonostante la carenza di sistematici studi comparativi sull'argomento a cui fare riferimento, la speranza è quella di esser riusciti a cogliere dal quadro d'insieme alcuni elementi distintivi che caratterizzano la microfinanza nei Paesi europei rispetto a quella globale, affinché siano occasione di reciproco stimolo.

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List of abbreviations

ADIE	Association pour le Droit à l'Initiative Economique
ASCA	Accumulating Savings and Credit Association
ATM	Automatic Teller Machine
BDS	Business Development Services
CDFI	Community Development Financial Institution
CERMI	Centre for European Research in Microfinance
CERSEM	Centre for Research on Social Enterprises and Microfinance
CGAP	Consultative Group to Assist the Poor
CIP	Competitiveness and Innovation (Framework) Programme
CoGC	(European) Code of Good Conduct for Microcredit Provision
COPIE	Community of Practice on Inclusive Entrepreneurship
COSME	Competitiveness of Enterprises and Small and Medium-sized Enterprises
CSR	Corporate Social Responsibility
CU	Credit Unions
DP	Development Partnership
EC	European Commission
ECA	Eastern European and Central Asian countries
EDF	European Development Fund
EEN	European Enterprise Network
EES	European Employment Strategy
EFSD	European Fund for Sustainable Development
EFSE	European Fund for Southeast Europe
EFSI	European Fund for Strategic Investments
EGF	European Adjustment Fund
EIB	European Investment Bank
EIF	European Investment Fund
EIP	External Investment Plan
e-MFP	European Microfinance Platform
EMN	European Microfinance Network
ENM	Ente Nazionale per il Microcredito
EPMF	European Progress Microfinance Facility
EPPA	European Parliament Preparatory Action
ESF (+)	European Social Fund (Plus)
ESIF	European Structural and Investment Funds
EUIFI	European Union Initiative for Financial Inclusion
FSP	Financial Service Provider
GLP	Gross Loan Portfolio
IADB	Inter-American Development Bank
KET	Key Enabling Technologies
KfW	Kreditanstalt für Wiederaufbau
MAP	Multiannual Programme for Enterprise and Entrepreneurship

MFC	Microfinance Centre
MFB	Microfinance Bank
MFI	Microfinance Institution
NBFI	Non-Banking Financial Institution
NEET	Not in Employment, Education or Training
NGO	Non-governmental Organisation
NOP	National Operational Programme
PAR	Portfolio At Risk
RITMI	Rete Italiana della Microfinanza
ROA	Return On Assets
ROE	Return On Equity
ROSCA	Rotating Savings and Credit Association
SACCO	Savings and Credit Cooperatives
SEEP	Small Enterprise Education and Promotion
SEWA	Self-Employed Women Association's Bank
SHG	Self-help Group
SME	Small and Medium Enterprise
UEAPME	Union Européenne de l'Artisanat et des Petites et Moyennes Entreprises
UMM	University Meets Microfinance
UNCDF	United Nations Capital Development Fund
UNDF	United Nations Development Fund
UNDP	United Nations Development Programme
WEETU	Women's Employment, Enterprise and Training Unit

Introduction

In 2018, the formal microfinance sector provided some 140 million low-income people across the world with a combined portfolio of $124bn in outstanding loans and $80bn. in savings. About 80 percent of customers were women, and 65 percent lived in rural areas (CGAP, 2020[1]).

Yet the average person living in Europe ignores what microfinance is about, a few people have heard it before, fewer have read the bestseller *Banker to the poor* co-authored by Nobel prize winner Muhammed Yunus and got an idea. However, microfinance is very present around us, yet underpromoted and disguised under programmes bearing fancy names such as 'Selfiemployment', 'Smart&Start', and so forth.

Several reasons make microfinance central in the current European economic policies debate. Firstly, the sheer importance of microenterprises in the EU[2], representing over 90% of all existing businesses. Secondly, in the light of recurring global and local economic shocks – notably the Great Recession (2007-2009) and the looming COVID-19 crisis – resulting in uncertainty and mass laid-offs, microfinance policies can have a tangible impact. In 2009, 'necessity entrepreneurs' made up 2 million people in the EU-27 and in many European countries this number is on the rise. The economic and social impact of necessity entrepreneurship is significant: According to the Global Entrepreneurship Monitor, about one third of the companies questioned responded that they had created between one and five new jobs between 2008 and 2010 (COPIE, b).

The European microfinance sector is young, fragmented and relatively understudied. It is young, as modern initiatives have gained momentum in the 1990s in eastern Europe and the 2000s in western Europe, when the European Union launched its Multiannual Programme for Enterprise and Entrepreneurship (MAP). It is fragmented as national regulations, economic environments and priorities differ considerably from one country to another, to the extent that we may speak of several 'ways' of microfinance in Europe. It is under-researched if compared to global microfinance, where large international NGOs operate donors' funding that require accountability and impact studies using expensive research tools such as randomised control trials.

[1] Housed at the World Bank, CGAP (Consultative Group to Assist the Poor) is a think tank of the world's 32 largest microfinance donors devoted to financial inclusion research (Convergences, 2019).
[2] For a definition of microenterprise at EU level, see: https://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition/

The aim of this writing is responding to the question: "What is microfinance in Europe?" by sketching an overview of the sector and mapping out actors, policies and practices over the past two decades (2000-2020). The methodology used involved a review of the relevant literature, the use of direct sources of institutional actors (EU, EIF, MFIs, etc.), and a selection of best practices that have passed the test of time.

Given the European context, the aspects we endeavour to highlight are the following:

- The notion of microfinance and financial exclusion, the analysis of beneficiaries and suppliers, micro-financial products and services (Chapter 1: Conceptual background).
- The roots of European Microfinance, from the Middle Ages until present day: the 'Montes Pietatis' of the Italian peninsula, the Irish Loan Funds, the German cooperative financial institutions (Chapter 2: Historical background).
- Some theoretical aspects that are recurrent both in Europe and elsewhere, such as the role of collateral in begetting social inequality, the dynamics of capital flows, and how to overcome market failure due to adverse selection and moral hazard issues (Chapter 3: Theoretical background).
- The actors involved, both public, such as national and supranational institutions, or private, such as NGOs and other non-banking institutions. In particular, we will present the series of programmes launched by the European Union during three programming periods covering two decades (2000-2020), the main microfinance networks and the environment with its fragmented regulatory framework. (Chapter 4: Microfinance actors and environment).
- the original Italian way of microcredit, describing the situation of the Italian market and the role of the unique institution that is the National Agency for Microcredit (Chapter 5).
- A quantitative dimension, reporting the most updated indicators on world and European microfinance and relevant remarks (Chapter 6).

By the end of this writing – once the picture is complete – we will be able to draw some conclusions about the 'uniqueness' of European microfinance traits in the wider context of global microfinance. In other words, are there unifying elements that underpin the multiple ways European microfinance has taken – allowing us to define it – or does the picture look rather like a map of isolated trails? A final balance of accomplishments and shortcomings of the European microfinance sector will underline the importance of laying out a roadmap of deliberate strategies and plans.

1 Conceptual background

What is microfinance?

As is known, there is no internationally accepted definition of microfinance. Yet defining microfinance is an important task, as some programmes bearing its name do not actually display the typical characteristics expected in a classical microfinance intervention, making their evaluation and benchmark difficult.

A general definition of microfinance can be drawn from Marguerite S. Robinson's work 'The Microfinance Revolution' (2001):

> Microfinance refers to small-scale financial services – primarily credit and savings – provided to people who farm or fish or herd; who operate small enterprises or microenterprises where goods are produced, recycled, repaired, or sold; who provide services; who work for wages or commissions; who gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools; and to other individuals and groups at the local levels of developing countries, both rural and urban. Many such households have multiple sources of income. (p. 9)

Robinson's definition recalls primarily an anthropological and economic landscape that is typical of a developing country, much like the one in which the Nobel prize laureate Muhammad Yunus operated, i.e. rural Bangladesh[3].

However, in developed countries the microfinance landscape present different features whereby the supply of microfinance products, mainly loans, is targeted to specific, mainly urban, *non-bankable* groups: Women, youth (especially NEETs), national minorities, migrants, disabled people, former convicts, etc. Moreover, in some European countries an articulated social welfare system competes with the prospects of a self-employment path.

True enough, Europe itself is no homogeneous territory and economically and socially advanced countries in north-western Europe coexist with the still underdeveloped

[3] For an overview of how the world's financially excluded juggle with money, see: Collins, D., Morduch, J., Rutherford, S., & Ruthven, O. (2009). *Portfolios of the poor: How the world's poor live on $2 a day*. Princeton: Princeton University Press.

countries in the Balkans.

If we compare Robinson's definition with a recent definition of microfinance by the European Commission that can be found in the ESF+ regulation, the difference is striking:

> Microfinance includes guarantees, microcredit, equity and quasi-equity, coupled with accompanying business development services such as in the form of individual counselling, training and mentoring, extended to persons and micro-enterprises that experience difficulties accessing credit for the purpose of professional and/or revenue-generating activities. (EC, 2018a)

The accent is on an array of sophisticated financial and non-financial tools geared at economic subjects that experience difficulties accessing credit for professional activities, in a bustling urban picture that stands in stark contrast to Robinson's rural landscape.

According to Rosengard (2011), the main features of microfinance institutions (MFIs) are the client base (low-income households), the lending methodology (based on a qualitative assessment), the transaction costs (very high due to the small value of the savings or loans at stake), the portfolio composition (a high volume of small short term loans), a decentralised structure and a weak governance (p. 163).

Karlan and Goldberg (2011) maintain that there are at least nine traditional characteristics that pertain to microfinance, namely: small transactions, loans for entrepreneurial activity, absence of collateral, group lending, focus on poor clients, focus on women, simple application processes, provision of services, interest rates at market level (p. 21). If we apply the said characteristics in the European context, we can observe the following:

- *small transaction* is a concept that is relatively applicable across the continent and business sectors: the European Union definition of €25,000 as microcredit loan roof has been questioned on account of its inadequacy to start a business in affluent countries such as Sweden or businesses involving the use of expensive machinery;
- *loans for entrepreneurial activity* are indeed key for running a business that allows unemployed people to lift themselves out of poverty. However, microloans can also help employed people mitigate temporary financial stress (e.g. a dentist bill). In most of Europe, social welfare limits the spread of social microcredit in certain areas (e.g. health and schooling);
- *absence of collateral* is the central feature of microfinance, what sets it apart from

commercial, conventional banking. The liability structure of microfinance loans can be described by three models: solidarity groups (also known as the 'classic' or 'Grameen model'), village banking (the group is enlarged up to 30 borrowers) and individual lending – which resembles traditional banking (Karlan & Goldberg, 2011);

- in the *group lending* model, borrowers (typically women) sort themselves into groups of five. At first, two members of the group get a loan. If they repay on time, the next two get their loan, and at last the fifth gets a loan. The process continues in turn as long as repayment is regular, but when a member defaults, all five members are barred from borrowing in the future (Armendáriz de Aghion et al., 2000). Group lending with peer monitoring as advertised by Yunus in his best-seller *Banker to the poor* does not pertain exclusively to an emerging country context. In Belgium, the MFI Microstart offers a financial product called 'Babyloan' which can be accessed also by a group of people, mainly minority groups in the Brussels area (Johnson, 2011).
- *focus on poor clients* is not always present in Europe. In certain contexts, beneficiaries can belong to well-off middle-class families, such as young Italian NEETs benefitting from the 'Youth Guarantee' tool *Selfiemployment* which does not discriminate upon income.
- *focus on women* is a feature of many microfinance programmes; however, recurrent tides of economic crises have made certain groups of European citizens vulnerable to financial distress regardless of gender (e.g. people aged over 50 or made redundant as a result of globalisation, etc.);
- *simple application process* addresses to the situation which can be present both in emerging countries and rural Europe where the borrower has limited mobility or a limited financial education. Borrowers who have to walk hours to reach the microfinance officer and/or lack sophisticated numeracy skills are an example.
- *the provision of services* is seen as a natural complement of microfinance practices. In literature there is an ongoing debate whether *business development services* (BDS) have an impact on the performance of borrowers[4]. Whether their usefulness is confirmed or not, the Italian legislator included them on a compulsory basis as a condition to obtain a loan through the national scheme 'Microcredit

[4] See, for example, Karlan & Valdivia (2011), pp 510-527.

for SMEs'[5].

– *interest rates at market level* is a condition to keep the microfinance industry economically sustainable. In Europe, many national or regional welfare microcredit schemes, such as the Italian *Selfiemployment*, do not observe this rule (interest on loans is absent altogether) [6].

According to Armendáriz and Morduch (2010), there are at least four myths that have made their way into conversations on microfinance:

– the first is thinking that microfinance is all about providing loans, i.e. 'microfinance equals microcredit'. As a matter of fact, low-income households can avoid financial distress by means of accumulating savings or buying an insurance; in addition, over time microfinance has incorporated other financial products such as insurance, money transfers, mobile money or crowdfunding programmes.
– the second myth is that high repayment rates are related with the group lending methodology, as practised by Grameen Bank in Bangladesh or BancoSol in Bolivia. In fact, if well managed, individual lending – which is the norm in Europe – can be just as effective;
– the third myth is that microfinance has a clear record as a tool of poverty alleviation and women empowerment. In fact, there is not yet a study that corroborates this statement with robust evidence;
– the fourth myth is that microfinance institutions are both serving the poor and making profits – whereas many microlenders struggle to make any profit at all (pp 4-5). (Armendáriz and Morduch, 2010).

In some cases, the commercialisation of the microfinance industry has gone so far as to speak of a *mission drift* and question the ethical nature of the sector. In 2007, the Mexican MFI Compartamos was the first institution in the world to be listed with an IPO raising over US$400m and attracting sharp criticism in the sector on account of the very high interest rates demanded from borrowers (Rosenberg, 2007). Even Yunus criticised Compartamos: "Microcredit was invented to fight the moneylender, not to become a moneylender" (The Economist, 2013).

Traditionally, microfinance has been employed by international organisations such as the development agency UNDP or foreign aid agencies like the German BMZ as a tool for mitigating poverty in emerging countries. The standard microcredit structure

[5] See par. 5.2.
[6] See par. 5.2.

envisages the cooperation of donor countries and NGOs together with local organisations, such as governments or third sector promoters, which team up with a network of local credit officers, as exemplified in figure 1.1 (La Torre, 2006 a):

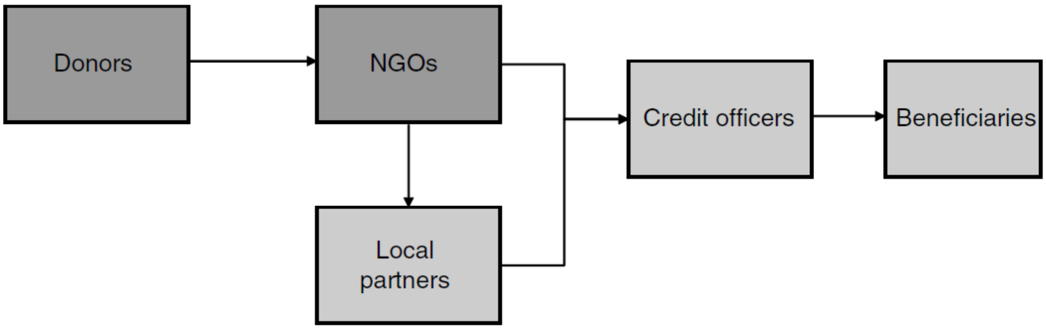

Figure 1.1 The standard microcredit model
Source: La Torre, 2006a

Financial inclusion

The engine that drives the microfinance movement is ostensibly the fight against financial exclusion as a mean to foster social inclusion at large. However, what does financial exclusion mean? Financial exclusion is expressed as the inability to access basic financial services, such as opening a bank account, both in emerging and developed countries.

So, what are the main differences between microfinance and financial inclusion? Guerin maintains that "the main difference is in the implicit goals underlying each of the terms. Financial inclusion pursues a purely quantitative goal, which points towards 100% banking inclusion. But that tells us nothing about the use of bank accounts. For microfinance's pioneers, it is not so much the access – of course you need access – but the impact that matters. That is, the ability to change people's lives through finance". (Convergences, 2019).

According to Demirgüç-Kunt (2008), financial inclusion, i.e. broad access to financial services, is defined as an absence of price or non-price barriers in the use of financial services. In a market economy, however, the price and size of the loans will depend on the creditworthiness of the customer and subsidies and regulation can modify this outcome only to a certain extent (p. 27).

Stiglitz and Weiss (1981) explain why in credit markets information problems can lead to credit rationing even in equilibrium, where supply equals demand. In fact, banks are concerned not only about the interest rate but also about the riskiness of the loan. Also, the interest rate itself may affect the riskiness of the loans, either by attracting high-risk borrowers (adverse selection effect) or by adversely affecting the actions of borrowers (moral hazard effect) (Stiglitz and Weiss, 1981, cit. in Demirgüç-Kunt, 2008, p. 31).

In order to ensure equal opportunities for all and tap the full potential of an economy, building inclusive financial systems and improving access to financial services across countries is a goal that is of utmost importance at all levels of development stage. Although the formal financial sector in high-income countries has essentially achieved universal coverage for basic services. a certain degree of financial exclusion persists and may be regarded as a serious handicap as it can be even more daunting to participate fully in those sophisticated economies (Demirgüç-Kunt, 2008). This is particularly true in Europe, where the target of microfinance has broadened from the poor to all victims of financial exclusion.

According to Ledgerwood (2013) financial inclusion may also be characterised by elements such as closeness (living a few miles away from an access point, be it a bank branch, an ATM, or a microfinance loan officer), alternatives available (many providers with different offers), and customers' financial education (ability to understand the system of offer, and how to use specific products). (p. 114).

Fouillet et al. (2007) observed how today, the expression 'financial inclusion'is likely to mark a new stage, in which the lack of access to financial services becomes more important than the question of poverty reduction. To meet the needs of the planet, it would be necessary a more significant change in the living conditions of the most vulnerable, going far beyond their financial inclusion, and a willingness to spread small loans (p. 320 et seq.).

La Torre (2006a) defines five categories of financial exclusion:

- *self-exclusion*, originating in a feeling of inadequacy towards financial intermediaries (e.g. poorest among the poor);
- *access exclusion*, as a result of being screened out by financial intermediaries (the standard poor). These first two categories may be grouped in the single wider 'poor' category;
- *political and social exclusion*, for being excluded from the socio-political system (e.g. undocumented migrants or ex-convicts); this category of beneficiary may be labelled as 'unregistered';
- *condition exclusion,* for being unable to meet conditions and bear costs of financial products (the 'disadvantaged');

– *marketing exclusion*, for being deemed unprofitable by financial intermediaries (e.g. small entrepreneurs, the 'marginalised'). (La Torre, 2006a).

The latest *Global Findex Database 2017* report from the World Bank offers us a measure of the phenomenon of financial exclusion on a global scale: 1.7 billion adults worldwide remain unbanked and the majority of these people live in developing countries, mostly China and India (in 2014 that number was 2 billion); 56% of excluded individuals are women; half of all unbanked individuals come from the poorest 40% of households; exclusion involves in particular individuals with a low level of education and who are not part of the labour force. However, the report shows a global, albeit uneven global growth in financial inclusion, accelerated by the spread of mobile phones and the Internet (two thirds of unbanked adults have a mobile phone). Millions of unbanked adults around the world still receive regular payments in cash — for wages, from the government, for the sale of agricultural products. Digitizing such payments is a proven way to increase account ownership. (Demirgüç-Kunt et al., 2018).

Finally, financial inclusion has become a key geopolitical concept, as the European Union Initiative for Financial Inclusion (EUIFI) [7] across the southern Mediterranean region of the Middle East and North Africa demonstrates. The programme, co-financed by the European Commission, should mobilise over €1.5bn benefitting more than 200 SMEs. In times of climate change and demographic pressure, the initiative should also help preventing mass economic migrations into Europe. (EC, *EU initiative for financial inclusion*).

[7] EU partnership with EIB, EBRD, the German KfW and Agence française de développement (Afd).

The demand side: beneficiaries

In 2018, 139.9 million borrowers benefitted from the services of MFIs, compared to only 98 million in 2009. Of these 139.9 million borrowers, 80 per cent were women and 65 per cent were rural borrowers, proportions that have remained stable over the past ten years, despite the increase in the number of borrowers (Microfinance Barometer, 2019).

Helms (2006) maintains that most microfinance clients appear to "fall around or just below the poverty line" (figure 1.2). In general, neither the extremely poor (10% of families), nor those who are slightly more affluent would borrow microloans. The former ones are difficult to reach, the latter have access to conventional banking. Most beneficiaries fall into the 'moderate poor' class, comprising those in the top 50 percent of households below the poverty line. On the other hand, some extreme poor households are microfinance customers, as well as the vulnerable non-poor – those just above the poverty line at risk of falling below it (Helms, 2006, p.18).

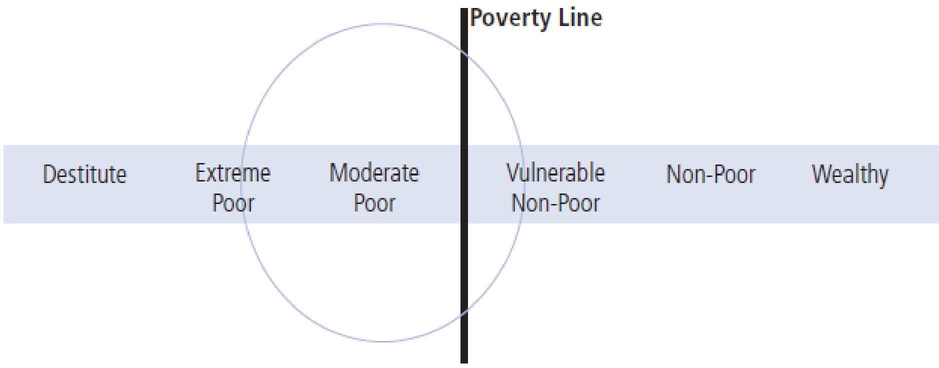

Figure 1.2 How poor are microfinance customers?
Source: Cohen (2003), cit. in Helms, 2006, p. 20

Financially excluded people need a range of financial services, many of which are attainable from informal providers such as moneylenders. The services are meant to tide financial problems that arise at different points in time in life. Helms (2006) cites Rutherford (2000), to point out three main categories of events that may strain a household's finances, namely:

1. *Life-cycle events* include once-in-a-lifetime occurrences (birth, marriage, death) or recurrent expenses (school fees, holidays, medical checks) confronting every household and representing a source of great anxiety for many people. In many places the

dowry system makes daughters' marriages an expensive business and funerals can be quite costly. Other life-cycle events looming in the horizon include home-building, widowhood, old age, etc.

2. *Emergencies* include personal crises such as sickness or injury, the passing away of a bread winner or the loss of employment, and theft. Many emergencies such as war, floods, fires, typhoons are completely beyond the control of the household and create a sudden need for cash.
3. *Opportunities* include business investments such as the purchase of land or tools or private consumption such as the purchase of items that make life more comfortable, e.g. home improvements, a fridge, a fan, etc. (ibid. p. 22).

To cope with the financial outlays required by the above-mentioned events, financially weak people need a range of options, including credit, savings, money transfer facilities, (health) insurance, etc. The following figure 1.3, taken from Helms (2006), illustrates the link between typical financial needs and financial services for poor and low-income households:

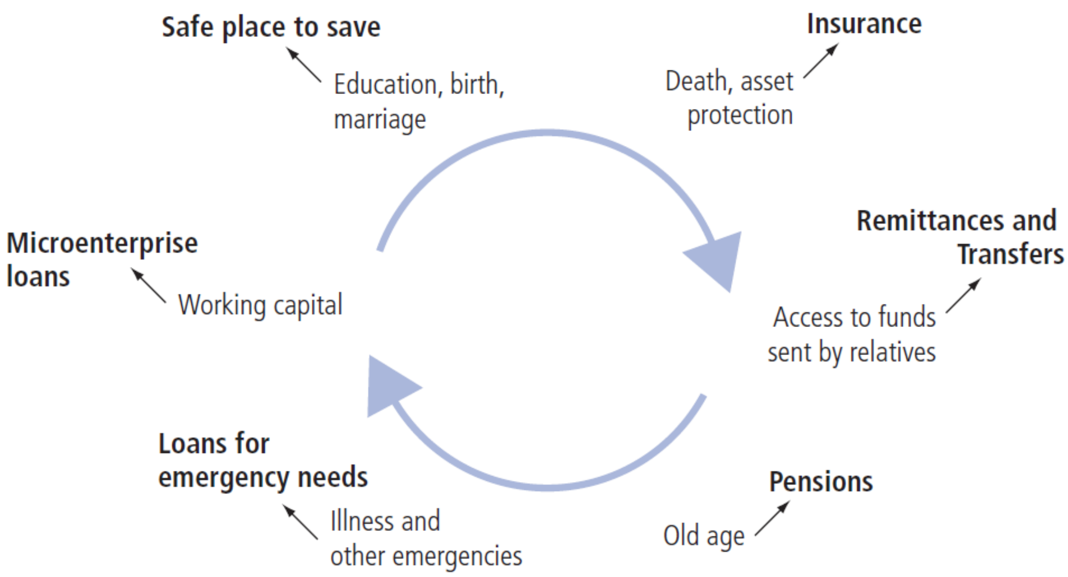

Figure 1.3 Serving poor clients with a variety of services
Source: Wright (2000), cit. in Helms, 2006, p. 23

Over the last years, many MFIs have gradually introduced innovative credit products, such as loans for housing improvements (e.g. solar panels under 'green microfinance' schemes), emergencies, and consumption purposes. With reference to saving services, as commercial banks hold it unprofitable to serve a myriad of petty accounts, most poor people save in informal ways—by keeping cash under the mattress, buying gold that can be sold off later, joining village savings circles, and so on (ibid., pp. 23-25).

Robinson (2001) drew a schematic diagram of a poverty alleviation toolbox linking income level, commercial financial services and subsidised poverty alleviation programmes (p. 20):

Table 1.1 Financial services in the poverty alleviation toolbox

Income level	Commercial financial services	Subsidised poverty alleviation programmes
Lower middle income	Standard commercial bank loans and full range of saving services	
Economically active poor	Commercial microloans, interest bearing savings accounts for small savers	
Extremely poor		Poverty programmes for such purposes as food and water, medicine and nutrition, employment generation, skills training and relocation

Source: Robinson, 2001, p. 20 (adapted)

According to the author, lower-middle income households will resort to commercial banks for their financial needs while the economically active poors are the typical target of microcredit providers both for lending and saving services. However, microcredit is not appropriate for the extremely poor (destitute and stuck in hands-to-mouth survival) who have no reliable income and therefore no means of repayment. (ibid.).

In this case, small grants, infrastructure improvements, employment and training programmes, and other nonfinancial services may often be the proper tool of intervention (ibid., pp. 20-21).

As mentioned above, in 2018, 80 per cent of 139.9 million borrowers benefitted from the services of MFIs. Therefore, MFIs have sought to empower some 120 million women around the world by improving their economic position in society. MFIs have been targeting women because they invariably represent the poorest layer of society, bear responsibility for child-rearing and often have fewer chances than men to improve their economic situation. In some societies, where Islam exerts a strong influence, women are left behind due to cultural barriers that often force them to domestic roles, making it hard for them to access financial services. In addition, women are often expected to perform large household obligations. Experience has shown that women generally have a higher sense of responsibility and a higher repayment and savings rates than male clients, to the extent that arguably an increase in women's income would benefit their household and community more than an increase in men's income (Ledgerwood, 1999, p 37).

To ensure the success of a microfinance programme the evaluation process of the beneficiaries is crucial. If customer screening is important in a conventional banking setting, it becomes pivotal in a context where collateral is missing. The first condition for the screening to work is the proximity of the loan officers network to clients, so as to minimise asymmetric information biases. However, as qualified credit officers are expensive, there is a trade-off between their number and skills on one side and their cost on the other. The second condition underlying the success of customer screening is the MFIs governance, as credit officers' priorities in the territory may differ somehow from those of the MFI. The third element to take into consideration is the adoption of recognised and standardised procedures, a valuable tool to manage a high amount of small loans often extended in dispersed territories (Vento, 2006a, pp. 39-41; Robinson, 2001, pp. 82-83).

With reference to loan disbursement methodologies, Robinson (2001) argues that institutional microfinance has learnt a lot from moneylenders and somewhat adapted for its own use their techniques: As an example, how to recover loans or how to rely more on the borrower's demonstrated willingness to repay rather than loan guarantees or project feasibility assessments. On the other hand, MFIs have been able to undercut their interest rates thanks to the scale of operations, savings mobilisation and professionalism (p. 81).

The supply side: microfinance providers

The most basic provider of financial services are money-lenders, often derogatively dubbed as 'loan sharks' for the exorbitant interest rate applied on loans extended to poor people. The role of informal commercial moneylending has been debated for many decades. As Robinson (2001) argued, the existence and survival of moneylenders or pawnbrokers along with formal financial institutions may be ascribed to several advantages they can take, including:

- better knowledge of the microcredit market;
- development of personal relationships with clients;
- effective methods of evaluating the repayment capacity and the character traits of prospective borrowers;
- methods of containing costs;
- products: mostly short-term working capital loans;
- streamlined loan disbursement procedures carried out in locations convenient for borrowers;
- practice of repeat lending to borrowers who repay promptly, with gradual increase of loan sizes. (p. 172).

However, informal financial services are considered inefficient because they do not reach all potential customer but only those in close proximity – same village, occupation or social group (Gonzalez-Vega, 1995, cit. in Robinson, 2001, p. 174).

If we consider the formal supply side, following La Torre's (2006a) sketched presentation, microfinance institutions (MFIs) may fall into different categories, depending on the perspective. From a regulatory perspective, we can have:

- *Informal institutions*: self-help groups (SHG), credit associations, moneylenders, ROSCAs, ASCAs, etc.

  Very common in India, self-help groups are community-based saving informal organisations made up of 10-20 poor adults who pool resources together.

  ROSCA (Rotating Savings and Credit Association) is a type of common microfinance organisation known by different names around the world, such as *cassa peota* in Italy, *tontines* in West Africa, *susu* in Ghana, *hui* in China, etc. A ROSCA is formed when a group of people decide to collect from every member a certain sum of money and in turn make a personal use of it on special occasions (such as a wedding, a funeral, an external shock, etc.) that are too expensive to cope by relying on oneself. An ASCA (Accumulating Savings and Credit Association) is an informal organisation where some members save and others borrow paying an interest on loans.

- *Semiformal institutions*: microfinance intermediaries that are subject to financial regulatory requirements offer credit but not deposit services. If they do offer saving schemes, they cannot grant credit (such as postal savings banks). This category includes financial NGOs (that offer support in development projects along with technical assistance) and financial cooperatives (e.g. Savings and Credit Cooperatives, aka SACCOs). Examples of NGO's may be 'Save the Children', 'World Vision', etc., while a type of financial cooperative may be represented by the German *Raiffeisenkassen*, Canadian *Caisses Populaires* or the Italian *Banche di Credito Cooperativo*, the Greek Cooperative Bank of Karditsa. La Torre includes MFIs (microfinance institutions) in this category, such as the Italian Permicro, the Romanian FAER, the Spanish Fundacion Nantik Lum, the Dutch Qredits, to name a few (table 1.2).
- *Formal institutions*: microfinance intermediaries that offer credit and savings and are under banking regulation. They include microfinance banks (MFBs) such as the Bangladeshi Grameen Bank or Bolivian BancoSol, microfinance-oriented banks (MOB), such as the Indonesian Bank Rakyat and microfinance sensitive banks (MFSBs), such as the French bank Crédit Agricole which supports the *Grameen Crédit Agricole Foundation* (La Torre, 2006a, pp.5-7). Other European banks worth mentioning are Tatra Banka (Slovakia), Millennium bcp (Portugal), Microbank (Spain), and Banca Popolare Etica (Italy).

The following table 1.2 summarises and illustrates the classification above:

Table 1.2 Types of microfinance institutions

Informal microfinance providers	**Semiformal Microfinance Intermediaries (MFIs)**	**Formal Microfinance banks**
Self-help groups	Financial NGOs	Microfinance banks
Credit associations	Financial cooperatives	Microfinance oriented banks
Families	Postal savings banks	Microfinance sensitive banks
Individual moneylenders		

Source: La Torre (2006a), p. 6. (adapted)

In table 1.3. Helms (2006) provided an interesting SWOT analysis of different microfinance providers:

Table 1.3 Pros and cons of different financial service providers

Service provider	**Example**	**Strengths**	**Weaknesses**
Informal	Moneylenders ROSCAs ASCAs	Convenient and fast Close to clients Low-cost Accessibility	Insecure, unstable Limited scope Rigid Expensive (moneylenders)
Member-owned	SHGs Cooperatives	Indigenous Low-cost Accessibility Profits to members	Governance risks Poor of supervision Limited scope Limited products
NGO's	International and national NGOs	Knowledge Mission-driven Risk prone	Donor dependent Limited services Limited savings Small scale (except South Asia) High-cost operations
Formal Financial Institutions	Gov't banks Rural banks Commercial banks	Large no. of services Many branches Own capital Technology Innovation	Profit-oriented Low outreach Product/needs mismatch

Source: Helms, 2006, p.54 (adapted)

From Helms' scheme in table 1.3 we can draw the assumption that informal microfinance providers such as moneylenders, ROSCAs and ASCAs display characteristics that are most suitable in rural areas (accessibility, closeness to clients, relative affordability) while formal financial institutions standardised offer of financial products may well be innovative and technologically-driven, but also suffer from a low level of outreach, a product/need mismatch and the risk of a commercialisation drift. (Helms, 2006).

Financial products and services

Providing microfinance products and services to *non-bankable* clients is a complex process requiring different kinds of skills and functions. Ledgerwood (1999) suggests four broad categories of services that may be provided to microfinance clients:

1. *Financial intermediation,* i.e. the provision of products and services such as savings, credit, insurance, credit cards, and payment systems. This type of activity should not be subsidised.
2. *Social intermediation,* i.e. the process whereby the human and social capital required by sustainable financial intermediation for the poor is created. This process may require subsidies for a certain period, but eventually they should be removed.
3. *Business development services* are nonfinancial services such as business training, marketing analysis, skills development that support microentrepreneurs. These services may require subsidies until clients are willing and able to pay for these services.
4. *Social services* are nonfinancial services that aim at improving the well-being of clients. They comprise various training on subjects such as nutrition, health, literacy and education. Social services are likely to require continuous subsidies, often provided by the state or NGOs.

MFIs may choose to provide each of these services at varying degrees, taking a *minimalist* or *integrated* approach. A *minimalist approach* entails offering only financial intermediation while an *integrated approach* envisages providing a combination of financial and the four types of the above-mentioned services, inspired by a holistic view of the client. (Ledgerwood, 1999, p. 64).

As Trezza (2006) observed, microfinance providers have long been *product driven* instead of being *market driven*, i.e. financial products were designed without considering the complex set of needs of beneficiaries. In the last two decades, the situation has changed and MFIs have started to design credit, savings, payment and insurance products that meet the corresponding poor customers' needs for medium and long-term funding, saving and liquidity, fast and cheap payment systems and risk hedging. The following matrix of table 1.4 shows the links correlating needs to products:

Table 1.4 Matrix of financial needs and products in modern microfinance

Products / Financial needs	Credit products	Savings products	Payment services	Insurance products
Short/ medium-term credit	Microcredit (working capital)			
Medium/ long-term credit	Microcredit Microleasing Micro venture-capital (working capital and fixed capital)			
Access to safe, fast and cheap payment systems			Money transfers Credit cards Smart cards	
Savings and liquidity needs		Voluntary products (demand deposit, contractual products, time deposits, equity products) Compulsory savings products		
Risk hedging				Microinsurance

Source: Trezza, 2006, p. 22

As shown in table 1.4, microcredit in the form of working capital serves the need of small businesses that are confronted with temporary or seasonal cash shortcomings, such as those occurring in the trade and agricultural fields respectively; microcredit in the form of micro-leasing and fixed capital serves the need to purchase machinery or cattle; money transfer services involve financial products typically used by migrants.

Savings serve the need to keep money in a safe place, but sometimes they are required by microfinance providers as a condition to obtain a loan. The use of technology opens the scope for removing micro-saving constraints. However, this is only possible by unbundling micro-savings from microfinance. (Armendáriz & Battaggia, 2014).

Microinsurance products are nearly exclusively employed by farmers to face possible climate-related crop failures.

Burlacu (2018) made a point regarding the sustainability of the microfinance industry: As borrowers grow their business thanks to microloans, they become over time ‘bankable’ and are transferred to the banking industry. In such terms, she reported the striking paradoxical statement that "the purpose of microfinance industry consists in no need of microfinancing" (Burlacu, 2018, p.2).

European vs global microfinance: uniqueness or deviation?

The concepts illustrated so far refer to global microfinance and are general abstractions drawn from field experience in the South of the world (be it southern Asia, Africa or Latin America).

Microfinance in Europe, and to a lesser extent in North America and South Korea, is characterised by the following features:

- it operates in a socio-economic environment marked by advanced industrialisation, where large capitals are needed to fund innovation; on the other hand, microfinance is used to start traditional businesses, mostly in trade and services (in eastern Europe also agriculture);
- borrowers are 'necessity entrepreneurs' often belonging to vulnerable and marginalised groups driven out from the labour market (women, youth, people aged over 50, the long-term unemployed, minority groups, migrants, disabled people, or persons that face discrimination at work for their sexual orientation) who are not necessarily poor but at risk to become;
- the supply side is represented by small and highly subsidised microfinance providers that extend relatively large loans;
- the preferred lending methodology is the individual lending (vs. group lending in the South);
- the provision of complementary non-financial services such as business development services. made compulsory by certain microfinance regulations (e.g. in Italy);
- the implementation of national and supranational public programmes such as the EU initiatives (code of good conduct for microfinance providers, incentives, funding instruments, etc.);
- lower technology-driven financial innovation: in the South (e.g. Kenya) the use of mobile phones for financial purposes is higher than in Europe;
- it is less researched, so there is a lower availability of relevant information.

The above-mentioned elements of distinction are not sufficient to make European microfinance 'unique' because there is not a single European model to refer to, but different pattern across the countries. What we can safely say is that microfinance in Europe deviates from global microfinance in a number of aspects, the most important of which is the fragile sustainability due to scarce profitability and commercialisation, so much remains to be learnt from the experience of the South. (O'Connor et al., 2020).

Microfinance for all?

Since microfinance was at centre stage in the 1980s, a debate has been ignited about its universal use, that is, whether it is a useful tool that can thrive in the industrialised countries or rather be considered a vestige of the past, suitable for developing countries.

Novak (2008) noticed that some critical circumstances make the South a more fertile ground for microcredit, including:

- the absence of a complex regulation framework, which makes self-employment a common option unhampered by the challenges entrepreneurs of developed countries face (red tape, high taxes, interest rate ceilings);
- the absence of job opportunities or a welfare safety net make self-employed people potential microcredit clients (80 percent of the population against 20 percent in Europe);
- microcredit customers are less dispersed and enjoy higher proximity relations, making group solidarity possible, whereas in Europe rural-urban migration has weakened social bonds;
- the banking network is not so dense as in developed countries, leaving microfinance institutions more room of action. (Novak, 2008).

With reference to Europe, the collapse of the public sector in eastern Europe has caused massive unemployment, giving rise to a wave of new entrepreneurs, customers of microfinance institutions backed by international donors (World Bank, USAID and other international foundations). The situation in western Europe is different as public opinion remains attached to wage employment. However, due to globalisation with subsequent delocalisation and deindustrialisation, the conditions conducive to self-employment and a microfinance upsurge are gradually emerging, although not on a scale seen in eastern Europe during the 1990s.

A critical voice on microfinance is represented by Milford Bateman in his provocative book *Why doesn't Microfinance work*. In his controversial analysis, Bateman names the risks that microfinance framed in neoliberal policies carries, such as customers' over-indebtedness (microfinance as a poverty trap), the commercialisation of microfinance and the so called 'africanisation' of the economy (the flourishing of petty businesses deprived of economies of scale) as seen in Bosnia and Hercegovina, which seemingly does not trigger true development. (Bateman, 2010; Bateman M. & Chang H.J., 2012).

2 Historical background

Tracing the origin of microfinance is by no means an easy task, owing partly to its multifarious and informal nature and partly to the very definition of historical microfinance. In fact, as a matter of example, some forms of self-help groups and ROSCAs, although unchartered in literature, may have been common among traditional African, American and Asian communities for centuries.

In Asia, a documented example of microfinance scheme that reminds modern European welfare policies can be traced back to the Chinese emperor Shenzong's reign (1068-85), during the Song dynasty. By then, the reforms of the statesman Wang Anshi were introduced: one initiative was the programme 'young sprouts' (*qingmiao*), rural collateral-free micro-loans granted by the State to farmers in springtime, which had to be repaid with interest after the harvest. The State thus tended to redeem the peasants from indebtedness towards the big owners, and to forfeit revenues that until then had been earned by speculators and usurers (Sabbadini & Santangelo, 2005, p. 339).

The Montes Pietatis

However widespread microfinance practices might be, it is Europe that takes the central stage if we consider documented forms of microfinancing. In fact, it was there that during the later stages of the Middle Age, by initiative of Italian Franciscan friars, a non-profit financial institution came to the fore: *Mons Pietatis (Lat., lit. 'Mount of Mercy')*, an organisation resembling a non-profit pawnshop[8].

As their name suggests, *Montes Pietatis* absolved the charitable function of lending cash-strapped people above the condition of indigency small amounts of money against a collateral. Franciscan friars ran the activity out of Christian solidarity, asking a pledge on the loan as collateral that was worth at least one third more the amount they lent. The term of the loan was usually one year, after which, if the sum was not reimbursed, the

[8] There is abundant literature about *Montes Pietatis*, starting with the pioneering work of Holzapfel in the early 20th century (Holzapfel. H. (1903) *Die Anfänge der Monte Pietatis (1462-1515)* [*The Origins of the Montes Pietatis* (1462-1515)], Munich. For a complete literature review, see Barile, N. (2012).

pledge was auctioned (Svoboda, 2015, pp. 12-13). The money accumulated in a heap, or *monte,* derived from donations and alms collected during church services (Muzzarelli, 2006).

Likewise, similar financial institutions could involve goods instead of money – e.g. seeds at *Monti frumentari* (it., lit. *mount of wheat*) for the sake of solidarity within rural communities. The first attested was set up in 1492 in Macerata, central Italy (Treccani).

In the middle of the 15th century, Italy was bustling with business activities, and in the Italian city-states money became scarce. Therefore, usury was common, to the extent that it became urgent to offer vulnerable people loans that could be interest-free or bear a small interest (initially 5% of the total credit) to cover service costs (Svoboda, 2015, p. 12). In addition, there was a need to subtract people from the influence of Jewish moneylenders (Angiolini, 1994, p. 203), a situation that W. Shakespeare later described in his play *The Merchant of Venice* (1596-9). There were no *mons pietatis* in Venice, as local authorities opted to compel Jewish brokers to assist the poor with affordable lending terms (Barile, 2012, p. 98).

As early as 1515, Pope Leo X through his papal bull '*Inter Multiplices*' had promoted the *montes pietatis* – financial institutions that lent money to poor people. This bull acknowledged that Monti di Pietà could charge a small interest on loans to cover service costs, ending a diatribe between those who sided 'holy', interest-free loans and those who allowed charging an interest (Muzzarelli, 2001).

According to Barile (2012), Franciscan friars were more involved with *montes* than Dominicans and Augustinians. In fact, they were reputedly considered more attuned to poverty alleviation than the latter two, more interested in philosophical speculation. However, this belief is not supported by facts. As an example, blackfriars Annius of Viterbo and Girolamo Savonarola supported *montes* within the Dominican Order. In particular, Savonarola was among the founders of the Florentine *monte pietatis* in 1496. (p. 92).

The first Monte di Pietà was set up in Perugia, Central Italy, on April 13, 1462, after friar Michele da Carcano's preachings against usury (Muzzarelli, 2001, pp. 18-20; Holzapfel, 1903, pp. 32 et seq.). Many other banking institutions bearing the name 'Monte' spread across Italy, including the famous Monte dei Paschi di Siena, a major bank still in operation to date.

Prior to this religious institution, laic *montes profanes* were devised by public institutions like city-states to finance public debt, offering burghers an interest on the sums lent. The first example is documented in Venice around the middle of the 12th century and it was set up to curb the deficit caused by the war between the Sacred Roman Empire and the Papal State (Holzapfel, 1903, cit. in Svoboda, 2015, p. 11).

Montes Pietatis continued thriving until Napoleonic armies' plunders gave them a severe blow. When in 19th century European governments tried to imitate the Italian *montes* creating public agencies with similar characteristics, in Italy they were dismissed by ideology and a hostile legislation as a product of a bygone era (Jayo Carboni et al., 2010, pp. 147-170).

Thereafter, they became laic organisations and were either overcome by more modern banking institutions or evolved into similar models.

As a lending model, the Monti di Pietà and pawnshops in general featured some important drawbacks. In fact, to make this model work, customers must own mobile objects that are valuable enough to serve as collateral and easy to store. The inefficiency of pawn-based lending for society derives from the loss due to non-use of the objects (usually tools regularly employed in production), which can be considered an implicit cost (Guinnane, 2011, p. 79).

The Irish Loan Funds

In Ireland, a country infamous for its recurrent famines, Gulliver's Travels author Jonathan Swift (1667-1745) is universally considered the trailblazer of contemporary national microcredit. As Sheridan (1787) in *The Life of Doctor Swift* recalls:

> There was one species of charity first struck out by him, which was attended with the greatest benefit to members of the lowest class of tradesmen. Soon after he was out of debt the first five hundred pounds which he could call his own, he lent out for poor industrious tradesmen in small sums of five and ten pounds, to be repaid weekly, at two or four shillings, without interest. As the sums thus weekly paid in, were lent out again to others at a particular day in each month, this quick circulation doubled the benefit arising from the original sum. In order to insure this fund from diminution, he laid it down as a rule that none should be partakers of it, who could not give good security for the regular repayment of it in the manner proposed: for it was a maxim with him, that any one known by his neighbours to be an honest, and industrious man, would readily find such security while the idle and dissolute would by this means be excluded (p. 234).

In the 1720's Swift lent without collateral the poor craftsmen of Dublin £10 each for a total of £500. In the mid-1700's the Dublin Musical Society applied Swift's scheme for the benefit of thousands of poor families (Hollis & Sweetman,1996, p. 5).

As Gilbart (1836) in *The History of Banking in Ireland* reported:

> 1777. A Loan bank established. The Act is entitled, "An Act for incorporating the Charitable Musical Society for lending out money, interest free, to indigent and industrious tradesmen." The preamble states that a voluntary society had been instituted in the year 1756, for lending money to indigent tradesmen, interest free; and to render such society more effective, they are by this Act erected into a corporation. The members of the corporation were, the Lord Lieutenant, the Lord Primate, the Lord Chancellor, the Lord Archbishop of Dublin, the Speaker of the House of Commons, the Judges, and several other noblemen and gentlemen therein named, and such others as should be elected pursuant to the Act. The corporation is empowered to receive gifts from charitable persons, and to lend out the money interest free, in sums not under forty shillings, nor above five pounds to any one person, and to take the borrower's note payable at such times and in such proportions as they shall think reasonable. The corporation were also empowered to appoint persons to lend on like terms in the manufacturing counties and market towns of kingdom (…) (p. 16).

After a century of slow growth, in 1823 a special law of the Irish Parliament provided a boost of the sector, regulating loan fund institutions and authorising them to charge an interest rate on borrowings. Such measures created the conditions for the establishment of charitable as well as profit-oriented loan funds, whereby some charitable funds operated like moneylenders.

The laws passed in 1836 and 1838 helped bringing the system to another level. They established a central monitoring authority, the Loan Fund Board, which increased the public's trust in the loan funds. The sector was streamlined with standard rules, a straightforward accounting system, the exemption of the burdensome stamp duty (a feature of commercial banks), the acceptance of deposits and an interest roof of 6% (Hollis & Sweetman,1996, pp. 6-7).

According to Seibel (2012), by 1840, some 300 funds had been established, mobilising deposits, securing deposit rates three times higher than conventional banks, while charging higher interest rates on loans. Loans were short-term and instalments weekly and peer monitoring was used to enforce repayment. Eventually, these funds managed to reach 20% of Irish households.

The loan funds reached their apex at an unfortunate time. In fact, in the 1840s the Great Famine hit the Irish economy hard and affected the loan fund system. Hollis and Sweetman, after conducting a research on a unique and extensive data set, noticed that although the highest rates of funds closing were naturally observed where the famine hit hardest, capital structures, managerial occupation, and female literacy were found to be the key independent variables that predict loan funds survival. In addition, the authors suggest that the weekly repayment system may have helped to maintain financial stability of microfinance funds throughout the Famine. Finally, they maintain that the whole system avoided collapse during the crisis because each fund was financially independent (Hollis and Sweetman, 2004).

Goodspeed (2016) suggests that in the short run access to microfinance plays a significant role in coping with adverse environmental shocks in a subsistence economy. Also, in worse affected districts with a microfinance fund, it seems that access to microcredit allowed farmers to buy cheap livestock (poultry, in particular), yielding a supplemental income stream through the sale of eggs (p. 274).

Yet it was another element that hit the funds most. Threatened by competition, commercial banks successfully lobbied for a law which in 1843 put a cap on interest rates. The loan funds thus lost their competitive edge, steadily declined during the second half of the nineteenth century, and finally disappeared in the middle of the 20th century (Seibel, 2012).

As Seibel (2012) well summarised, 'the history of microfinance in Ireland is the story of how self-help led to a financial innovation, legal backing and conducive regulation created a mass microfinance movement for the poor, and adverse regulation brought it down' (p. 1).

Finally, Guinnane (2012) raised some doubts about the philanthropic nature of the Irish Loan Funds as described by Hollis and Sweetman, as they were often sources of local patronage ad corruption. Also, he contended that they lacked organisational features apt to manage information and enforcement problems with mechanisms seen in modern microfinance institutions such as Grameen Bank (pp. 78-79).

The movement of the cooperative financial institutions in Germany

In the 18th century, Germany witnessed the birth of many charitable funds, including widows and orphans' funds.

However, the real breakthrough took place when cooperative financial institutions came to the fore. They trace their origin in the first thrift society established in Hamburg in 1778, learning from the experience of the early Irish charities that charity is not sustainable and that there is a strong demand among the poors for safe deposit facilities (Seibel, 2012, p. 2).

. In particular, as Guinnane (2011) noted, two main types of networks[9] emerged:

- savings funds (*Sparkassen),* created in the 1840's by the Saxon social reformer Hermann Schulze-Delitzsch, and
- member-owned credit cooperatives (Darlehnskassen-Vereine), appeared in the late 1850's upon initiative of the Rhineland-Palatinate-born mayor and social reformer Friedrich Raiffeisen[10].

The former type would later evolve into *Volksbanken,* while the latter would have been known later as *Raiffeisenkassen*.

While *Sparkassen* developed among small entrepreneurs in urban areas, *Raiffaisenkassen* thrived in rural areas among peasants as credit associations. Both were indirect reaction to the famine of the 1846-47 winter and the 1848 failed revolution, a time when starvation was widespread and many peasants lost their farms to moneylenders, and many small businesses went bankrupt (Guinnane, 2011, p. 80; Seibel, 2012, p. 2).

In a broader perspective, these institutions arose within the so-called Stein-Hardenberg reforms within the Prussian Reform Movement – a series of constitutional, administrative, social and economic reforms that deeply influenced the old agrarian and feudalistic social structure (Schmidt, 2017, p.3).

In principle, both types of financial institutions shared the legal form of a cooperative, owned by its members who had the right of vote in members' meetings following the democratic 'one person one vote rule'. However, as members were inhibited from accumulating votes, their control in the management's governance was limited to an auditing

[9] The German term for these networks is *Verbünde (pl.)*, a term and phenomenon for which no equivalent exists in the English language (Schmidt, 2017, p. 8). A third type of network founded by Wilhelm Haas started as an offshoot of the Raiffeisen group and shared similar characteristics (Guinnane, 2011, p. 80).

[10] The Swabian Victor Aimé Huber, father of the Housing Cooperatives (*Wohnungsgenossenschaften*) is invariably associated with Schulze-Delitzsch and Raiffeisen in the pantheon of the German cooperative movement.

level (ibid., p. 5).

Cooperatives could choose their policies on memberships and operations. After the ground-breaking Prussian law of 1867, cooperatives could register in a special section of the business registry, were given legal personality and could contract in their own capacity. The 1889 Cooperatives Law introduced the owners' limited liability for their investments, as joint liability was the norm until the early 20th century. This change attracted wealthier members of a community into the cooperative as the disproportionate risk was finally waived; also, as most owners were relatively poor people with assets such as land and livestock, larger banks such as the Reichsbank would not dare lending them money. The 1889 Law also allowed a cooperative to own shares in other cooperatives, enabling the birth of regional cooperatives in the late 19th century (Guinnane, 2011, p. 81).

Most cooperatives charged one-time membership fees. Credit cooperatives were usually exempt from business taxes as long as they dealt exclusively with their members. As for their institutional structure, cooperatives had three managerial bodies:

- a management committee (*Vorstand*) was the formal representative body before the law and made most important decisions, such as accepting new members, granting loans, etc.;
- a board of supervision (*Aufsichtsrat*) charged with the task of overseeing the management committee;
- a general assembly of members (*Generalversammlung*) which met once a year to elect the aforementioned two bodies and to make decisions on policies such as interest rates.

A treasurer complemented the structure (Guinnane, 2001, p. 369).

The following table drawn and adapted from Guinnane displays some characteristics of the two main strands of cooperatives:

Table 2.1 Differences between types of German cooperatives

	Schulze-Delitzsch	**Raiffeisen**
Location of institutions	Primarily urban	Nearly always rural
Regional institutions	No regional banks, but regional auditing associations	One national central bank with branches
Membership (size)	Varied widely; some over 1000 members	Usually less than 200
Membership (class)	Poorest applicants screened out	Virtually everyone in the community accepted
Management of local cooperatives	Paid professional staff	Part-time treasurer only paid employee
Type of loans (duration)	Primarily short-term	≥ 10 years
Type of loans (security)	Co-signers. Inventory and raw materials	Personal security, co-signers and property
Source of capital	Paid-in shares, reserves and deposits	Deposits
Legal form	Many had limited liability after 1889, some were corporations	Unlimited liability required

Source: Guinnane, 2011, p. 85 (adapted)

Three stages mark the history of the credit cooperatives in Germany:

– informal beginnings with slow growth (reaching about 245 rural cooperatives in the mid-1880') (Seibel, p. 2)

– regulation of cooperatives as special financial institutions which led to rapid growth and worldwide dissemination (by 1914 there were 15,000 credit cooperatives in total) (Guinnane, 2011, p.80); and

– consolidation under the banking law of 1934, which turned them into universal banks. Three main factors account for their success: A tailored legal framework, effective delegated supervision, and institutional self-reliance (Seibel, pp. 2-3).

Contemporary microfinance

After WWII, Europe left the centre stage, taken over by what used to be called the 'Third World'. Between the 50's and the late 1970's the Governments of many developing countries such as India or Indonesia, adopted the policy of subsidized credit for poverty alleviation and promotion of the agricultural sector using state-owned development finance institutions or farmers' cooperatives. This phase was characterized by low, subsidized interest rates to ensure that even the poorest would be able to repay loans. However, in order to be able to offer below-market interest rates, the issuing financial institutions had to be subsidized. These policies were rarely successful, as rural development banks could not cover their costs with subsidized interest rates. Furthermore, borrowers had poor repayment discipline, because they considered their loans as gifts from the government. Therefore, these institutions' capital base eroded and eventually got depleted. Moreover, funding did not always reach the poor, often ending up in the pockets of more influential and well-off farmers (Helms, 2006).

Once the development banks withdrew from the microcredit market, they were replaced over time by semi-formal, mostly donation-based, microfinance institutions - NGOs. Early microfinance schemes were based on solidarity group lending, whereby every member of a group guaranteed the repayment of all members. Many of these new microfinance institutions were founded in the early 1970s and would become major players in the microfinance market: In Brazil, Acción International has been operating in Latin America since the early 1970s; Muhammad Yunus founded his Grameen Bank in Bangladesh in 1976; in India, SEWA, the Self-Employed Women's Association Bank, a bank owned by a women's trade union. The aim of these start-ups was the fight against poverty through economic development (ibid.).

In the 1980s, microcredit programmes methodologies across the world improved and there was evidence that well-managed programmes proved that financially excluded people's (particularly women) repayment rate was higher than that of better-off people, who get loans from conventional banks. Also, there was evidence that poor people could bear the burden of paying interest rates sufficiently high so as to recover microfinance institutions' costs. Once the MFIs break even, they attract deposits, loans from commercial banks and investment capital and can increase their outreach without being limited by a scarce and uncertain supply of subsidized funds from governments and donor agencies. As an example, the government-owned Bank Rakayat Indonesia (BRI) village branch system could serve over 30 million low-income customers (ibid.).

The 1980s represented a turning point in the history of microfinance and by the end of the decade the paradigm shift towards commercialisation was well under way. Both the Bangladeshi Grameen Bank and the Indonesian BRI showed that microfinance institutions could reach more than 1 million customers with remarkably high repayment rates. While an increasing number of institutions had then entered the market, most of the programmes created in the 1960s and 1970s all but vanished due to dismal repayment rates combined with corruption and heavy subsidization, leading to a *grant mentality* among clients. (Paxton, 1996, cit. in Robinson, 2001, pp. 53-54).

The 1990s witnessed a growing interest among international development agencies and networks in promoting microfinance as a tool to alleviate poverty. Microfinance initiatives sprung up in many countries, including many eastern European ones newly freed from the Soviet bloc, especially Bosnia and Hercegovina, devastated by the civil war. By then, the term 'microfinance' rather than 'microcredit' began to be used to refer to a range of financial services for the poor, including credit, savings, insurance, and money transfers.

As Brigit Helms (2006) observed, microfinance has gone a long way over the past years. However, three major challenges define the frontier of financial services for the poor:

- scaling up quality financial services to serve even larger numbers of people (scale);
- reaching poorer and more remote people (depth); and
- lowering costs to both clients and MFIs (cost) (p. 5).

By the late 1990s commercial microfinance was a rapidly growing industry. In this context the development of large microfinance institutions like the Indonesian BRI with its micro-banking system and the Bolivian BancoSol are particularly interesting, because of the scale on which they conducted unabatedly profitable operations and their leadership roles in the development of the commercial microfinance industry (Robinson, 2001, p. 54).

The early 21st century saw the commercialisation of the sector: formerly non-profit microfinance institutes transformed into profit-oriented actors, such as the Mexican MFI Compartamos, which became a listed company or the Indian SKS, which launched an IPO in 2010. This 'mission drift' was justified by arguing that only by increasing the capital stock it could have been possible to bring the outreach to poor people to the next level.

The new paradigm highlights the idea that, if enabling macroeconomic, political, and regulatory conditions are enacted, commercial institutions can without subsidies widely provide financial intermediation for the active poor in a profitable and sustainable way. Moreover, it is emphasized that commercial microfinance complements and does not replace government and donor poverty alleviation programmes for the poor (Robinson, 2001, p. 73).

Across the world, sleeping giants such as the postal networks provide a valuable source of savings and transfer services for millions, for example in China (Battaggia, 2016b). In some areas, such as the Russian Federation, "the microfinance market has become a kind of modern usury tool, not a tool to support socioeconomic development", as Tsvetkov et al. noted. (Tsvetkov et al., 2019, p.109).

Global rating agencies have appeared in the sector, helping MFIs secure adequate funding form the market. An example is MFR (former Microfinanza Rating) headquartered in Milan, Italy and operating worldwide with assessment and certifications aiming at increasing transparency, facilitating investments and promoting best practices in the sector. In time, rating agencies started to adopt innovative assessment tools to evaluate the impact of operations on the 'double bottom lines' of a balance-sheet of microfinance institutions, i.e. the economic and the social impact (cfr. SEEP Network 2005; Rosenberg, 2009).

Innovations like microinsurance, 'green microfinance', microcredit via mobile banking (cfr. Kenyan M-Pesa), digitised money and international money transfers have gained ground and have become object of research in the academic world, which has been trying to integrate the latest findings into the discipline (e.g.: the frontiers of behavioural economics and ethical studies) (Allet & Battaggia, 2013; Ashta & Battaggia, 2013; Geraert & Battaggia, 2016; Tan, 2018; Sukadi-Mata & Battaggia, 2013).

Meanwhile, in Europe the microfinance sector witnessed the increasing attention of international NGOs (tilting heavily toward eastern Europe) or the European Community, now European Union (western Europe).

The most recent story of microfinance in Europe is intertwined with the increasing role of transnational cooperation (EU enlargement in size and depth, establishment of microfinance apex organisations), as is well described in Table 2.2, drawn and adapted from a White Paper (ADIE et al., 2019) which summarises 30 years of microfinance in Europe, from the late '80s to the present time:

Table 2.2 Timeline of European microfinance

Pre-1989	Credit cooperatives engaged in activities that strongly overlap with microfinance, without explicitly naming it such. To date, credit cooperatives and microfinance institutions share values with many features in common.
1989	"Association pour le Droit à l'Initiative Economique" (Adie) founded in France.
1997	Set-up in Warsaw of the Microfinance Centre for central and eastern Europe and Newly Independent States (MFC) by 21 members. In 2020 it had more than 100 members.
2003	Creation of the European Microfinance Network (EMN), based in Paris. In 2011 it moved to Brussels.
2007	The European Commission published "A European initiative for the development of microcredit in support of Growth and Employment" – a landmark document that set the course for the future of the EU institutions' support for microfinance.
2007	Creation of the "Luxembourg de la Plateforme Européenne de Microfinance", dedicated to investors and European microfinance lenders in developing countries.
2007-2013	JASMINE + Progress (first EU technical assistance programme for microfinance).
2014-2020	EU Programme for Employment and Social Innovation (EaSI) (EU financial instruments and grants for microfinance).
2021-2027	InvestEU and ESF+ (the future sources of EU support for microfinance).

Source: Adie, EMN, Paris Europlace (2019) (adapted)

The 2020-2021 pandemic will certainly exert its influence in the development of European microfinance, in view of the implementation by the European Union of extraordinary policy interventions aimed at recovering the economies of the Continent and creating jobs lost during the crisis (Next Generation EU €750bn on top of the €1074,3bn multiannual financial framework 2021-2027) (European Council, 2021).

3 Theoretical background[11]

As already mentioned, microfinance has been primarily investigated within the field of development studies, as it is most widespread in emerging countries within an agricultural context, i.e. areas like southern Asia, Africa and Latin America. Village and group lending are the norm and the loan disbursement system can manage without collateral by relying on peer monitoring.

In Europe, on the other hand, microfinance is more likely encountered in an urban context (less so in south-eastern Europe where agricultural microfinance plays a noticeable role), on an individual or company basis and often linked to public policies aimed at levelling regional gaps, mitigating poverty and fighting social exclusion.

Despite marked regional differences, we can however examine a few economic models that shed light on the *raison d'être* of microfinance as well as shared microlending practices the world over. The questions that these models try to address include: How people take decisions about their occupational choice? Why capital does not naturally flow to the poor? Why intervene in credit markets? When agency problems arise? What role do adverse selection and moral hazard play in microfinance transactions, and which remedies can be put in place?

Firstly, we may seek to understand how some people become entrepreneurs and why.

In order to set up an enterprise, some managerial and technical skills plus a certain amount of funds are essential. When existing funds (savings, family or friends borrowing, etc.) are insufficient, recurring to formal or informal credit markets is inevitable. The conventional banks often avoid lending to small entrepreneurs because managing small loans is burdensome and unprofitable: Braverman and Gulasch estimated that the administrative costs of handling small loans range from 15 to 40% of the loan size (Braverman & Gulasch, 1989, p. 33).

A crucial aspect of conventional lending is collateral, which serves the lender as a guarantee against a possible default of the borrower. Since conventionally a microcredit loan is collateral-free, understanding the importance of collateral leads on to justifying

[11] This chapter draws on Ray D. (1998). *Development Economics*, Princeton, NJ: Princeton University Press, pp. 226-237; 531-586; Armendáriz B., Morduch J. (2010) *The Economics of Microfinance*, Cambridge, MA: The MIT Press.

the existence of microcredit, at least for those sensitive to social equality.

The economist Debraj Ray has linked collateral to inequality in society. He observed: "In unequal societies the poor may lack access to credit markets for precisely the reason that they lack collateral" (Ray, 1998, p. 227).

Ray (1998) introduces a model to explain to what extent people are free to make their occupational choice: In a simple economy, let there be three occupations: the subsistence producer that can produce an amount z of funds, the industrial worker who earns a wage w and the entrepreneur who employs industrial workers. According to this author, the entrepreneur will honour the loan if the following condition is met (pp. 229-230):

$$I\,(1+r)\ \leq W\,(1+r) + F + \lambda\,\{q - mw\,(t)\} \qquad (1)$$

Where:

I = start-up cost or investment	q = output
r = interest rate	m = industrial workers
W = starting wealth, given as collateral	w = wage
F= fine	t = time
λ = fraction of the amount	

The equation (1) reads as follows: the discounted start-up cost $I\ (1+r)$ should not exceed the discounted value of the collateral $W\ (1+r)$ plus the expected cost of default or fine (F) plus a fraction (λ) of profits $(q - mw)$ at any given time t.

The same formula can also be rearranged as follows:

$$W \geq I - \frac{F + \lambda\,\{q - mw\,(t)\}}{1+r}$$

We can see that the amount of collateral is critical to obtain a loan and enable the potential entrepreneur to start up a business.

As Ray (1998) maintains, three features of this model are noteworthy: inequality is inefficient, it begets further inequality and it perpetuates itself (pp. 234-7). The first feature derives from the fact that business improvements require additional access to credit, barred by wealth inequality. The second one implies that inequality replicates itself as lower income individuals are unable to acquire wealth while wealthy entrepreneurs make high profits from cheap labour. The latter implies government policies such as wealth distribution. (Ray, 1998).

While this model describes how potential entrepreneurs are hindered from accessing to credit in their endeavours to start and run a business, in Europe typical microloans borrowers are generally self-employed people who would not hire any workers, at least in the early stages of their enterprise.

Once turned away from the formal credit market represented by banks, the borrower may resort to the informal credit markets, represented by moneylenders.

It is a commonplace to represent moneylenders as loan sharks who exercise a monopoly in informal credit markets. However, reality is different, especially where markets work. Ray (1998) gives an explanation of high interest rates resorting to the *lender's risk hypothesis*, where the following equation represents the moneylender's expected profit (p. 544):

$$p(1+i)L - (1+r)L = 0$$

$$i = \frac{1+r}{p} - 1$$

Where:

p = exogenous probability of borrower's default

L = total amount of funds lent out

i = interest rate charged in informal markets in a competitive equilibrium

r = opportunity cost of funds for moneylenders (interest rate rewarded by a bank)

When $p = 1$, we have no default risk and the rates $i = r$. If $p < 1$, then $i > r$, so the interest rate must be higher than the opportunity cost to cover the default risk. The higher the risk, the higher the interest rate.

The risk of default may also depend from the size of the loan: large loans are unlikely and the use of loans for fixed investments instead of working capital or consumption is frowned upon by moneylenders because it would set borrowers free from further borrowing, thus eliminating the threat to stop future lending (Ray, 1998, p. 546).

In literature, it has constantly been empirically observed that the default rate among rural borrowers resorting to the informal market is lower than that of the formal sector: 5% against 25% (Aleem, cit. in Ray, 1998, p. 545). The reasons behind this difference are multiple: roughly 80% of microcredit borrowers worldwide are women (Microfinance Barometer 2019, p. 2), who are considered to manage funds better than men (Armendáriz et al., 2010, p. 216-219); most borrowers are poor and therefore wont to juggle with money to survive (Collins et al., 2009); monitoring systems of collateral-free loans is much stronger than observed in the formal sector (Stiglitz, 1990, p. 351-66).

In a rural context, landowners who double as moneylenders may enlarge their land size by lending to borrowers who pledge their piece of land as collateral (Ray, 1998, p. 547). This phenomenon occurs rarely in Europe and does not deserve our attention here.

Why capital does not flow naturally to the poor?

A question that is worth considering is why capital does not flow naturally to the poor. The question, raised by Lucas (1990) with reference to the capital flow from developed to developing countries, is revisited by Armendáriz in the field of microfinance.
After all, as Armendáriz et al. noted, the *principle of diminishing marginal return to capital* should favour enterprises with little capital on account of the concavity of the production function (Armendáriz et al., 2010, p. 6):

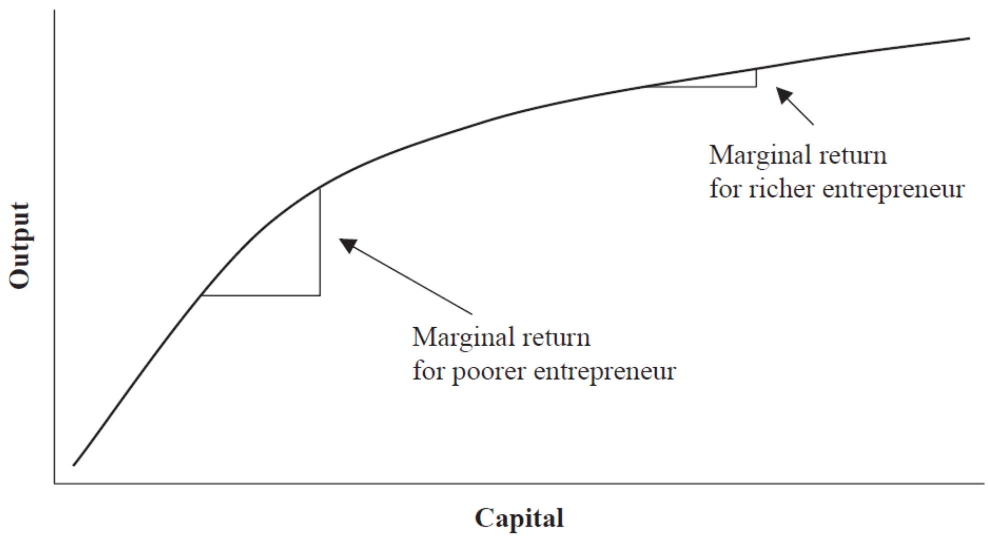

Figure 3.1 Marginal returns to capital with a concave production function
Source: Armendáriz et al. (2010), p. 5

This is tantamount to say that with every additional unit in capital – all other factors being held constant – the incremental output per unit will decrease at some point.

The size of the marginal gains impacts the borrower's ability to pay. Therefore, little enterprises should be able to pay higher interest rates than larger ones and capital should flow from rich countries to poorer ones and, also within any given country (ibid., p. 6).

However, other factors than capital influence the production curve, such as education levels, business savvy, contacts and access to other inputs (Armendáriz et al. 2010, p. 20). Therefore, marginal returns for enterprises with little capital but different inputs may be lower than those for richer enterprises (fig. 3.2):

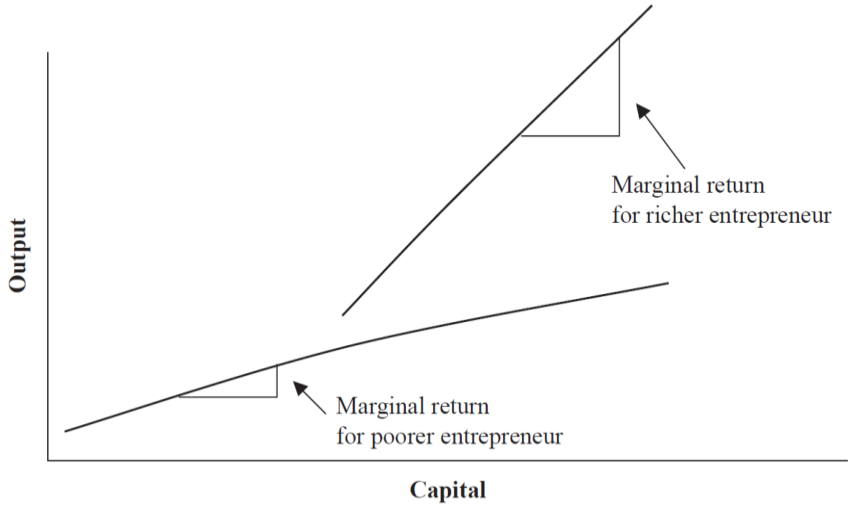

Figure 3.2 Marginal returns to capital for entrepreneurs with differing complementary inputs.
Source: Armendáriz et al. (2010), p. 20

Even if both large and small enterprises displayed similar characteristics unrelated to capital, the production curve may still not be 'conveniently concave', because scale economies play a role in favour of large enterprises, as shown in fig. 3.3. (ibid., p. 21):

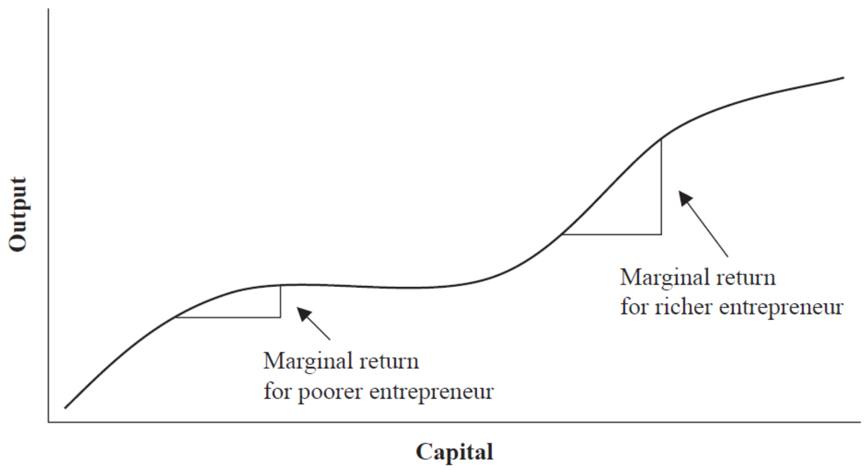

Figure 3.3 Marginal returns to capital with a production function that allows for scale economies
Source: Armendáriz et al. (2010), p. 21

As Armendáriz et al. (2010) underline, the fundamental factor is risk, as poorer economies present higher investment risks, mainly due to two major problems: Adverse selection and moral hazard.

Adverse selection and moral hazard

Adverse selection denotes a form of market failure that results from the information asymmetry existing between contractual partners (buyers and sellers) before the contract is concluded (*ex ante*). As lenders cannot ascertain which borrowers are riskier than others (because some characteristics are observable and others are not), they raise the average interest rate, thus excluding some potentially safe customers (*credit rationing*).

Armendáriz et al. follow the pioneering work of Stiglitz and Weiss (1981) to illustrate the mechanism arising with adverse selection (Armendáriz et al., 2010, p. 42). Their model considers a competitive bank and two types of customers: a safe and a risky type. It is assumed that both try to maximise their profit and have identical expected returns. The safe borrower invests \$1 to secure a return of $\underline{y}$ while the risky borrower invests the same to secure a revenue $\bar{y}$ with probability p.

The bank tries to cover the full cost of raising money (k) for each dollar spent, that is, k > \$1 must hold. If all customers were safe, the bank would break even with an interest rate equalling the gross cost k. If the bank cannot tell apart safe and risky borrowers, it is forced to raise the interest rate from k to R_b. The bank will set the new interest rate R_b so that the expected return from lending to an unknown customer equals k:

$[q + (1 - q)\, p]\, R_b = k$

or: $R_b = k/([q + (1 - q)p])$ (1)

Where:

q = portion of the loan applications filed by safe borrowers

1- q = portion the loan applications filed by risky borrowers

From the formula (1), Armendáriz et al. deduct that R_b will surmount k by an amount $A = [\, k\,(1 - q)(1\text{-}p)]/[\, q + (1 - q)p]$, so that it is possible to shorten it thus: $R_b = k + A$. So, if R_b is the rate that both safe and risky borrowers will have to pay, some safe borrowers may consider it too high and give up their loan application. This leads to the inefficient and inequitable situation where some creditworthy projects go unfunded. The authors illustrate the situation with two figures. In figure 3.4, at a gross interest between k + A and $\underline{y}$ the bank makes a profit. When the interest rate rises above $\underline{y}$, safe borrowers leave the market and the bank faces losses. When the interest rate reaches k/p, the bank breaks even again serving risky borrowers only. Finally, when the interest rate reaches $\bar{y}$, even risky borrowers leave the market, which collapses (ibid., pp. 43-44).

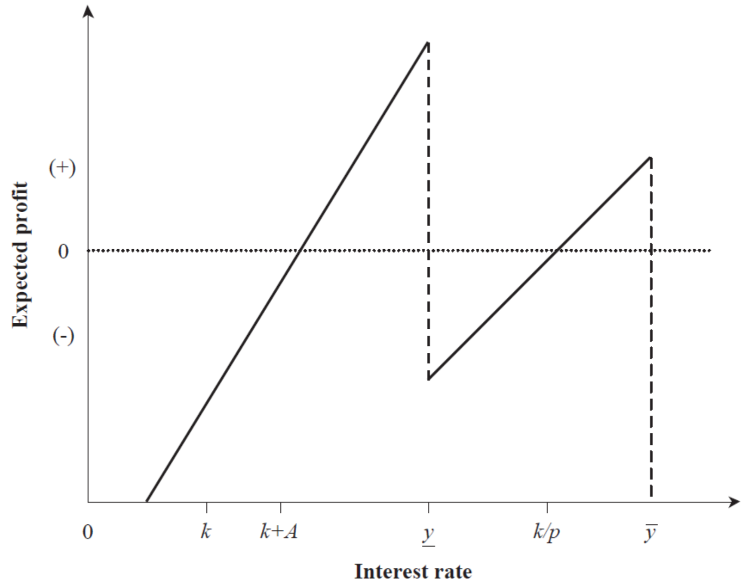

Figure 3.4 Adverse selection example (a)
Source: Armendáriz et al. (2010), p. 44

Observing fig. 3.4, it is worth while noting that the greatest profits are earned at a lower interest rate, making lending both efficient and equitable.

In fig. 3.5, even at the interest rate y the bank does not break even, and eventually at the level k/p the bank will earn a profit:

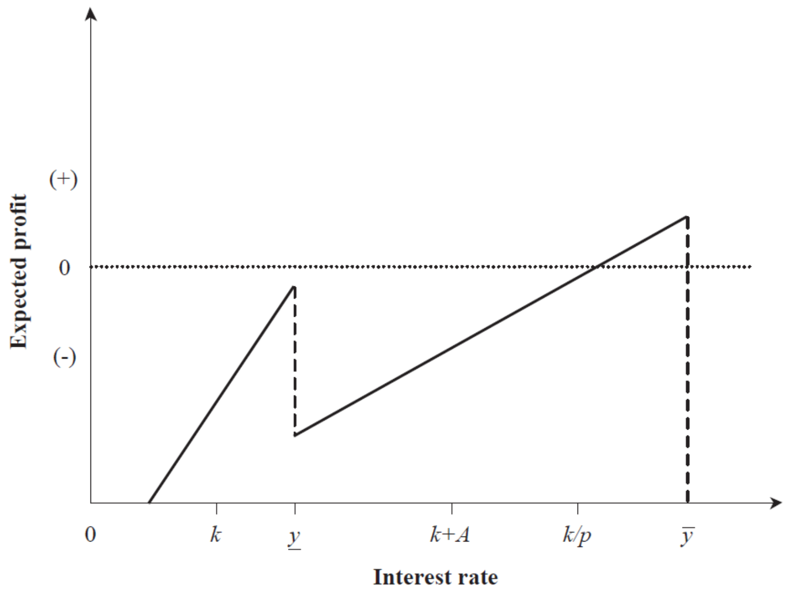

Figure 3.5 Adverse selection example (b)
Source: Armendáriz et al. (2010), p. 45

Moral hazard occurs when the loan is not assisted by collateral – a typical case within microfinance – and can take place in two forms: The first one occurs after the contract is concluded and the loan is disbursed but before the returns are achieved (*ex ante*); the second one occurs when returns are achieved but cannot be correctly assessed or payment cannot be enforced either because the borrower takes the money and runs or the local judicial systems are inefficient (*ex post*). Both refer to the situation when risk arises from a collision of the interests of the contracting parties as well as hidden information. The problem is that the behaviour of the better-informed partner affects the pay-off of the less informed (ibid., pp. 48-50).

Armendáriz et al. developed a model explaining how limited liability combined with *ex ante* moral hazard can bring about inefficient outcomes. The authors suppose that a borrower has secured a loan and that s/he may either puts efforts to obtain profits y with certainty or refrains from working hard, making profits with the probability $p < 1$ (ibid., p. 48).

Now, the borrower is likely to put efforts if the following condition is met:

$$(y - R) - c > p\,(y - R) \qquad (2)$$

Where:

y = borrower's output

R = gross repayment (capital + interest)

c = cost of effort for the borrower (opportunity cost of forgoing a wage)

The equation (2) reads as follows: The net return putting effort must be above the expected net return without efforts. The same equation can be written as follows:

$$R < y - [c / (1-p)]$$

If the gross interest rate exceeds $y - [c / (1-p)]$, the borrower will relinquish his/her endeavours, therefore the bank will have to cap its interest rate to reduce its risk. However, if the bank cost of capital k is less than $y – c$, it is still greater than $y - [c / (1-p)]$, hence the bank will need to set $R > y - [c / (1-p)]$. At that level the borrower will shirk and the bank refrain from lending (ibid., p. 48).

The *ex post* moral hazard is linked to the enforcement problem. This occurs when the borrower receives a loan to invest in a business but may decide to abscond the outcome and migrate and change identity. The question that Armendáriz et al. try to explain is the following: Under what circumstances will the borrower choose to repay his/her loan? The authors make three assumptions: The first one is that the borrower owns some private wealth *w* that can be used as collateral; the second one is that the interest rate R is fixed and let the lender break even; the third one is that default can be verified with probability s (ibid., p. 49).

According to the authors, the borrower's *ex post* reward if s/he repays is $y + w - R$. On the other hand, the outcome if s/he does not repay is $(1 - s)(y + w) + sy$, where:

$(1 - s)$ = probability that the borrower keeps his/her returns and collateral without paying the interest due

$(y + w)$ = event that happens with probability s that the borrower keeps his /her returns y but the bank manages to seize the collateral w.

The borrower will flee with the money if the following condition is met:

$$y + w - R > (1 - s)(y + w) + sy$$

which yields:

$$R < sw \qquad (3)$$

The equation (3) states that the gross interest rate R cannot exceed the collateral multiplied by the probability that it will be confiscated (ibid., p. 51).

With the aim of overcoming the afore-mentioned agency problems, the microfinance sector has devised some countermeasures. As an example, a solution proposed to fill the gap between resources and skills is increasing the amount of information available by linking with local markets, e.g. hiring well-informed local agents, that can be former moneylenders who accept to receive a fixed wage and work for a bank or a microfinance institution.

Microfinance has also devised innovative methods, like group lending, peer monitoring, threat of denying future access to loans, progressive lending, frequent repayment instalments (i.e. weekly), public repayments, flexible approaches to collateral and targeting women.

In group lending with joint responsibility, as practised by Grameen Bank, assortative matching works in favour of comparably safe borrowers, who do not want to cross-subsidise risky members and prevent them to join the group.

Group lending include screening potential members, peer monitoring and cross-reporting: These practices arise out of fear to lose one's collateral, making lending sustainable.

Armendáriz et al., however, point at the limits of group lending citing hidden costs, collusion and emerging tensions. Group meetings, which are key to monitoring, entail costs in terms of time and travel expenses, causing dropouts. The personal risk is compounded by contract with other group members' risk. Another issue is collusion, i.e. the possibility that borrowers misuse their social capital to plot against the bank (ibid., p. 122). On the negative side, a potential drawback may occur when a member of the group for some reason defaults, resulting in a general default strategy adopted by all remaining group members, given that the group rating has been destroyed anyway (Ray, 1998, p. 580).

Progressive lending is a type of dynamic incentive whereby an MFI repeats and increases the volume of loans over loan cycles. Progressive lending allows the bank to cut average costs, screen borrowers first with small loans before taking the risk of lending larger amounts while encouraging borrowers to repay their loans. Borrowers would work hard for fear of getting blacklisted (Armendáriz et al, 2010, p. 140 et seq.).

Unlike what is the norm in conventional business, frequent repayment instalments (i.e. weekly) is a mark of microfinance practice. This measure sets up an early warning system allowing loan officers a timely awareness of emerging problems. Often, early repayment instalments are repaid using other streams of income, which reduces the bank risk (ibid., p. 148).

Public repayments serve the lender in many ways. First, there's the threat of stigma; second, it reduces transaction costs for the loan staff; third, they can elicit cross-reports; finally, it is an occasion to organise financial and business education sessions which can enhance the business performance of borrowers (ibid. p. 157).

Flexible approaches to collateral deviate from the traditional concept of collateral as a way to restore the lender: they tend to consider it not under its resale value but how its alienation would impact the borrower. It is the notional value, not the resale value that matters (ibid, p. 157).

As for targeting women, empirical research has proved that, all other variables being equal, they seem more reliable than men in repaying their loans. As to why women appear to be more reliable is up to debate. Rahman stated that men are more likely to be more argumentative and noncompliant (Rahman, 2001, cit. in Armendariz et al., 2010, p. 158).

As far as the European context is concerned, the questions that we have dealt with from the beginning of this paragraph still hold but should be adapted in an environment where welfare state safety nets play an important role.

So far, research has yet to investigate the relations between welfare policies and microfinance, particularly important in Europe. As a parallel example, Banerjee et al. (2019) have investigated how the Universal Basic Income (UBI) could work in the developing world, where focus is in bottom line issues such as nutrition, health, and education

(Banerjee et al., 2019).

Given that the main concern of microfinance in Europe is about empowering marginalised groups through self-employment, welfare measures often intersect the microfinance sector. As an example, at present in Italy a person can claim in advance full unemployment benefits (NASPI) to start up a company. On the other hand, as soon as an unemployed person formerly working with a collaboration contract (aka 'co.co.co.') - and therefore, entitled to the relevant welfare benefit (DIS-COLL) - opts for a self-employment solution, access to the benefit is discontinued, despite much-needed support in the beginnings. In other countries, such as Romania, there is a mandatory welfare bridge for self-employment out of unemployment, although once a person registers as self-employed and reports earnings that exceed the minimum income of €400 per month, his/her welfare benefits are cut. (EMN, 2019c). Therefore, on account of these and other European welfare programmes unknown in developing countries, such as recent universal income schemes, microfinance models describing the European context will have to include market distortions that impact on microfinance providers operations and sustainability.

4 Microfinance actors and their environment

4.1 The actors

To outline the European microfinance sector, we will firstly provide a short taxonomy of microfinance actors. Each one will be dealt with more in depth in the pages to follow.

Microfinance players active in Europe can be divided in two main categories, according to their public or private nature. It should be noted, however, that some private organisations, receive also public funding.

Public actors include:

- supranational institutions such as the European Union (in the branches of the European Commission and the European Parliament) or the European Investment Fund (EIF);
- national bodies, such as the Italian Agency for Microcredit (Ente Nazionale per il Microcredito);
- other international organisations such as the UN agencies FAO or IFAD which have their seat in Europe and have run microfinance programmes[12]. However, since those programmes have been implemented overseas, they will not be taken into consideration here.
- academic institutions, such as the Belgian CERMI (*Centre for European Research in Microfinance*), the Solvay Brussels School (which also organises the master degree *European Microfinance Programme*) and the University of Mons, the French Paris-Dauphine University, the Dutch Wageningen University (specialised in rural microfinance), the Spanish Universidad Autónoma de Madrid, the Norwegian Center for Research on Social Enterprises and Microfinance (CERSEM) at the University of Agder, the Boulder Institute of Microfinance with its Turin branch, and so forth.

Private actors include:

- non-governmental organizations (NGOs) such as the European Anti-Poverty Network (EAPN) or foundations such as the Grameen Crédit Agricole Foundation, non-bank financial institutions (NBFIs), CDFIs (Community Development

[12] Another UN agency involved in microcredit initiatives worth mentioning is UNDP (United Nations Development Programme) with HQs in New York.

Financial Institutions), savings and commercial banks, credit unions, cooperatives and religious institutions;

- microfinance institutions (MFI) operating inside Europe (*infra 4.1.2)*.
- European microfinance actors working in developing countries: they also will not be a matter of study in this writing;
- national MFI umbrella networks such the Italian RITMI or the German Deutsches Mikrofinanzinstitut;
- European MFI apex networks, such as the European Microfinance Network (EMN), the Microfinance Centre (MFC), the Network of European Financial Institutions (NEFI);
- the European Microfinance Platform (e-MFP), a network of European organisations based in Luxembourg, involved in the financial inclusion sector in developing countries. It hosts a renowned autumn event in Luxembourg;
- microfinance rating agencies, such as MFR-Microfinanza Rating, based in Milan;
- individuals who operate at various title in the microfinance field, such as consultants, politicians and prominent people[13], free-lance journalists, professionals who coach prospect borrowers to prepare a convincing business plan, etc.

[13] Among others, the Dutch Queen Maxima and the Belgian Queen Mathilde. On 19 October 2015, the latter opened the First European Microfinance Day at a ceremony in Brussels.

4.1.1 The European Union and its microfinance initiatives

A brief history

Within the framework of its cohesion policy, the European Union has intended to support Member States and Regions to improve their contribution to microcredit by devising policies and promoting the spread of good practices. In fact, microcredit is considered cost-effective, as every job created with a microloan has resulted costing less than €5,000, cheaper than any other labour market policy (Kraemer-Eis H. & Conforti A. (2009).

The historical background of the European Commission interventions in favour of microcredit spans over two decades (2000-2020) and is intertwined with interventions fostering entrepreneurship and the growth of SMEs.

Microfinance for new or existing small companies was recognised as an issue by several EU Councils of Ministers in 2000, including the Lisbon European Council of 23-24 March 2000 where "the Union set itself a new strategic goal for the next decade: to become the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion" (EP, 2000).

Closely related to microfinance are the policies concerning the support of SMEs. Upon pressure from UEAPME (Union Européenne de l'Artisanat et des Petites et Moyennes Entreprises)[14], the so-called *European Charter for Small Enterprises* was approved by EU leaders at the European Council in Feira, Portugal, on 19-20 June 2000. This document calls upon Member States and governments to undertake actions to support SME's in areas such as: improved legislation, education and training for entrepreneurship, cheaper and faster start-up processes, shortage of skills, taxation and financial matters, technological upgrading, etc. Each member state publishes every year a report on the progress made to implement the Charter. Vesterdorf (2006) cites three best practices:

- the Czech Republic, Finland, Ireland, Norway, Poland and Spain included entrepreneurship education into their curriculum;
- Denmark helped Estonia to set up a one-stop-shop supporting SME to learn how to improve the use and protection of their design;
- a joint project on restructuring, bankruptcy and a fresh start (p. 116).

In December 2000, to fulfil the Lisbon goal, the 2001-2005 *Multi-Annual Programme*

[14] Also known as the European Association of Craft, Small and Medium-Sized Enterprises or SMEunited.

for Enterprise and Entrepreneurship (MAP) was established with a budget of €450m. Microcredit to small enterprises is defined there as a loan below €25,000. (Vesterdorf, 2006)

On 21st January 2003 the European Commission launched a debate on entrepreneurship policy by inviting public consultation on a series of key questions and published the report *Entrepreneurship in Europe,* also known as the 'Green Paper on entrepreneurship'. This document acknowledged the importance of entrepreneurship in the economy at various levels such as innovation and competition; also, it stated that Europe lagged behind the major western economies (e.g. USA, Canada, Australia) owing to cultural reasons, i.e. an environment that is not fostering entrepreneurship (EIM, 2003, p. 7).

Furthermore, the Green Paper identified the key factors for building a climate conducive to entrepreneurial initiative and business activities. In order to face this 'European challenge', the Commission asked ten questions under three pillars of action, namely: removing barriers to business development and growth; correct the imbalance between the risks and rewards of entrepreneurship and promoting the values of entrepreneurship within society. The objectives identified by the responses to the questions were the following:

- access to finance should be made easier for businesses in the different stages of development. Promotion of loan guarantees for start-ups and microloans; securitisation to support bank lending to SMEs was also a proposal; promoting investment by individuals (family and friends, business angels);
- increase of labour market flexibility and reduction of the 'opportunity costs' of self-employment vs. wage-employment;
- reduction of administrative and legal burdens for start-ups;
- encouraging innovation, technological progress and business internationalisation as well as improved knowledge transfer from universities and availability of venture capital (EC, 2003a).

On 11th November 2003, the European Commission published the report *Microcredit for small businesses and businesses creation – bridging a market gap*, an overview made by experts on the situation in Europe regarding providers, challenges and best practices. As the report declared, it dealt mainly with access to finance for small entrepreneurs and described their relationship with public or private banks, private micro-finance providers, guarantee societies and business support services. SMEs often face major challenges when they approach finance providers for both investment and working capital. Supply of microloans is an issue, especially when potential or actual entrepreneurs are unemployed people, women or belong to ethnic minorities. Therefore, supporting the supply of microloans becomes an issue of social inclusion, not only of entrepreneurship and economic growth. Commercial banks often consider microcredit as an unprofitable and risky business due to the high handling cost for microloans, so there is a market gap based on information asymmetry (see chapter 3). In order to somehow bridge this market gap, Member States can offer public support in various form, such as through an enabling environment and tax incentives for investors, supplying funds to microcredit retailers or by providing funds to specialised lenders, by sharing part of the risk with specialised guarantee societies or by promoting business development services (EC, 2003b, p.5).

On 22nd-23rd September 2004, the first *European Conference on Microcredit* was organised in Brussels jointly by the European Microfinance Network (EMN), the Microfinance Centre for Central and Eastern Europe and the New Independent States (MFC), and the Network of European Financial Institutions (NEFI). The aim was to disseminate good practices in providing access to microfinance for small businesses, in order to identify strategies for the future. Mr Romano Prodi, then President of the European Commission, gave a speech on the ability of microcredit to help preventing marginalised people from being left behind. He also stressed the need to improve the regulatory framework for SME's and for microcredit, as well as disseminate best practices throughout the Union (European Conference on Microcredit, 2004, pp. 40-44).

On 11th September 2004, the European Commission published the report addressed to its staff *Microcredit for European small businesses*: a study on the availability of microcredit in Europe. The report outlined the microcredit background and actors, looked at business support services, presented trends and discussions, set out the microcredit performance assessment and contained conclusions and ideas for consideration (EC, 2004a).

The United Nations Economic and Social Council proclaimed the year 2005 as the International Year of Microcredit. In that year, the European Commission and the European Investment Bank (EIB) through its European Investment Fund (EIF) launched the JEREMIE initiative (Joint European Resources for Micro to Medium Enterprises initiative), which gave Member States, through their national or regional Managing Authorities, the opportunity to use part of their EU Structural Funds[15] to finance SMEs in a

[15] The Structural Funds, which were established to promote economic and social cohesion within the EU, represent the most significant source of EU funding after the Common Agricultural Policy.

sustainable way.

In April 2007, the European Commission Directorate-General published the report *The Regulation of Microcredit in Europe*. This report summarised the main findings of an expert group from 20 Member States and Turkey that examined the different types of regulatory frameworks governing microcredit activities. In sum, the expert group made four recommendations:

- allow non-banks to run banking activities; European law only forbade non-bank institutions deposit-taking but not lending activities per se. However, some Members States restricted almost all lending activities to banks, which might have been too restrictive;
- avoid setting too low interest rate caps on microloans and promote risk-adjusted, cost covering lending. The risk can be mitigated with public and private support mechanisms such as guarantees.
- ensure minimum legislative standards for non-banks;
- create a favourable general environment for micro-enterprises, including favourable tax rules and easy business registration (EC, 2007b).

On 13th November 2007, the European Commission released a document entitled *A European initiative for the development of micro-credit* which highlighted the potential of microcredit to stimulate the EU's economy and underlined the need to facilitate access to finance for microenterprises and disadvantaged people. The document identified the following areas of interventions:

- upgrading the legal and institutional environment for business in the EU by lowering interest rate caps, introducing tax incentives providing access to microcredit databases for borrowers, adapting banking legislation and supervision and applying the rules of the Single Market.
- improving the conditions and providing more development services for micro-enterprises so as to promote a positive vision of entrepreneurship;
- disseminating good practices through training, technical know-how and coordination; creating a code of conduct for MFIs;
- organising training, technical know-how and coordination activities to disseminate good practices.
- increasing financial capital for MFIs, with a focus on new and non-banking institutions (EC, 2007a).

On 12th September 2008, at the Nice Ecofin Council, the European Commissioner for

Regional Policy Danuta Hübner and EIB President Philippe Maystadt announced the launch of JASMINE, a three-year (2009-2011) pilot project set up by the European Commission (DG Regio) and the European Investment Bank (EIB) Group to provide technical support and funding to non-bank micro-credit providers in the European Union. JASMINE's purpose was to help MFIs reach high standards and to develop a financial environment where banks and MFIs would work in partnership on microcredit issues and complement each other in economically sustainable conditions. Technical assistance to MFIs took the form of an assessment by a specialised rating agency and subsequent training in areas where improvement was deemed necessary.

On 25th June 2008, the European Commission presented the *Small Business Act* (SBA), with the overall objective to support the growth and competitiveness of small enterprises by reducing red tape, foster entrepreneurship, improve access to finance and markets. The SBA served as a framework for guiding SME policy-making, based on a set of voluntary policy recommendations centred on the following 10 key principles:

1. *Entrepreneurship:* create an environment that is rewarding for the entrepreneurial spirit and where entrepreneurs and family businesses can thrive.

2. *Second chance:* ensure that honest entrepreneurs who have experienced insolvency are quickly given a second chance.

3. *Think small first:* consider the needs of SMEs whenever formulating European policies and legislation.

4. *Responsive administration:* make public administrations permeable to the needs of SMEs, reducing bureaucratic and administrative burdens wherever possible.

5. *State aid & public procurement:* facilitate SMEs participation in public procurement and make better use of State Aid possibilities for them.

6. *Access to finance:* facilitate SMEs' access to finance and develop a legal and business environment conducive to the specific requirements of SMEs;

7. *Single Market:* help SMEs to benefit from the opportunities offered;

8. *Skills & Innovation:* promote innovation and the upgrading of skills in SMEs;

9. *Environment:* enable SMEs to turn environmental challenges into opportunities

10. *Internationalisation* encourage and support SMEs to benefit from the growth of international markets (EU, 2008; EU 2018).

A 2011 European Commission review of the SBA found that most initiatives had been adopted; of the four legislative proposals, only the European private company statute had not been adopted; there were different approaches of EU countries to the implementation, with different results; most EU countries had adopted targets to reduce administrative burdens but not all had achieved them (EC, 2008a).

In March 2010, Decision No. 283/2010/EU of the European Parliament and the Council of the European Union established the EPMF (*European Progress Microfinance Facility*). The facility was the first dedicated instrument available for all microcredit providers that operate in the European Union and offered its products – guarantees and funded instruments, such as loans and equity – not to individual persons or enterprises, but to microfinance intermediaries (MFIs). The continuation of Progress Microfinance was ensured in the framework of EaSI (2014-2020).

In November 2010, European Commission DG Industry published the report *Gaining scale in microcredit: can banks make it happen?* on occasion of two workshops organised on the role of banks for microcredit in Europe. The key findings were the following: The microlending segment is characterised by low returns and high transaction costs. A way to reduce transaction costs could be liaising with business support services providers or MFIs. On the other hand, borrowers experience a gap between their demand (flexible credit) and offer. Also, banks invariably ask for a collateral or third-party guarantees, so risk-sharing instruments could be a tool to overcome the hurdle of the collateral. Increasing competence and standards among MFIs are conducive to a better cooperation with banks. Policy makers should ensure that a suitable promotion and coordination of existing offers and that information be properly disseminated. In this respect, the exchange of best practices should continue and further data about the supply and demand of microcredit should be made available. Finally, the client base of microcredit should be enlarged to raise entrepreneurial levels in Europe (EC, 2010).

Since 2010 social innovation has been explicitly mainstreamed into the EU's new growth strategy. This phase was characterized by a stronger emphasis on social entrepreneurship. In 2015, OECD published a *Policy Brief on Social Impact Measurement for Social Enterprises* where social enterprises were defined as "a new type of business, characterised by an entrepreneurial approach to delivering activities that are aligned with an explicit social mission" and can be considered a natural beneficiary of micro-financing (OECD, 2015).

As of January 2014, three EU programmes managed separately between 2007 and 2013, namely Progress, EURES and Progress Microfinance were pooled under the Employment and Social Innovation (EaSI) programme, managed directly by the European Commission. These programmes formed the three axes of EaSI:

– Progress axis, focused on modernising labour and social policies (61% of funds);
– EURES axis, regarding job mobility (18% of funds);
– Microfinance and Social Entrepreneurship axis (21% of funds).

The total budget for 2014-2020 was €919,469,000. The Microfinance and Social Entrepreneurship (MF/SE) axis supported actions in two thematic sections: microcredit for vulnerable groups and micro-enterprises; and social entrepreneurship.

In November 2018, on occasion of the 10th Anniversary of the *Small Business Act*, the European Commission presented the *Annual Report on European SMEs 2017/2018 growing beyond borders.* The report stated that: "Since 2011, the principles 'access to finance', 'entrepreneurship', 'skills & innovation', and to a lesser extent 'responsive administration' have enjoyed the greatest policy progress, with around two-thirds of the identified policy measures adopted/implemented". (EU, 2018, p. 25).

In November 2019 the European Commission presented the *Annual Report on European SMEs 2018/2019 Research & Development and Innovation by SMEs.* In its background document, the authors investigated what hurdles influence the innovative behaviour of SME's. The main factors reported were the following: finding new customers, competition, access to finance; production or labour costs; availability of skilled staff; regulation. Findings suggested that there was a positive correlation between access to finance and generic innovation, and that SMEs should innovate to attract scarce external funding. The interpretation of results depends on the types of innovation, as: "For instance, there is no clear relationship between problems with access to finance and product innovation. This may be because the 'barrier' and the 'solution' effects are of similar magnitude: on one hand, the launch of an improved product can be a compelling incentive for investors. On the other, product development can require large upfront costs and therefore be impeded by barriers to finance" (EC, 2019, p. 58).

In the following paragraphs we will consider how the European Commission initiatives have been enacted in the past three programming periods (2000-2006, 2007-2013 and 2014-2020).

The programming period 2000-2006

MAP

As already mentioned, in December 2000 the European Union established the *Multi-Annual Programme for Enterprise and Entrepreneurship* (MAP 2001-2005, extended to 2006), as an important means of fulfilling the goal of the Lisbon European Council of March 2000 – i.e. making the EU the world's most competitive, dynamic, knowledge-based economy by 2010. With a budget of €450m, MAP was a plan of actions meant to improve the business environment within the EU, and was grouped in three pillars:

1. the exchange of experience and the identification of good practices between Member States;
2. the operation of a network of *Euro-Info-Centres (EIC) Network*, which supported local information centres all over Europe that informed, advised and assisted SMEs in EU-related areas;
3. the provision of financial instruments for SMEs (EU, 2004b).

The third pillar was implemented with the following financial instruments:

a. the start-up scheme *European Technology Facility* (ETF), operated by the European-Investment Fund (EIF).

The ETF provided loan guarantees to encourage banks to make more debt finance available to innovative SMEs, particularly those in high technology sectors, in their start-up and early development phases. By the end of 2005 the ETF had committed €143.2m, which represented 34.25% of the MAP budget committed by then. An external report (EC, 2004b) stated that the fund encountered difficulties in attracting private capital, on account of the intrinsic riskiness of this market segment (especially after the downturn in stock exchanges in 2003-04) and the condition to secure at least 50% of capital from the private sector to qualify (EU, 2000, para. 4.a.i; EC, 2004b; UK Parliament, House of Commons, 2007).

b. *SME Guarantee Facility* (SMEG)

SMEG provided cross-guarantees or co-guarantees for guarantee schemes operating in Member States, and direct guarantees in the case of the EIB or any other appropriate financial intermediary. Microcredit was explicitly mentioned as a remedy for a market failure.

This facility had the largest budget, accounting for 64.3% of the MAP overall expenditure. An external report (EC, 2004b) praised the effectiveness of SMEG, highlighting its quantitative impact in improving access to debt finance for European SMEs — for example, by the end of 2005, there were 570,000 people employed in organisations that received loans, compared with 310,000 in 2004 (EU, 2000, para. 4, a, ii; EC, 2004b; UK Parliament, House of Commons, 2007)

c. *Seed Capital Action* (SCA)

Operated by the EIF, as the Decision by the Council stated, "The Seed Capital action aims to stimulate the supply of capital for the creation of innovative new businesses with growth and job creation potential, including those in the traditional economy, through support for seed funds, incubators or similar organisations in which the EIF participates – either from its own resources or on its mandate – from their early years onwards". (EU, 2000, para. 4, a, iii). By the end of 2005, the SCA had committed €5.6m, representing 1.3% of the MAP budget committed. A report commissioned by the European Commission (EC, 2004b) underlined that the SCA failed to meet expectations, with only three grant agreements signed; the unsuccessful result was attributed to the difficult market conditions for raising venture capital (EC, 2004b; UK Parliament, House of Commons, 2007).

In 2004, to increase the effectiveness of the programme, an external evaluation of the MAP for the period 2000-2004 made recommendations in all three pillars. With reference to the first pillar, it recommended an enhanced dissemination, focus on benchmarking and best practices rather than creating databases or one-off publications, more follow-up and more long-term projects. The EIC network, object of the second pillar, should be better promoted through awareness-raising, better coordination with other business support networks. As regards the third pillar – the financial instruments – it highlighted the need for more innovative financial products and less emphasis upon loan guarantees (EC, 2004b).

Analysis and fieldwork confirm that several policy and regulatory changes which have taken place later in the years can be related to MAP actions and policy recommendations. A few examples include:

- In Belgium, policy recommendations had a specific impact on SME registration, education for entrepreneurship, a ‘Transfer of Business’ website and round tables in the Walloon Region as well as on information and support services in the Brussels-Capital region.

- In France and the Netherlands, MAP policy recommendations have been used in drafting national SME-oriented programmes (e.g. *Loi sur l'initiative Economique* 2003, Action Plan for Entrepreneurship 2003 respectively).
- In Ireland, the design of specific national programmes was influenced by the 'Administration of start-ups' and 'Management of incubators' studies.
- The Netherlands quickly implemented. the recommendations of the 'Transfer of Business' Project.
- In Spain, the MAP contributions helped the development of a guide for 'Family Business', the creation of a new law for speeding up company registration, and the consideration of entrepreneurial attitude in education and training.
- In Sweden, MAP recommendations influenced the development of the Swedish business angels network and an action plan for education in entrepreneurship. Also, a new legislation on bankruptcy was implemented;
- In the Czech Republic, Malta, Poland, Romania, Slovakia and Slovenia, MAP contributions were taken into account in the preparation of specific government programmes on entrepreneurship and SMEs.
- In Veneto, Italy, the 'Transfer of Business' project indirectly supported new regional legislation.

External reports drew the following conclusions:

- an overall positive appraisal of the impact of the financial instruments, especially SMEG and ETF-Start Up;
- management of the EIF as an example of good practice, identifying it as a delivery model for future SME financing;
- more flexibility would be required in the design of financial instruments in future programmes, including a more innovative suite of financial products;
- the programme would have benefitted from increasing its visibility;
- one of the MAP weaknesses was the lack of robust evaluation (EC, 2004b; UK Parliament, House of Commons, 2007).

EQUAL

The EQUAL initiative was financed with €3bn investment by the European Social Fund (ESF) and co-funded by the EU Member States within the 2000-2006 programming period.

As the name suggests, the initiative focused on projects tackling all forms of discrimination and inequality in the labour market by supporting innovative and transnational projects.

EQUAL was in many respects a unique funding stream, a 'test bed' to explore new ways of addressing the employment difficulties faced by vulnerable groups using partnership-based approaches. The result was a wide range of lessons, insights and good practices, which have been later disseminated to practitioners and policy-makers across Europe.

EQUAL was structured according to thematic fields defined within the four pillars of the European Employment Strategy (EES)[16] and a further area of activities to help the social integration of asylum seekers.

- *Employability*: access and return to the labour market, diversity, pathways to employment, education and training;
- *Entrepreneurship*: business support, microfinance, social enterprise;
- *Adaptability*: lifelong learning, age management, ICT & knowledge society;
- *Equal opportunities*: gender equality, work-life balance, desegregation;
- *Asylum seekers*: social integration.

The EQUAL Development Partnerships were built on six underlying principles:

- *Partnership*: involve key actors (private, public and NGO's) in Development Partnerships (DPs)[17] on a geographical or sectoral level to address labour market challenges;
- *Innovation*: develop and test new ideas and approaches;

[16] The EES was introduced by the Luxembourg Summit in 1997 to provide coordinated guidelines for national employment policies and is based on four 'pillars': employability, entrepreneurship, adaptability and equal opportunities. The European Employment Strategy has been put in place in order to ensure the survival of the European Social Model in view of institutional change resulting from the introduction of the European Monetary System. Since 2011, the EES is fully integrated in the European Semester. (Biffl, 2007)
[17] An EQUAL project was known as an EQUAL Development Partnership, DP for short.

- *Empowerment*: Strengthen the capacity of all stakeholders, including beneficiaries, by working together on an equal footing and with a 'bottom-up' approach;
- *Transnational cooperation*: establish a partnership with at least one other EQUAL DP in another Member State, transferring good practice across national boundaries and creating long-lasting networks;
- *Mainstreaming*: Share good practice and influence policies and practice at the local, regional, national and international levels, ensuring that the activities and ideas have an impact on labour market policy beyond the lifetime of EQUAL;
- *Thematic focus:* Concentrating on a thematic field consistent with the EES.

EQUAL was remarkable for its overarching approach, covering the full innovation development cycle from diagnosis and design to testing and validation of results, and finally to the dissemination of successful policy strategies that have increased inclusiveness in Europe's diverse labour markets, achieving 3,480 DPs with more than 20,000 partners, and reaching over 200,000 people (EC, 2008b).

Box 1 Case story: EXZEPT (Germany)

The German EXZEPT (Erleichterung von Existenzgründungen durch Akzeptanz [Facilitating business start-ups through acceptance] Development Partnership was set up to address the challenge of business supports centres failing to attract disadvantaged groups wishing to start their own company.

The ESF priority area was entrepreneurship and the German regions involved were Hessen, Nordrhein Westfalen and the City of Hamburg. The project lasted from January 2002 until April 2005. The ESF funding was €2,244,479 for a total funding of €4,746,094.

The national EQUAL partners were Exzept GmbH Offenbach, KIZ GmbH Offenbach, GLS Gemeinschaftsbank Bochum, Deutsches Mikrofinanz Institut e.V. Berlin, and others. Transnational partnership was set up with the UK, the Netherlands, and the Czech Republic.

Firstly, EXZEPT performed a survey among marginalised groups and ascertained which specific coaching was needed. As an example, it highlighted the importance of childcare and public transport for women. As regards migrant workers, coaching highlighted 'unrealistic ideas about potential earnings'. The next step was designing regional *one.stop-shops* (OSS) models of start-up support connected with regional networks and employment agencies.

It was the field of microfinance where the experience of the EXZEPT DP had the strongest impact. In April 2004 a German Mikrofinanz Institut (MFI) was established as an umbrella organisation consisting of more than 60 organisations from all German regions (as of 2012).

Source: EC, 2005a, pp. 22-23

Box 2 Case story: Sant Cosme Innova (Catalonia, Spain)

The name of this ESF Spanish project is Sant Cosme Innova, stemming from the Barcelona neighbourhood Sant Cosme, where restructuring of old industries left the area with a high rate of unemployment (25%) and a overwhelming (2/3) population with a migrant background.

The ESF priority area was entrepreneurship, the region involved was Catalunya, Spain, the project duration was from May 2002 until December 2004, the ESF funding amounted to €770,518, for a total of € 1,541,036. National EQUAL partners were the Ayuntamiento El Prat de Llobregat, Fundación Un Sol Món, Fundación FIAS, ADIGSA, Generalitat de Cataluña, UGT del Baix Llobregat, Union Comarcal Baix Llobregat del Sindicato CONC. A transnational partnership was established with France.

The project involved Fundación Un Sol Món (created in 2000 by the large bank Caixa de Catalunya) and Fundación FIAS (a mentoring NGO). The basic product offered by Un Sol Món was a small collateral-free loan of €600 upgradable through step-lending to a maximum of €15,000. Default rates for the whole fund were around 6%.

The microcredit fund set up by Un Sol Món disbursed around 600 loans for a total value of €6m. Some 1,000 jobs had been created, mainly benefiting women and ethnic minorities. According to an impact evaluation among clients, 80% of borrowers had become more prosperous and 70% thought that the microcredit had stabilised their business. However, further actions had been called for, such as the extension of the unemployment benefit covering the early stages of the start-up and changes in the legal situation of migrant workers.

Source: EC, 2005a, pp. 28-29

Box 3 Case story: ADIE (France)

The ESF project 'Appui aux activités génératrices de revenu dans les réseaux ethniques ou communautés' [Supporting income generating activities among ethnic groups and communities], involved the French region of Ile-de-France, and lasted from May 2002 until December 2004. The ESF funding was € 297,313 for a total funding of €569,092.

It was led by ADIE National (Association pour le Droit à l'Initiative Economique) partnering with the Agence Nationale pour l'Emploi (ANPE), and three other partners; a transnational partnership was established with Spain.

The DP envisaged three successful innovations:

- the first was to use word of mouth channels within ethnic networks to reach out into minority communities.
- the second was to develop a mix of step and peer lending techniques. The loans, lent at a commercial rate of interest, started very small, at around €1,000, but could be increased up to €5,000 upon good repayment behaviour. The problem of lack of collateral was overcome with group lending (three people).
- the third innovation was a package of financial education comprising courses on household budget management, the risks of consumer loans, calculating income and expenditure and cash-flow management.

Source: EC, 2005a, pp. 30-31

The programming period 2007-2013

In the programming period 2007-2013 the financial engineering instruments grew of importance and enjoyed a systemic definition in the regulatory framework of the European Commission – EC Regulations 1828/2006 and 1083/2006 and structural funds specific regulations (arts. 3-6 of EC regulation 1080/2006 for ERDF and EC Regulation 1081/2006 for the ESF). In particular, art. 44 of EC Regulation 1883 stated that structural funds could finance financial engineering instruments for enterprises, urban development funds and any loans or guarantees for repayable investments (Centurelli et. al., 2016).

Our own taxonomy of the fund streams related to microfinance in the programming cycle 2007-2013 takes into account the *managing authorities* of the various funds:

1. *Microcredit funds managed by peripheral authorities (States and Regions)*
   1.1. Structural funds
      1.1.1. JEREMIE under the ESF
      1.1.2. JEREMIE under the ERDF
      1.1.3. ESF and ERDF funds used irrespective of the JEREMIE instrument
   1.2. Funds treated as Structural Funds
      1.2.1. The European Globalisation Adjustment Fund (EGF)

2. *Funds managed directly by the European Commission through the European Investment Fund (EIF)*
   2.1. EPMF – European Progress Microfinance Facility
   2.2. JASMINE
   2.3. CIP
   2.4. SME guarantee facility (SMEG)
   2.5. EU/ACP Microfinance Programme

3. *Other funds*
   3.1. EFSE – European Fund for Southeast Europe
   3.2. EPPA – European Parliament Preparatory Action

Microfinance policies at EU level can be implemented by means of two structural funds: the European Regional Development Fund (ERDF) and the European Social Fund (ESF). The first type focuses on funding small and medium enterprises (SMEs) while the second one aims to address social exclusion by promoting self-employment and start-ups.

These funds can be used for several scopes, including:

- Capital investments;
- Establishment of professional bodies dedicated to microcredit, etc.
- Exchanges and meetings;
- Funding of MFI umbrella organisations;
- Housing;
- Investments in guarantee accounts;
- Investments in insurance accounts;
- Investments in interregional pilot actions;
- Securitisation;
- Studies;

In the following paragraphs we will consider each fund listed in the above-mentioned taxonomy.

JEREMIE

JEREMIE, acronym of 'Joint European Resources for Micro to Medium Enterprises', is an initiative launched in 2005 jointly by the European Commission and the European Investment Fund (EIF)[18]. Run by DG REGIO in partnership with national and regional authorities, it promoted the use of financial engineering instruments to support the development of SMEs through structural funds (the total ERDF allocation exceeded € 300bn for the period 2007-2013)[19]. EU Member States (and Acceding States Romania and Bulgaria) could use part of the appropriations dedicated to Structural Funds to invest in

[18] The European Investment Fund (EIF), part of the European Investment Bank (EIB) Group, with headquarters in Luxemburg, is a European Union agency that facilitates European SMEs' access to finance. EIF's shareholders are the EIB, the European Union (represented by the European Commission) and many other public and private financial institutions. EIF performs its activities using both its own resources and those provided by third parties, such as the European Investment Bank, the European Commission or EU Member States.

[19] In this regard, JEREMIE is a predecessor to the current ESIF-backed programmes managed by EIF under the new 2014-2020 programming period.

revolving funds such as venture capital, loans or guarantee funds. The revolving nature of the funds allows a repeated use over time, in stark contrast with the assistance traditionally provided through one-off grants. Also, JEREMIE funds were paid in advance, unlike grants that are balanced upon presentation of invoices (Minnetti et. al., 2016, p. 52).

These funds could be used to finance:

- the creation of new businesses or the expansion of existing ones;
- access to investment capital for enterprises (notably SMEs) in order to modernise and diversify their activities, develop new products, ensure and expand market access;
- business-oriented research and development, technology transfer, innovation and entrepreneurship;
- the technological modernisation of production structures in order to meet the objectives of low-carbon economies;
- productive investments that create and safeguard sustainable jobs.

The advantages of JEREMIE were:

- competence: It allowed the managing authorities of the Structural Funds to benefit from EIF's expertise in form of capacity building initiatives, thus enhancing the effectiveness of the investment in business;
- flexibility: Both in terms of structures and in the allocation of funds that could be provided in the form of equity, debt securities or guarantees, according to the specific needs of different countries and regions;
- leverage: It could engage other potential financial partners by combining Structural Funds with other complementary sources of funding, increasing the resources that could be used to provide assistance to a wider range of projects;
- partnership: The Commission, acted as an important catalyst for cooperation between countries, regions, EIF, EIB and other banks and investors to improve access to finance for businesses, especially SMEs;
- sustainability: financial engineering instruments were based on the provision of repayable assistance from structural funds to investments that should generate returns and thus repay investors. (EIF, 2012a).

JEREMIE was aimed at financial intermediaries and did not provide direct contributions to SMEs. Under JEREMIE, the Member States and regions had the possibility to place part of their EU-allocated structural funds in a dedicated 'Holding Fund' which acted as 'fund of funds'.

The Holding Fund was governed by an Investment Board and could either be managed directly by the EIF or by national institutions selected through public procurement. This was formalised through a 'Funding Agreement' between the managing authority and the selected Holding Fund. The Holding Fund provided selected Financial Intermediaries with financial instruments focused on SMEs, such as guarantees, co- and counter-guarantees, equity guarantees, micro-loans, securitisations, venture capital financing, business angels and investments in technology transfer funds (ibid.)

The Financial Intermediaries provided then loans and equity participation to SMEs (the final beneficiaries). JEREMIE also foresaw a selected use of grants to build and maintain infrastructures that facilitate access to finance, e.g. technology transfer offices, incubators, business angels networks and investment readiness programmes. Finally, JEREMIE provided also technical assistance (EIF, 2006).

Box 4 Case story: Finlombarda (Lombardy, Italy)

Finlombarda, the financial arm of the Lombardy region, ran a JEREMIE programme that was believed to be unique in that it supported the expansion of co-operatives by bolstering their capital.

In 2008, Finlombarda, gathered €20m of ESF funding with €20m funds from banks chosen by public procurement. It used this €40m pot to make fixed loans of €4,000 to individuals, for investment in the shares of their co-operative. If the borrower stayed in the co-operative for five years, half of this sum was converted into a grant and written off. The other half was repaid to the participating bank, at an interest rate of 2.65%. The scheme was set up as a response to the diagnosis that co-operatives and especially social co-operatives are excluded from the credit market – a fact that was aggravated by the financial crisis.

The scheme has made 4,000 loans and given a significant boost to the capitalisation of co-operatives in Lombardy, enabling them to create more jobs and provide more services. Finlombarda's spokesman Paolo Zaggia in his presentation at COPIE Access to Finance peer review, WeiberWirtschaft, Berlin, 7 Oct 11, reported that there were about 600 co-operatives in Lombardy and Finlombarda had reached around 400 of them.

The scheme applied to new and existing members of existing (but not new) co-operatives. Both types of social co-operatives were eligible, as well as worker co-operatives where at least 30% of the workforce was disadvantaged. The number of borrowers from any given co-operative was limited to 20, to avoid infringing European state aid rules. The banks who acted as intermediaries were Banca Etica, Banca Popolare di Bergamo and Banco Popolare di Sondrio.

Source: Johnson, 2011b; Maas & Lämmermann, 2012

EGF

The European Globalisation Adjustment Fund (EGF) was established in December 2006 with EC Regulation 1927/2006, became operational in January 2007 and it was renewed in 2013 for the period 2014 to 2020.

It was conceived to show solidarity with workers who had lost their jobs in large scale redundancies resulting from changes in global trade patterns due to globalisation and demonstrated in particular by a substantial increase in imports into the Union, a serious shift in Union trade in goods or services, a rapid decline of the Union market share in a given sector, or a delocalisation of activities to third countries. In June 2009 changes to the EGF had the effect of broadening the eligibility criteria to include redundancies resulting from the global financial and economic crisis. These 'crisis derogations' ended on by the end of 2011 (EC, 2015).

EGF co-financed active labour market policy measures projects including measures such as help with job search; careers advice; outplacement; education, training and up-skilling; mentoring and coaching and *entrepreneurship support*. This last area was particularly interesting for the possible synergies with microfinance schemes.

The fund paid 60% of the total cost and the rest was paid by Member States, Regions, local authorities or local funds. The eligibility threshold for EGF applications was 500 redundant workers over a 4-month period (over a 9-month period, in SMEs; the maximum funding period was 24 months). Passive social protection measures, such as unemployment benefits or early retirement pensions were not eligible. With the new EC Regulation 1309/2013, greater emphasis was put on measures which focused on active labour market policies and support for entrepreneurship. The regulation also sought to ease administrative burdens and speed up decision making processes.

An evaluation stated that between 2007 and 2014, 134 applications were received from 20 Member States, concerning 45 sectors (most commonly the automotive, textiles, machinery and equipment, printing industry). Some 122,000 redundant workers were targeted and some €560m were requested. France requested the highest amount (€84m targeting more than 15,000 workers) followed by Ireland and Denmark (EU, 2015).

EPMF

The *European Progress Microfinance Facility* (EPMF, commonly called *Progress Microfinance*), launched in 2010, was a microfinance initiative, managed by EIF (specific financial instruments) and the European Commission (overall implementation), without the participation of national and local authorities. It was conceived in the aftermath of the 2007 global financial crisis as a response to the worsening credit market in the European Union, and to contribute to the goals of the Europe 2020 Strategy on growth and jobs.

Progress Microfinance aimed at supporting eligible intermediaries to enhance their capacity to provide microloans and guarantees to micro-entrepreneurs – who in turn would extend credit to individuals or enterprises – through the following financial products:

- loans and equity investments;
- long-term loans (Senior Loans) financing 5-7 years;
- subordinated loans to long-term creditors, usually aimed at increasing the capital structure of intermediaries;
- risk-sharing loans, i.e. long-term loans combined with risk-sharing in micro-credit provided by intermediaries;
- equity participations: Investments through ordinary or preferred shares, typically with a time horizon of 6-8 years;
- micro-credit direct or counter-guarantees.

The funds available, allocated half from the European Commission and half from the European Investment Bank (EIB), amounted to €200m, and were fully deployed.

Progress Microfinance did not directly finance entrepreneurs but allowed selected EU microcredit intermediaries to increase the volume of loans by issuing guarantees to cover the risk of possible losses and by making additional funds available for microfinance. Microcredit intermediaries could be private or public banks, non-bank microfinance institutions and non-profit microcredit providers. They could establish independently their lending conditions – amount, duration, interest rate and fees, and lending process. This facility could not be used to cover credit lines such as overdrafts or short-term revolving financing.

Among the MFIs that have benefitted from the fund, we can mention the Belgian *Coopest, Crédal* and *microStart*, the Bulgarian *JOBS MFI* and *Mikrofond AD*, the Cypriot *Central Cooperative Bank*, the French *Créa-Sol*, the Greek *Pancretan Cooperative Bank Ltd (PCB)*, the Lithuanian *Šiaulių bankas*, the Dutch *Qredits*, the Polish *FM Bank* and

Inicjatywa Mikro, the Portuguese *Millenium bcp SA*, the Romanian *Bank Transylvania, FAER IFN S.A.* and *Patria Credit*, and the Spanish *Instituto de Crédito y Finanzas Región de Murcia (ICREF)*.

According to an external evaluation, the number of credit intermediaries involved in EPMF grew to 60 providers in May 2015, covering 22 of the 28 EU Member States, and by September 2013 disbursed 13,252 microloans with an overall value of €124.6m (with the most recent estimates of the European Commission further increasing these figures to 31,000 final recipients and €270m). Progress Microfinance effectively allowed a growing number of persons and micro-enterprises to invest or develop their small businesses, although the reach-out to vulnerable groups was not as successful as planned. The finding of the external evaluation was that in the relevant economic environment, financial exclusion was a problem for a broad, heterogeneous group of microenterprises and not restricted to specific vulnerable groups (Attström K. et al. 2015; Tymowski, 2015).

Box 5 Case story: FdP (Flanders, Belgium)

Karen is a young lady from Antwerp, Belgium. She graduated as a jeweller and goldsmith but could not find the job she was looking for. While working in a coffee shop to make a living, she started to attend evening classes to become a chocolate confectioner.
In 2007, Karen could turn her dream of opening her own chocolate boutique into reality when the Belgian financial intermediary FdP (Fonds de Participation/Participatiefonds) extended her a Progress microfinance microloan of €12 000.
Karen is still in business today and stands as a model for other young people who wish to become self-employed.

Source: EIF, 2015

JASMINE

In synergy with EPMF, this pilot project was jointly launched by the European Commission and the European Investment Bank (EIB) in 2009 and lasted three years, until 2011[20]. It provided selected MFIs with technical assistance with the aim of improving the quality standards in running their businesses, with the long-term ambition of becoming reliable partners of commercial banks and attract more funding.

The technical assistance services included:

- an institutional assessment conducted by the rating agencies Microfinanza Rating and Planet Rating;
- tailored training in the areas deemed worth an improvement, such as governance, IT systems, risk management and strategic planning (capacity building).

In addition, JASMINE provided the entire EU microcredit sector with business development tools such as:

- the European Code of Good Conduct (CoGC) for Microcredit Provision;
- a JASMINE Helpdesk;
- specialised microcredit workshops;
- JASMINE OnLine, a web-based application.

Among the microcredit providers chosen to run the project were "the British *Prince's Youth Scottish Business Trust (PSYBT)*, the Bulgarian *Ustoi. Nachalamikrofond*, the French CRÉASOL, the Hungarian Primom, *Mikrohitel and Fejér Enterprise Agency*, the Italian *PERMICRO, Fondazione Risorsa Donna, BCC Mediocrati*, the Romanian *Foundation for the Agricultural Promotion of Regional Development (FAER), Opportunity Microcredit Romania (OMRO), Express Finance, Lam,* and the Spanish *C'PAC2.*" (EC, 2011; EC, 2013).

During the period 2008 to 2012 covered by an evaluation performed in 2013 (EC, 2013), the following outputs emerged:

- expenditure amounted to €4.3 m.;
- technical assistance was given to 48 microfinance providers across Europe;

[20] The foundation of JASMINE lay in an EC communication (EC, 2007a) that highlighted four priorities of action to improve the role of microcredit in Europe: addressing the regulatory framework, encouraging entrepreneurship, promoting good practice and providing funding for MFIs. The last two were expressly addressed by JASMINE.

- delivery of some 572.5 training days;
- participation of 495 microcredit stakeholders (practitioners, investors, policy makers, academia, etc.) in 17 workshops (EC, 2013, p. IV).

The evaluation concluded that JASMINE Technical Assistance Pilot Phase had met its objective of contributing to the development of the European microcredit sector by improving the standards of productivity, professionalism, efficiency, transparency and good governance of MFIs. (EC, 2013).

Along with JASMINE, in 2011 the European Commission issued the *Code of Good Conduct*, a self-regulation instrument developed by industry experts, serving also as a quality label.

The purpose of the Code is not to introduce or replace existing regulations of microcredit providers, but to set common standards in five areas: customer and investor relations; governance; common reporting standards; management information systems; risk management. The Code is an important element to promote best practices within the sector, enabling them to attract funding from private investors (EC, 2017).

Following the changing market reality and reflecting the wide diversity of the institutions in the microfinance sector, in November 2019 the European Commission issued an updated version of the Code due to come into force in 2021. (EC, 2020).

CIP

The financial instruments of the *Competitiveness and Innovation (Framework) Programme* (CIP), the MAP successor, started in 2007 and covered the period 2007-2013 for an overall budgetary amount of €3,621bn.

The programme, run jointly by the European Commission (DG ENT) and EIF, was established primarily to bridge financial market gaps SMEs are confronted with, offering several financial schemes in form of access to loans and equity aimed at fostering competitiveness and innovation. In particular, CIP aimed to promote the competitiveness of SMEs through all forms of innovation, especially 'eco-innovation'; give momentum to the ICT sector by accelerating the development of a sustainable, innovative, inclusive and sustainable information society; enhance the energy efficiency by exploring renewable energy sources in all sectors, including transport (EC, 2005b).

In operational terms, CIP was split in three pillars:

- the Entrepreneurship and Innovation Programme (EIP): accounting for 60% of the implementation, about 1/5 thereof for the promotion of environmental innovation;
- the Information Communication Technologies Policy Support Programme (ICT-PSP): 20% of the budget;
- the Intelligent Energy – Europe programme (IEE): 20% of the budget (EC, 2005b).

CIP was complementary to the 7th Framework Programme for Research and Technological Development, helping to bridge the gap between research and innovation.

Depending on the stage of development of the SME (start-up or expansion phase) and its particular financial needs, the CIP provided two types of financial instruments:

- Equity financing: High Growth and Innovative SME Facility (GIF)
- Guarantees: The SME guarantee facility (SMEG)

The CIP SMEG provided four 'windows', one thereof specifically dedicated to microcredit:

a) Loan guarantees: Guarantees for loans to SMEs with growth potential;
b) **Microcredit Guarantees**: Guarantees for loans of up to €25,000 to micro enterprises with up to nine employees, mainly for start-ups (see below);
c) Equity and quasi-equity guarantees: guarantees to existing capital guarantee schemes and mezzanine finance providers to support investments in enterprises

with more than 249 employees;

d) Securitisations: guarantees to support securitisation structures, to assist financial intermediaries in mobilising debt finance for SMEs (EC, 2005b).

b) CIP SMEG: the guarantee window for microcredit

By reducing the banks' exposure to risk, SMEG provided loan guarantees to encourage them to make more debt finance available to SMEs, including microcredit and mezzanine finance. CIP SMEG provided co-, counter- and direct guarantees to financial intermediaries providing SMEs with loans, mezzanine finance and equity.

According to a final report by EIF, the CIP SMEG facility produced 69 contracts signed, covering 23 countries, for a total (counter-) guarantee amount of €507.2m, providing €21,231.5m of financing to SMEs. It enabled the support of 389,988 SMEs and the creation of 1,359,142 jobs (EIF, 2018).

According to an audit of the European Parliament (EP 2012), some aspects of the CIP SMEG facility could have been object of improvement, namely:

- the application process was too slow: The average period from the receipt of the CIP application from an intermediary up to the signature of the agreement was nearly eleven months. Such a long time frame was considered unreasonable.
- EIF exercised a high level of discretion in evaluating the applications as no scoring standards had been set, and the selection criteria lacked precision. Also, the EIF's documentation relating to the setting of the agreement parameters proved to be weak.
- as regards achievements of the SMEG facility, findings suggest that although the loan sample included some very innovative investments, only 22 loans (12%) financed projects that had any innovative aspects, and only half of them were assessed as market or world-new types of innovation (EP, 2012)

Here are a few examples of businesses which have benefited from guarantees and equity participations under the CIP scheme in the period 2007–2013 (boxes 6-7-8). They encompass different businesses, locations, sizes and financing needs. What they had in common was, however, the need for assistance in obtaining finance to grow and create jobs.

Box 6 Case story: First Step (Ireland)

In Dublin, Almaz had been contacting banks for almost six months looking for a loan for his start-up in the catering sector, to no avail. All banks were unwilling to lend him any money to start up his business Then he was introduced to the microfinance provider First-Step Microfinance. In 2009, thanks to CIP SMEG, First-Step could extend him a loan worth € 20,000 to start his own 'Happy Foods' business.

Almaz wanted to provide healthy eating in schools, so he set a team to help him supply food to more educational institutions and create additional jobs in the catering sector. So far his business has enjoyed huge success and support from students and parents. Healthy, plant-based lunches and snacks provided in the school are tasty and cool to teenagers whilst at the same time maintaining a healthy food content. Reportedly, teachers said that his business made a significant difference to the teaching environment.

Source: EIF, 2012

Box 7 Case story: Microbank (Catalonia, Spain)

In Sant Esteve de Palautordera (Barcelona), dance teacher Núria received an initial micro-credit contribution of EUR 25,000 from the Spanish microlender MicroBank. This loan was used to refurbish the premises and in July 2007 she opened her dance school, which is open for all ages and offers various genres, including flamenco.

Initially, Núria started off with six employees and 20 pupils but was soon able to exapnd to 60 pupils.

Source: EIF, 2012

Box 8 Case story: KfW (Sachsen-Anhalt, Germany)

Manuela enrolled at an academic course in speech therapy borrowing a student's loan. In order to repay her loan, she was bent on starting a business, but commercial banks were not interested to support her. At some point, she had a chance to meet the German lender KfW (Kreditanstalt für Wiederaufbau) that agreed to lend her €25,000 necessary to set up her speech therapy clinic. The demand for speech therapy services was very high and she expected to recruit more staff in the next few years.

The speech therapy clinic in Thale, Sachsen-Anhalt catered for all ages: Children and teenagers who have problems with pronunciation, grammar and stammering; slow learners and children with disabilities; adults with speaking and reading difficulties or who need rehabilitation programs after suffering from brain injuries following illnesses and accidents.

Source: EIF, 2012

EU/ACP Microfinance Programme

Although the EU/ACP microfinance programmes were not implemented in Europe, we think that they contributed to the consolidation of a micro-financial know-how among European and no-European practitioners, so they are worth mentioning.

The EU-ACP States[21] cooperation goes back to the Treaty of Rome (1957) which gave a special status to 31 *overseas collectivities and territories* (OCTs) situated in areas that were former European colonies and established a *European Development Fund* (EDF) to grant technical and financial assistance. Its budget is untied from to the European budget and is provided by voluntary donations of EU Member States.

The first agreement was signed in Yaoundé in 1969, followed by the Lomé Agreement in 1975 and the Cotonou Agreement of 2000, which aimed at a sustainable development and the eradication of poverty in line with the Millennium Development Goals (MDG).

Since 2005, thanks to the 9th and 10th EDF, the EU and the ACP States have implemented the EU/ACP Microfinance Programme, exclusively dedicated to microfinance, which straddles between EU programming periods: The EU/ACP I Microfinance Programme (2005-2010) and the EU/ACP II Microfinance Programme (2010-2014).

The EU/ACP I Microfinance programme deployed a total of €15m from the 9th European Development Fund over a five-year timeframe (2005-2010). It was rolled out when the socio-economic picture was veering considerably, due to the 2009 crisis and the 'growth' crisis of microfinance. The programme focused on heightening the capacity building of the microfinance actors in ACP countries. In particular, the programme aimed at strengthening the capacity building of local MFIs, support rating and information systems, enhance efficiency and transparency. Among the achievements, there was an 150% increase in people served by 40 MFIs partners in 50 countries (over 775,000 clients), over 500 MFI staff trained, 53 scholarship for the Microfinance Boulder Training, 90 MFIs rated, 20 MFIs received IT advice and 11 African countries and Central banks received technical assistance on their regulatory and legal framework (ACP/EU, 2011).

The EU/ACP II Microfinance Programme was a four-year programme (January 2010 – December 2014) run by DG DEV and Europeaid with a budget of €15m. allocated by

[21] The ACP Group of States comprises 79 countries with 800 million people on three continents. Roughly speaking, it can be understood as sub-Saharan Africa, some countries bordering the Caribbean Sea and archipelagos of the Pacific Ocean. The latter two groups include almost all the British and French overseas territories or departments; with a population of about 800,000 people, only one in five families has access to financial services

the 10^{th} EDF.

Much like the first edition, the overall objective of the programme was to increase capacity building and good practice dissemination across the ACP regions. In particular, the programme aimed to achieve access to financial services through new business models aimed at the poorest of the poor and vulnerable communities; strengthening the consumer empowerment of ACP microfinance clients (*consumer empowerment*) and the training of microfinance institutions (*capacity building*) by improving the level of transparency of their financial and social performance.

As was already the case with the first programme, to achieve its objectives ACP/EU Microfinance supported the actions of various international organisations. At global level EU/ACP Microfinance supported:

- the efficiency and transparency of local markets, in partnership with CGAP;
- the training of politicians in ACP countries (Boulder Microfinance Training) and microfinance operators (Making Finance Work) through a partnership with the International Training Centre of the International Labour Organization (ITC ILO).

At regional level, the programme supported:

- the MSME Investment Fund for Sub-Saharan Africa (REGMIFA), through a partnership with KfW;
- the Carib-Cap programme for microfinance development in the Caribbean, together with the Inter-American Development Bank (IADB);
- the Pacific Financial Inclusion Programme in Oceania, with UNDP and UNCDF.

According to an evaluation carried out in 2012, the EU/ACP Microfinance Programme clearly contributed to progress in the ACP microfinance sector, in terms of building capacities of microfinance institutions and strengthening the knowledge and practices of the overall microfinance community. However, the long-run sustainability was put in question for some programme results especially for 2nd tier MFIs. The Programme had a certain level of impact on end-clients' use of a broader range of products or services, but available information did not allow to have a full view on this, owing to lack of monitoring data or to the rather indirect link between certain actions and the overall objectives (EU, 2012).

EFSE

The EFSE (European Fund for Southeast Europe) Development Facility was launched in 2006 with the target of promoting the development the Southeast Europe and the European eastern neighbourhood regions (shown in Fig. 4.1) by means of supporting SMEs and entrepreneurship initiatives, such as the EFSE Entrepreneurship Academy (EFSE).

The fund is still running and its intervention consists in supplying capital to local intermediaries, such as banks, MFIs, and NBFIs (e.g.: leasing firms), which in turn on-lend it to local SMEs. Furthermore, the facility provides technical assistance, training, and other non-financial support to institutions to enhance the overall impact (ibid.).

The EFSE Development Facility is supported by contributions from donors such as EIF, the German Federal Ministry for Economic Cooperation and Development (ibid.).

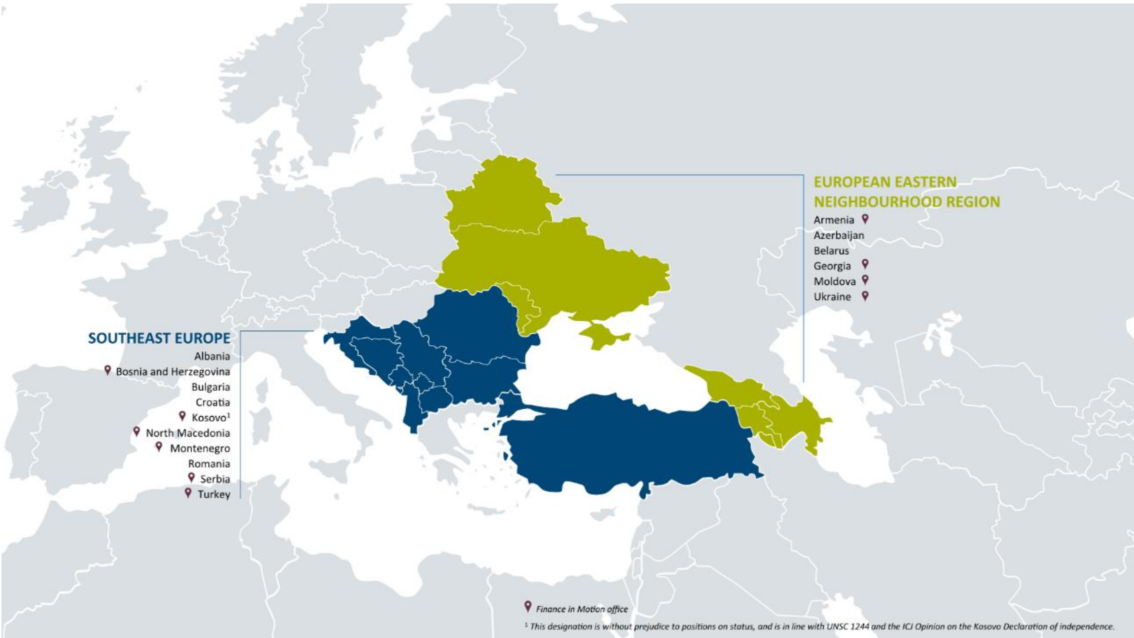

Figure 4.1 EFSE's target region
Source: EFSE

The accomplishment key figures since the inception of the Development Facility in 2006 are as follows: 523 projects; total project volume of €32.1m; 148 institutions served; 28,516 direct beneficiaries of technical assistance (ibid.).

EPPA

The aim of the *European Parliament Preparatory Action* (EPPA) was to foster the development of microcredit in Europe on a sustainable basis, complementing Progress Microfinance and JASMINE technical assistance programmes.

The €4m budget of the programme was used to provide seed funding and other financial support to selected EU non-bank MFIs focusing on social cohesion. The aim was helping them reaching a meaningful size and scalability in their operations, and indirectly improving access to finance for non-bankable customers.

On 1st February 2011 EIF and the Italian MFI PerMicro signed the first agreement under the European Parliament Preparatory Action (EPPA), marking EIF's first direct equity investment into an MFI. In fact, EIF invested €1m in the acquisition of 20.4% of PerMicro's shares. It was expected that this investment would have attracted further resources amounting up to a total of €3m made available in support of micro-entrepreneurs in Italy (EIF & PerMicro, 2011).

The programming period 2014-2020

In the timeframe 2014-2020, over half of the EU funding was channelled through the five *European Structural and Investment Funds* (ESIF), jointly managed by the European Commission and the Member States. The purpose of all these funds was to invest in job creation and a sustainable and healthy European economy and environment.

The ESIF mainly focused on five areas: research and innovation; digital technologies; supporting the low-carbon economy; sustainable management of natural resources; and small businesses.

In line with the objectives of the *Europe 2020 Strategy*, five main funds worked together to support economic development across all EU countries:

- European Regional Development Fund (ERDF);
- European Social Fund (ESF);
- Cohesion Fund (CF);
- European Agricultural Fund for Rural Development (EAFRD);
- European Maritime and Fisheries Fund (EMFF).

Every EU region could benefit from the ERDF and ESF while only the less developed regions could receive support from the Cohesion Fund.

The two main programmes targeting microfinance were the EU Programme for Employment and Social Innovation (Easi) and the European Social Fund (ESF).

EaSI

Self-employment had an important role in the *Europe 2020 Strategy*, with its three key pillars: *smart, sustainable and inclusive growth*. All member states were expected to remove measures that hamper or even hamstring self-employment.

For the said programming period, the European Commission devised the *Employment and Social Innovation* (EaSI) programme, a financing instrument to promote a high level of quality and sustainable employment, guaranteeing adequate social protection, combating social exclusion and poverty and improving working conditions.

EaSI was designed as a successor to JASMINE and EPMF and was managed directly by the European Commission (DG Employment, Social Affairs & Inclusion) with a budget of €919,469,000. It unified three EU programmes managed separately in the programming period 2007-2013: PROGRESS, EURES and Progress Microfinance. As of

January 2014, these programmes formed the three axes of EaSI:

- PROGRESS axis: Supporting the modernisation of employment and social policies;
- EURES axis: Job mobility;
- **the Microfinance and Social Entrepreneurship (MF/SE) axis**: Access to micro-finance and social entrepreneurship.

The declared objectives of the programme were the following:

- strengthen the coordination of action at EU and national level in the areas of employment, social affairs and inclusion;
- support the development of labour market policies and social protection systems;
- modernise EU legislation and ensure its effective application;
- develop an open labour market with the aim of promoting geographical mobility and boost employment opportunities;
- increase the availability and accessibility of microfinance for vulnerable groups and micro-enterprises and social enterprises.

In pursuing these objectives, EaSI paid particular attention to vulnerable groups (i.e. young people).

The EaSI Technical Assistance was implemented on behalf of the European Commission by the following subjects:

- Frankfurt School of Finance & Management, leading the partnership with the Microfinance Centre (MFC) and the European Microfinance Network (EMN) to offer technical assistance to MFIs and disseminate best practices.
- MicroFinanza Rating, providing rating or assessments to microfinance institutions and evaluating their compliance with the European Code of Good Conduct for Microcredit Provision[22] (EC, 2018e).

Under EaSI, the European Commission made the following financial instruments available:

- *EaSI Guarantee Instrument*: to increase access to finance for social enterprises, micro-enterprises and vulnerable groups with €96m initially earmarked, and final amount of €400m;
- *EaSI Capacity Building*: €16m were earmarked for the objective of building up

[22] Signing up or endorsing the Code, was a prerequisite for microfinance institutions and banks to benefit from the access to the EaSI financial instruments or EaSI Technical Assistance services.

the institutional capacity of selected financial intermediaries that had not yet reached sustainability or were in need of risk capital to sustain their growth and development.

- *EaSI Technical Assistance*: services, offered free of charge, to help MFIs prepare themselves to comply with the Code of Good Conduct and to build capacity;
- *Easi BDS Pilot for refugees and migrants*: €1m of EaSI resources were later made available to financial intermediaries (MFIs) implementing programmes to increase the financial inclusion of refugees and migrants. The objective was to provide partial coverage for business development services (BDS) costs incurred by intermediaries to serve this target group.

For microfinance, structural funds could subsidise the provision of BDS such as coaching and mentoring. Despite the importance and growing recognition of self-employment, microbusiness and microcredit at the EU level, national ESF and ERDF bodies have only marginally taken up these issues in their operational programmes. The platform Fi-compass[23] published a factsheet to support Managing Authorities link microfinance financial instruments with structural funds (Adie et al., 2019; EU, 2020).

Box 9 Case story: Neapolide Cooperativa Sociale (Campania, Italy)

In 2010, in Pozzuoli, near Naples, southern Italy, an Italian cooperative created a coffee roaster inside women's prisons, running the whole production line on a circular economy model (e.g. using recyclable plastic packaging, avoiding capsules, and recycling coffee waste to make fertilizer).
The project fostering social inclusion involved two vulnerable realities: Women in jail and small coffee producers – at the same time adding value to local traditions and helping to prepare offenders re-integrating into society. The brand 'Lazzarelle', meaning 'rascals' in Neapolitan dialect – was chosen by the inmates themselves.
As business throve, they wanted to add an external point of sale, winning a tender to open a bistro in a historical gallery between the National Archaeological Museum and the Academy of Fine Art. With the support of an EaSI Guarantee Financial Instrument (Social Entrepreneurship) loan from Banca Etica, the cooperative managed to set up a coffee bar, renovate the space and purchase the relevant machinery and furniture. The new bar, which opened in September 2018, created jobs for six women in prison plus three more external people.

Source: Euclid Network, 2019

[23] A platform for advisory services on financial instruments under the European Structural and Investment Funds (ESIF).

COSME

The *Competitiveness of Enterprises and Small and Medium-sized Enterprises* (COSME) was the EU programme for the Competitiveness of Enterprises and SMEs, running from 2014 to 2020, with a budget of €2.3bn. COSME supported SMEs in the following areas:

- *facilitating access to finance;*
- supporting internationalisation and access to markets;
- creating an environment favourable to competitiveness;
- *encouraging an entrepreneurial culture.*

COSME was a programme run by DG Internal Market, Industry, Entrepreneurship and was aimed at implementing the Small Business Act (SBA) which reflected once again the Commission's political will to recognise the central role of SMEs in the EU economy.

COSME backed the implementation of the Entrepreneurship 2020 Action Plan through a wide range of activities, categorised in nine Thematic Areas (TA): Access to finance; business management capacity services (EEN); digitisation and Key Enabling Technologies (KETs); entrepreneurship; Framework Conditions in the Single Market (FC); internationalisation; responsible innovation; sectoral competitiveness; and SME policy. COSME focused on digital entrepreneurship to help European businesses drive their digital transformation and fully benefit from the unprecedented new opportunities created in the digital era, which are crucial for their competitiveness and growth (Technopolis Group, 2017).

The programme included mobility exchanges, research, dissemination of best practices and pilot projects in areas such as entrepreneurship education, mentoring or the development support services for new and potential entrepreneurs, including young, women and senior entrepreneurs. As an example, *Erasmus for Young Entrepreneurs* was a cross-border exchange scheme which aimed to help new and aspiring entrepreneurs acquire relevant skills to run and grow a business by working abroad with a seasoned entrepreneur for up to six months. Some 2,000 young entrepreneurs increased thus their know-how and fostered cross-border transfer of knowledge and experience between entrepreneurs (Technopolis Group, 2017).

One of COSME's main objectives was to improve access to finance for SMEs in different phases of their life cycle: creation, expansion or business transfer. In order to achieve this goal, the EU mobilised loans and equity investments for SMEs through two facilities:

- the Loan Guarantee Facility (LGF) issued guarantees and counter-guarantees to financial institutions (e.g. guarantee societies, banks, leasing companies) to enhance their provision to SMEs of loans and lease finance up to €150,000. The budget in 2014-16 amounted to €375.5m, i.e. 43% of the total budget;
- the Equity Facility for Growth (EFG), supplied venture capital to equity funds investing in SMEs' growth. The budget pledged amounted to €172.9m (20% of the budget).

The Access to Finance strand absorbed the highest share of the 2014-2016 budget (€551.4m or 63% of the total budget) (Technopolis Group, 2017).

Box 10 Case story: Social Entrepreneurs Exchange Development Plus (SEED Plus)

The Social Entrepreneurs Exchange Development Plus (SEED Plus) was part of the Erasmus for Young Entrepreneurs programme aimed at developing social enterprise in Europe by bringing together aspiring and experienced social entrepreneurs to learn from each other.
Set in the timeline 2017-2019, and with a budget of €867,000 (€734,000 from the European Commission), the programme provided funding for aspiring social entrepreneurs to spend 1 to 6 months in another European country collaborating with and job-shadowing an experienced social entrepreneur. For would-be entrepreneurs, this was a great opportunity to learn from the best and fine-tune their business case. For host entrepreneurs, the programme offered a unique chance to get a fresh perspective, gain access to international markets and help social enterprise grow in Europe.
Nine countries were involved: UK, France, Spain, Portugal, Greece, Bulgaria, Estonia, Germany, Croatia involving ten consortium partners from nine countries and producing more than 200 international exchanges for social entrepreneurs and NGO leaders.

Source: Euclid Network, 2019

What does the EU have in store?

The European Union policies planned for the programming period 2021-2027 will seek to implement the UN agenda of Sustainable Development Goals. In particular, as shown in table 4.1, the financial instruments for microfinance will address 9 of the 17 UN SDGs.

Table 4.1 SDGs connected to the policies targeting microfinance (2021-2027)

Topics	Final beneficiaries	1	2	4	5	7	8	10	13	17
Description of goal	–	End poverty in all its forms everywhere	End hunger, achieve food security and improved nutrition and promote sustainable agriculture	Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all	Achieve gender equality and empower all women and girls	Ensure access to affordable, reliable, sustainable and clean energy	Promote sustained, inclusive and sustainable growth, full and productive employment and decent work for all	Reduce inequalities	Take urgent action to combat climate change and its impacts	Strengthen the means of implementation and revitalise the global partnership for sustainable development
Financial instruments targeting microfinance	Micro-enterprises and vulnerable groups	✓	✓	✓	✓	✓	✓	✓	✓	✓
EU policy highlight (51)	na	European Pillar of Social Rights	Common Agricultural Policy	European Pillar of Social Rights	European Commission strategic engagement for gender equality 2016-2019	European Energy Union	Juncker Plan/EFSI	European Pillar of Social Rights/EU Cohesion Policy	EU Covenant of Mayors for Climate and Energy	EU External Investment Plan (EIP) and European Fund for Sustainable Development (EFSD)

Note: na = not applicable.

Source: EC (2020, p. 15)

Specifically, SGS will be highlighted in the relevant EU policies as follows: SDG 1 ('End poverty in all its forms everywhere'): European Pillar of Social Rights; SDG2 ('End hunger, achieve food security and improved nutrition and promote sustainable agriculture'): Common Agricultural Policy; SDG 4 ('Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all'): European Pillar of Social Rights; SDG 5 ('Achieve gender equality and empower all women and girls'): European Commission strategic engagement for gender equality 2016-2019; SDG 7 ('Ensure access to affordable, reliable, sustainable and clean energy') European Energy Union; SDG 8 ('Promote sustained, inclusive and sustainable growth, full and productive employment and decent work for all'): EFSI (Juncker Plan); SDG 10 ('Reduce inequalities'): European Pillar of Social Rights / EU Cohesion Policy; SDG 13 ('Take urgent action to combat climate change and its impacts'): EU Covenant of Mayors for Climate and Energy; SDG 17 ('Strengthen the means of implementation and revitalise the global partnership for sustainable development'): EU External Investment Plan (EIP) and European Fund for Sustainable Development (EFSD) (EC, 2020, p. 14).

For the programming period 2021-2027, the budget for funding microfinance initiatives is € 1.95bn (with € 7.39 bn available), targeting 700 thousand microenterprises and creating 1.3m new jobs. However, as the financing gap in 2019 was estimated at €12,9bn (plus €11.1bn for EU candidates countries), the difference between supply and unmet demand (€24bn) creates a sizable mismatch (EC, 2020, pp. 6-16).

4.1.2 Microfinance providers

The European microcredit sector is diverse with respect to institutional types disbursing microloans, organisational size and focus. This diversity is related to the peculiar regulatory environment present in each country.

In western Europe the sector has only started developing since the year 2000, although some initiatives had already been set up before that date. On the other hand, in eastern European countries microfinance have been in operation as private initiatives (often supported by international funders such as World Vision, Save the Children, etc.) since the early 1990s, after the fall of Communism, in an economic context characterised by an industrial sector in disarray and high unemployment rates (Maas & Lämmermann, 2012).

There are two main types of institutional forms of microfinance providers operating in Europe as a whole: Those with or without a banking licence.

Non-bank providers

MFI is an umbrella term that refers to any organisation that provides microfinance services. Non-bank providers engage in microfinance activities under different legal types, such as NGOs, NBFIs, credit unions/financial cooperatives, public funds, etc. NGOs, NBFIs, credit unions/financial cooperatives represent 88% of microfinance providers in Europe (Ruesta & Benaglio, 2020).

NGOs are generally not-for-profit organisations with a social mission such as foundations, charities, social purpose cooperatives, and religious institutions. Their primary aim is the social development of vulnerable people, by fighting social exclusion due to discrimination, unemployment or physical disability. Some NGOs are specialised in microfinance such as ADIE in France and ANDC in Portugal and they are inspired by international practice and integrate non-financial services; other NGOs focus on specific groups – examples are Mikrofinans Norge in Norway (targeting immigrants and women) or CDFIs (Community Development Financial Institutions) such as the British Fair Finance, Business Finance Solutions and the Norfolk based WEETU[24] (Women's Employment, Enterprise and Training Unit).[25]

NBFIs (Non-Bank Financial Institutions) are primarily for-profit institutions that

[24] Founded in 1987, closed in 2013.
[25] In the UK, NGOs that lend have a specific legal status as Community Development Finance Institutions (CDFI) (Maas & Lämmermann, 2012).

provide credit services similar to those of banks but generally target the lower end of the market. NBFIs are licensed under a separate category from banks, which in certain countries can correspond to a special regulation created for microcredit providers. They are particularly represented in eastern Europe – examples are Patria Credit and ROMCOM in Romania (Ruesta & Benaglio, 2020).

Credit unions/financial cooperatives are membership-based organisations that aim to encourage savings and use pooled funds to make loans to members. Widespread in rural Central Europe, credit unions are allowed to lend money exclusively to members, also for business purposes.

As for public funds, we can mention institutional support programmes such as FdP (Fonds de Participation/Participatiefonds) in Belgium and Invega in Lithuania, which are part of existing programmes of development banks (ADIE, 2019; Maas & Lämmermann, 2012; Molenaar & Lehmann, 2016).

In many European countries, non-bank financial institutions are allowed to operate. However, as they lack a banking license, they face some important restrictions to the provision of microcredit. The most important restriction is the prohibition from taking deposits, which means that they have to resort to *on-lending*, i.e. they must borrow capital to serve their clients. This partly explains why MFIs charge borrowers higher prices and struggle to become financially sustainable. Those who succeed in being financially sustainable (without relying on public subsidies) would often pass these costs on to customers (EC, 2020; ADIE, 2019).

These circumstances exert tension on the MFIs' social mission, forcing them to shape their economic model to fit their environment and clients. Sometimes MFIs may not be allowed to extend loans, in which case they would usually partner with a bank which delivers the loans. In this context, MFIs would add value through marketing and Business Development Services (BDS). Non-bank MFIs often rely on public support tools such as financial guarantees that cover part of their portfolio risk (ADIE, 2019).

The relationships between banks and non-banking MFIs can be diverse. In some countries, such as the Netherlands, banks created MFIs that serve the clients they cannot reach, in a complementarity relation. In other countries, the relationship is much weaker or absent. It is common for banks to partner with MFIs in the framework of their corporate social responsibility activities, partly subsidising MFIs' operations or supporting them with on-lending (ADIE, 2019; Maas & Lämmermann, 2012).

Bank providers

In general, banks operate microcredit activities as a small part of their overall operations. They run microcredit programmes on account of their corporate social responsibility (CSR) activities – as part of a philanthropical strategy to improve their reputation – or as a type of specialised commercial activity, often operated through finance companies.

In Europe, the main categories of bank models providing microcredit include:

- commercial banks with *downscaling* strategies or operating finance companies that provide microloans;
- development banks or funds owned by the state;
- ethical banks that focus on social and micro-enterprises, providing first or second-tier (wholesale) finance;
- microfinance providers transforming into banks;
- savings and cooperative banks (Cozarenco, 2015).

According to Rosengard (2004), "banks bring several competitive advantages to microfinance, as they are experienced in managing a number of financial risks, including interest rate, liquidity, maturity, foreign exchange, and credit risks." (Rosengard (2004). However, when banks practice the so-called *downscaling*, i.e. adapt their lending activities to smaller loan amounts without designing the financial product to reflect the social mission of financial inclusion the result does not always lead to serving excluded clients, to the extent that the wording ‘microcredit’ should be replaced by ‘small loans’ (ADIE, 2019). However, the downscaling process can also achieve profitability if performed well, as can be seen in the experiences of different countries. Examples of banks involved in commercialisation of microfinance are: Axa Group, Barclays, BNP Paribas, Citigroup, Commerzbank AG, Crédit Agricole, Deutsche Bank, ING Group, Morgan Stanley, Rabobank, Société Génerale, Standard Chartered, BBVA, Crédit Suisse, Grupo Santander, Caixabank, AIG, Allianz (Chretien et al., 2014).

Other types of banks worth mentioning include *ethical banks*, i.e. banks who have a strong social mission ingrained into their operations, incentivising their operations to maximise social good, such as Banca Popolare Etica in Italy, La Caixa’s Mikrobank in Spain, FM Bank in Poland; *savings and cooperative banks* which both take deposits and disburse small, mostly consumption loans, such as Crédal and Hefboom in Belgium and Nachala in Bulgaria. (ADIE, 2019; Maas & Lämmermann, 2012).

The following figure 4.2 illustrates the share of MFIs by institutional type, as per a survey conducted in 2018 (Diriker et al., 2018):

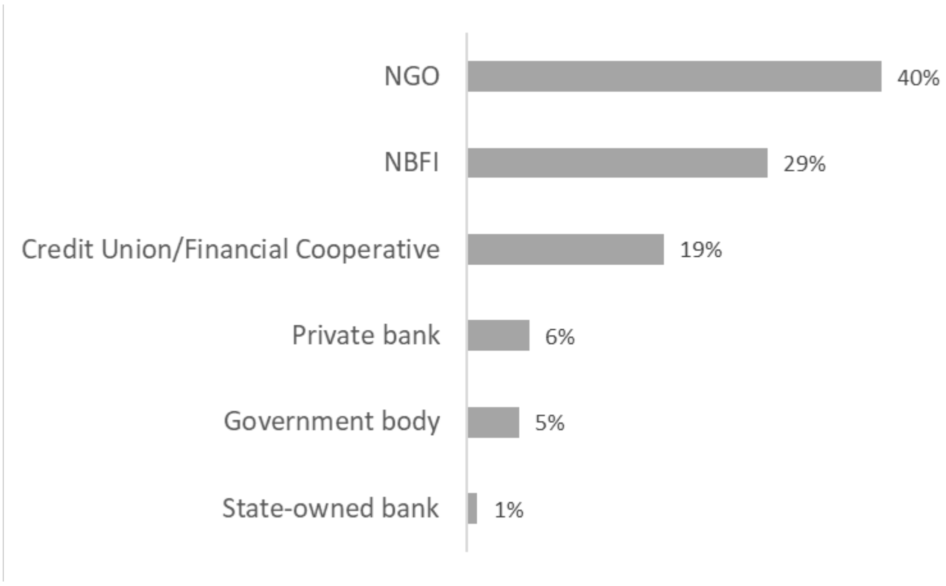

Figure 4.2 Share of MFIs by institutional type
Source: Diriker et al., 2018

Box 11 Case story: French ADIE's microinsurance programme

ADIE is a French not-for-profit organisation operating nationwide and specialised in granting loans and BDS to non-bankable people who want to start up an enterprise. Over the years ADIE has developed a partnership with local banks providing a loan guarantee and follow up to the micro-enterprise, while banks managed the loans, funded mainly from public institutions, such as the European Union, the French Government and regional authorities.

ADIE's microinsurance programme was developed in partnership with two insurers - AXA and MACIF, which merged in 2007 - involved in a co-insurance scheme. In mid-2013, after a four-year pilot, the microinsurance offer was extended nation-wide. ADIE introduced four insurance products to address its client's needs: Basic public and product liability, property with premises protection, property without premises protection and motor insurance. Microentrepreneurs could choose the products according to their specific needs and after three years they were integrated int the usual insurance contracts.

ADIE's microinsurance programme was innovative on several aspects: Partnership were developed with insurers to deliver services rather than providing only financial support; insurance services address clients exposure to recurrent risks; and introduced a new area of skills for MFI staffs at headquarters and branch level. An assessment on clients' needs was conducted through surveying 600 clients. The assessment found that there was a lack of awareness of professional risks, difficulties accessing an appropriate offer from insurance companies, and pricing-out due to high cost. As a result, insurance plans were adapted to address precisely ADIE's clients' needs.

Source: Lämmermann, 2010; EMN, 2016; Gautier, 2015.

4.1.3 Networks

Historically, in Europe two umbrella organisations co-exist to cater the need of microfinance actors and MFIs in particular: The European Microfinance Network (EMN) and the Microfinance Centre for Central and Eastern Europe and Newly Independent States (MFC). Both networks have a private nature, though receive funding from various organisations such as the European Commission, the EIF or IFC.

MFC was set up in Warsaw in 1997. By 2020 it served 113 member organisations[26] (including 77 MFIs) across 36 countries of Europe and Central Asia, who in turn deliver microfinance services to almost 2,000,000 low-income clients. MFC offers capacity building, financial education modules and campaigns, and assessment services.

EMN was set up in Paris in 2003 by its founding members ADIE (France), NEF (UK) and evers&jung (Germany), with the support of the European Commission and the French Caisse des Dépôts et Consignations (CDC). In 2011 it moved to Brussels, Belgium, where it is registered as an international non-profit organisation. It counts over 85 members, scattered all over Europe, but present mainly in its western part. Their mission is to advocate for transparency and good governance in the European microfinance sector, while developing capacity building, promoting best practices and fostering research within and beyond the membership.

Each year EMN holds an annual conference in a different country. In 2017 the 14th edition of the event was held in Venice, Italy and the thematic area was financial education. The main topic of discussion was about how financial education and financial literacy can help the microfinance sector rethink its products, giving priority to clients' needs and ensuring a high social impact. In addition, it was highlighted that transparency measures that keep clients informed and the organisation of financial education are two steps that should be embraced by the industry so that customers take responsible financial decisions and relevant risks.

At the above-mentioned event a declaration was drafted, the *Venice Declaration*, with the aim of promoting microfinance in Europe as an instrument for a safer and more sustainable community from a social and financial point of view. The idea behind the declaration was to produce a document that stated the common goals of the sector, in line with the UN Sustainable Development Goals (SGD): "SDG Goal 1: End poverty in all its forms;

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[26] MFC members include microfinance providers, such as Moldcredit (Moldova), Banca Etica (Italy), Mikro Kapital JSC (Russian Federation).

SDG Goal 8; Promote inclusive and sustainable economic growth employment and decent work for all; SDG Goal 10: Reduce inequalities". As regards tangible goals, according to the declaration: "Financial education programmes run by microfinance practitioners address mostly one or several of the following objectives: 1) consumer protection and awareness; 2) product uptake and improved product use; and/or 3) personal development for improved livelihoods." (EMN, 2017).

In addition to MFC and EMN, an honourable mention goes to the *European Microfinance Platform* (e-MFP), which is headquartered in Luxembourg and is focused on the financial inclusion in developing countries.

With over 130 members from all over the world and the most diverse specialisations, e-MFP promotes "activities which increase global access to affordable, quality, sustainable and inclusive financial services for the un(der)banked by driving knowledge-sharing, partnership development and innovation. The Platform achieves this through its diverse publications, numerous year-round expert Action Groups, the annual European Microfinance Week which attracts over 400 top stakeholders representing dozens of countries from the sector, the prestigious annual European Microfinance Award and many other activities." (European Microfinance Platform, 2021).

4.2 The environment

4.2.1 Mainstreaming microfinance

As we have been outlining so far, European microfinance displays a blend of unique features that set it apart from global microfinance. In fact, microfinance programmes are being run under different names in a complex environment by diverse actors and are aimed at segmented target groups. Therefore, to manage the challenges microfinance stakeholders have to face, a specific set of skills is necessary.

As an example, the Italian programme *Selfiemployment,* is a microcredit programme funded by the ESF and run since 2016 jointly by Invitalia, Ente Nazionale per il Microcredito (the Italian Agency for Microcredit) and ANPAL (a governmental agency that promotes full employment) which target NEETs'[27] ambition to become self-employed. The collateral- and interest-free loan up to €50,000 envisages the preparation of a business plan measuring the sustainability of the business idea chosen (see chapter 5.2).

Within the Selfiemployment microloan scheme, a dedicated 80-hour course 'Yes I Start Up' was launched with the aim of coaching potential entrepreneurs to prepare a business plan. Special skills were demanded from the teaching staff – well beyond a business formal education – to encompass psychological and social skills needed to deal with young people who often hail from difficult backgrounds (migrants, disabled or psychologically vulnerable people).

[27] NEETs = young people that are not employed and not involved in educational or training programmes.

The European Microfinance Programme and CERMI

With reference to MFIs, a few higher education institutions offer programmes devised at preparing professionals in the field of microfinance.

The European Microfnance Programme (EMP) is a Master's degree offered by the Solvay Brussels School, which is the economics department of Université Libre de Bruxelles. Launched in 2005, the programme has been designed by microfinance experts to offer European and non-European students a unique blend of theory and practice.

The theoretical foundation is taught by professors from three European universities in Belgium (Université libre de Bruxelles; Université de Mons) and France (Université Paris Dauphine) and includes subjects such as banking, financial management, public policies, rural development, and product design. Furthermore, there is plenty of opportunities to participate in seminars and conferences addressed to microfinance experts;

Practice involves a mandatory two to four months internship in a developing country for European students – to experience the daily reality of microfinance on the field – and a European country for overseas students. Practitioners from the NGO partners ADA, BRS, CERISE and SOS Faim provide insights into the latest techniques used by international microfinance institutions;

The goal of the programme is to develop future professionals in microfinance who will contribute to the strengthening of microfinance institutions worldwide, in accordance with the highest international standards. With about 70% of students coming from the South, 17 nationalities and experts from all parts of the world, the EMP is a particularly international Master's programme, which allows to create and keep new (professional) networks (EMP 2020; Battaggia, 2016a).

Solvay Brussels School also hosts the *Centre for European Research in Microfinance* (CERMi). Its mission is "to promote academic research in order to support the key stakeholders in the microfinance industry: NGOs, cooperatives, donors, investment funds and financial institutions, and to develop suitable frameworks to critically examine existing microfinance practices" (CERMi, 2020).

Other higher education institutions offering post-graduation programmes in microfinance are: Universidad Autónoma de Madrid (Spain) Agder University (Norway) and Bergamo University (Italy).

An initiative worth mentioning is 'University Meets Microfinance' (UMM), launched in 2009 by PlaNet Finance and Freie Universität Berlin and supported by the European

Union and other stakeholders. Its aim was to serve as a forum between academia, students and professionals around themes such as microfinance education and research (University Meets Microfinance).

COPIE

Working groups active in peer monitoring and dissemination of good practises have been very important for improving microfinance practices in Europe (Battaggia, 2017).

As an example, the *Community of Practice on Inclusive Entrepreneurship* (COPIE), was a learning network led by the German Federal Ministry of Labour and Social Affairs ESF unit focusing on the development of favourable conditions for the growth of self-employment and micro-enterprises, especially for marginalised groups. COPIE's partners included managing authorities from the Regions Asturia, the Czech Republic, ESF Agency Flanders, the German Microfinance Institute (DMI), the Spanish Ministry of Social Affairs, etc.

The goal of COPIE was to describe good practices and organise their exchange among EU Member States, to facilitate mutual learning and to transfer knowledge and experiences to other entrepreneurship support systems, in order to close existing gaps or simply to promote continuous improvement.

For the funding period November 2009 to March 2012, the COPIE partners selected five thematic groups:

- action planning;
- entrepreneurship education;
- quality management;
- integrated business support;
- access to finance.

The groups consisted of five to seven partners each and engaged in regional baseline studies in each of the five themes, held inclusive entrepreneurship workshops, conducted regional surveys and in-depth analysis and developed a toolkit for supporting inclusive entrepreneurship (COPIE, 2021).

4.2.2 Microcredit regulation in Europe[28]

The European microcredit sector is a recent phenomenon. In addition, it is a fragmented sector, due to the diversity of national regulatory frameworks which account for the wide array of institutions and lending models. (Lorenzi, 2016). Bringing into the picture microcredit regulation allows us to understand the playground where microcredit providers and policy makers operate.

As early as June 2003, CGAP published standard guidelines for the design and implementation of national legal frameworks for the regulation and supervision of microfinance (Christen et al., 2003).

However, since then the growth of customers as well as the range of products and services – including some that are not strictly financial – have implied a greater management complexity for MFIs and more risks for the financial system. In the light of the increased complexity, the most suitable scheme of regulation depends on the intensity of the goals that need to be achieved, including stability, efficiency, competitiveness, conduct of business and transparency (Vento, 2006b).

In the microfinance context, regulation is grouped into three types: *prudential*, *non-prudential* and *enabling*. Prudential regulation is aimed specifically at protecting the financial system in general and small deposits in particular, involving the government in overseeing the financial soundness of the regulated institutions. Non prudential regulation (e.g. the disclosure of effective interest rates) can be largely self-executed and accomplished under general commercial laws. The general principle is to avoid using burdensome prudential regulation for non-prudential purposes. The enabling regulation purpose is a positive one, i.e. allowing the entry of new institutions or new activities (Christen et al., 2003).

In the European Union there is not a common legislation covering the microfinance activities. In fact, the regulatory approach to microfinance differs across the Continent due to historical, cultural and economic factors that have shaped the development of financial systems (TrustLaw, 2011).

There is, however, a traditional definition of microcredit as loans up to €25,000. This definition has been the object of scrutiny revision proposals by many players of the sector (EMN/MFC, 2018) resulting in a recent definition in the ESF+ regulation where

[28] This chapter draws on Ruesta C., Benaglio N., (2021) *Microcredit Regulation in Europe: An Overview*, European Microfinance Network publication.

microcredit is meant as a combination of credit and accompanying business development services and the ceiling of € 25,000 has been removed (see chapter 1).

An element of continuity in this definition is the exclusion of personal microcredit in favour of income generating activities (business microcredit). However, as is known, personal microcredit covering family needs can have positive effects on financial inclusion and is offered by half of the MFIs in Europe (Ruesta & Benaglio, 2020, p.3).

In Europe, the main regulation concerning banking activity are the European banking legislation and national banking laws. According to the EU Banking law, a *credit institution* is defined as "an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account." (EP, 2013, p. 18). Therefore, a credit institution is regulated by the EU banking law if it is allowed to take deposits.

As for the national banking laws, Ruesta & Benaglio (2020) identify three cases:

- countries where a microcredit legislation exists: Albania, Bosnia and Hercegovina (BiH), Greece, France, Italy, Montenegro, Portugal, Romania;
- countries where there is no microcredit legislation yet non-bank institutions can extend loans: Belgium, Bulgaria, Finland, Hungary, Ireland, Luxemburg, Spain, Sweden, the Netherlands and UK;
- countries where there is no microcredit legislation and banks have a lending monopoly: Austria, Germany and Serbia (p. 5).

Table 4.2 Matrix on microcredit regulation in Europe

	Without banking monopoly for lending	**With banking monopoly for lending**
With microcredit regulation	Albania, BiH, France, Greece, Italy, Montenegro, Romania	Portugal
Without microcredit regulation	Belgium, Bulgaria, Finland, Hungary, Luxemburg, Spain, Sweden, The Netherlands, UK	Austria, Germany, Serbia

Source: Ruesta & Benaglio, 2021 (adapted)

In 2001, France was the first country to adopt a law on microcredit (Monetary and Financial Code, L. 511-6-5), followed by Bosnia and Hercegovina in 2006 (Law on microcredit no. 59/06). In 2009, Romania passed the law n. 93/2009 on non-bank financial institution (NBFI), followed in 2010 by Italy (Consolidated Law on Banking, Title V art. 111, 113) and Portugal (Legislative Decree no 12/2010). All these regulatory frameworks envisage the National Bank as supervisor (ibid., p. 7).

Among the countries that adopted a legislation on microcredit, Ruesta et al. (2020) highlight the different approach used: While in France, Italy, BiH and Portugal a distinct category of microcredit providers is introduced, in Romania and Montenegro such category is missing and microcredit is mentioned among the products that NBFIs can offer (ibid.).

As for the subjects entitled to disburse microloans, France restricts the right to not-for-profit organisations while Italy and BiH allow both for-profit and not-for-profit organisations to operate. In Portugal, despite favourable legislation, microloans are disbursed only by banks[29] (ibid., pp. 8-9).

With reference to the products offered, France Italy and Montenegro legislations define clearly business and personal microloans, with relevant specific conditions, while Portugal, Romania and BiH do not introduce any distinction and leave MFIs free to design their own offer (ibid., p. 9).

We will now consider three countries where legislation on microcredit has been implemented in time: France, Romania and Italy.

Legislation in France

In France, since 2001 non-bank MFIs are allowed to grant microloans thanks to a specific regulation on microcredit which distinguishes between personal and professional microcredit, each type with specific features. The relevant legislation is contained in the Monetary and Finance Code (CMF), where article L. 511-5 states that only credit institutions are allowed to disburse loans, however with a list of exceptions, including not-for-profit organisations which can grant loans up to €10,000 to certain categories of people i.e. the unemployed and beneficiaries of social minimums (FEBEA, 2010, p.35).

The French microfinance sector is supervised by the Central Bank which authorises non-profit organizations and recognized public-interest foundations to disburse microcredit. Associations and foundations must respect a few prudential ratios and fund loans from their own equity or debt from commercial banks. In particular, MFIs must respect

[29] Cfr. Afonso J., Battaggia S., (2014) on the microfinance environment in Portugal.

the following ratios:

- total equity must remain higher than 12% of outstanding microcredits that are not provisioned and have no guarantee; and,
- equity must include a reserve fund higher than 30% of the outstanding microloans that are not provisioned and have no guarantee (this ratio can be revised depending on historical default rates) (EMN, 2019a).

Microcredit provision for both personal and professional microcredits must be guaranteed. MFIs are required to produce a quarterly report on their activities, portfolio and an annual review of their financial situation. Although in France there is no national credit bureau, there is a 'negative data file' that non-bank lenders can access where clients with negative credit records are blacklisted (ibid.).

Legislation in Romania

Microfinance activities in Romania started in the early '90s, in a period of transition from a centralised economy to a market economy. By then, the first international MFIs with extensive experience in the sector, such as Opportunity International, Community Habitat Finance (CHF) and World Vision, launched their programmes aimed at supporting the development of the private sector through financing the establishment and further development of farms and micro and small enterprises in the country. During 2002-2006, the regulatory framework for the non-bank financial companies followed the fast pace of changes experienced by the sector mainly owing to the successful lobbying efforts of the non-bank financial services providers and international aid programmes, funders and investors (Doiciu & Bialus, 2010; Doiciu, 2019).

Since 2005, the Law no. 240/2005 regarding microfinancing commercial companies allows non-bank lenders to directly disburse loans to the public.

In 2009, the National Bank of Romania (NBR) enacted the law no. 93/ 2009 on non-bank financial activities, unifying the various legal frameworks regulating NBFIs, such as MFIs, leasing companies, mortgages companies, and consumer lenders and establishing a department within NBR for the specific regulation, supervision and registration of all NBFIs. Under the law, NBFIs are not allowed to collect savings from their clients. Furthermore, even though microcredit is explicitly mentioned in the law, MFIs do not enjoy any distinct status compared to the other financial institutions. Credit Unions (CUs) are regulated by laws 93/2009 and 122/1996, which determine their legal framework and functioning. Their supervision is provided by both NBR and the National Association of

Credit Unions (UNCAR) (EMN, 2019c).

As for the offer of products and services, NBFIs are allowed to disburse both business and personal microloans, as well as other financial products such as factoring, leasing and mortgages, without any limit in size or interest cap. CUs are only allowed to extend personal loans to their members (ibid.).

Legislation in Italy

In 2010, Italy was the third country in Europe to pass a specific regulation on microcredit after France and Romania.

The regulation on microcredit was introduced by Legislative Decree No 141 of 13 August 2010, which amended the Consolidated Banking Act (Legislative Decree No 385 of 1 September 1993 – T.U.B.) by including provisions on the microcredit sector in Articles 111 and 113.

In 2012, amendments were made by Legislative Decree no. 169 of 19 September 2012, after a public consultation aimed at making changes and additions to the initial regulatory proposal.

In 2014, the Ministerial Decree 176/2014 introduced the definition for microcredit activities and created a register of MFIs, managed by the Bank of Italy which acts as supervisor through mandatory reporting, due diligence, and the establishment of capital and liquidity requirements.

The Italian Banking Law allows MFIs and not-for-profit organisations to operate in the form of a specialised microcredit operators (Art. 111), which have a lower capital requirement than banks but need to comply with additional conditions in line with their microcredit offer. However, banks, NBFIs (for-profit organisations regulated under Article 106 of the banking law) and mutual financial operators (cooperatives with specific by-law conditions) can offer microloans, upon condition that they comply to the criteria of Art. 111. Although MFIs are not obliged to share client data with the credit bureau, however, they have access to it (EMN 2019b).

The Ministerial Decree 176/2014 (the implementing rule of Art. 111) defines the technical characteristics of business and personal microloans. The maximum amount for business microloans is €25,000 with a maximum term of seven years. In special cases, an additional €10,000 could supplement the first business microloan and the term could be extended to ten years. As for personal microloans the threshold is fixed at €10,000 with a maximum term of five years. Both types of microcredits must be accompanied with non-financial services (BDS) in form of technical assistance, tutoring and monitoring. (ibid.). Furthermore, the Decree defines the purposes and the beneficiaries for each type of microfinance, as well as the requirements for operators to be entered in the register pursuant to Article 111. Finally, according to Art. 16 of the Decree, mutual financial operators can disburse business loans up to €75,000 (Credito Solidale). As for the economic conditions, the interest rate cap for business microloans is set by the Italian anti-usury legislation while the interest rate cap for personal microloans is set according to Decree 17/10/2014 n. 176, which stipulates that the usury level is calculated as the difference between the interest rate cap and the average market annual percentage rate known as 'TAEG' (ibid.).

5 The Italian Way

5.1 Microfinance in Italy

A short history

As we have seen in the historical background (chapter 2), financial inclusion initiatives have been common in Italy since the Lower Middle Ages with the *Montes Pietatis*. In the 19th century those initiatives took on the form of structured institutions absorbed into the mainstream commercial providers, such as cooperatives and savings banks.

More recently, in the 1960s, credit consortia called Confidi[30] were created as an expression of trade associations in the industrial, commercial, craft and agricultural sectors, based on principles of mutuality and solidarity. The first credit consortia, or guarantee cooperatives, were set up as early as 1956 to facilitate access to credit for small businesses. In the 1970s, special financial networks were created: the Mutue di Auto Gestione (MAGs), i.e. self-managed mutual associations. The first MAG was set up in Verona, followed by others in northern Italy (Milan, Turin, Reggio Emilia, Venice, and so on). They are structured as cooperatives where capital is pooled and disbursed in form of collateral-free loans for certain scopes such as helping the under-banked, fighting social exclusion, promoting solidarity, youth education, etc. According to art. 6 of the Banking Consolidated Act, MAGs are not allowed to collect capital through savings and deposits, but only via membership of owners' equity (Di Castri, 2010, p. 67; Niccoli & Presbitero, 2010).

From the early 2000s until the financial crisis of 2007, the sector has witnessed the birth of a hundred initiatives, subsidised by public and private initiatives (often involving the intervention of the Catholic Church). These projects – of a small size and scale and often short-lived – disbursed a total amount of €75m, to almost 8,000 clients, with an average loan amount of €10,000 (ibid., p.61).

The period from the 2008 crisis onwards is marked by an intensified awareness of the importance of microcredit, given the combined phenomena of a worsened economic situation, the boom of the 'necessity self-employed' and the credit crunch. The main actors

[30] Short for 'Consorzi collettivi di garanzia dei fidi' [en: Collective credit guarantee consortia]

involved were the Standing Committee for Microcredit (from 2012 National Agency for Microcredit), the European Commission (see chapter 4.1.1.) and the Italian Microfinance Network 'RITMI' (acronym of Rete Italiana della Microfinanza, created in 2008). Among the first tasks that the Standing Committee took was the collection of data about the microcredit sector in Italy, the financing of a course of higher education in Microcredit operators at Bologna University (coordinated by prof. Luisa Brunori), the promotion of a legislative framework and nationwide networking events.

Poverty and financial exclusion in Italy

The demand for microcredit is directly correlated to the financial exclusion, which in turn is correlated with the degree of absolute and relative poverty. Absolute poverty represents the monetary value of a basket of goods and services considered essential for every family: If consumption equals or is lower than this value, a family is considered as absolute poor. Relative poverty is defined considering the average expense for consumption per person. If a family equals or is less then this value (€1,095 in 2018), it is considered poor. According to ISTAT, in Italy in 2018 over 1.8m families lived in absolute poverty, i.e. 5m people (6.4% of the total), 1.5m. thereof are foreigners (30,3% of the total). In the same year, 3m. families, i.e. 9m. people were in a condition of relative poverty. Severe material deprivation includes lack of fuel, inability to cope with an unexpected expense, not being able to afford a protein-based meal every two days or a washing machine or a car, being late in paying rent or bills, etc. Furthermore, material deprivation has been correlated to poor health conditions which results in marginalisation (cborgomeo&co, 2019, pp. 12-14; WHO, 2019).

We have dealt with financial exclusion in chapter 1 (conceptual background) and defined it as the inability or reluctance of certain people to access basic financial services. The period 2012-2016 has witnessed both a credit crunch and the demise of many bank counters, counterbalanced by an increase use of new technologies. Financial exclusion hits hardest the southern regions of Italy, people with lower education levels and those who have no access to the Internet (Schiona L., Messina A., 2018), cborgomeo&co, 2019).

The actors

According to the latest microcredit survey conducted by cborgomeo&co for the fiscal year 2018, some 139 organisations promoted microcredit initiatives serving 12,359 borrowers for a portfolio of €186m loans disbursed (cborgomeo&co, 2019).

The main actors in the Italian microfinance sectors are three: promoters, beneficiaries and financial providers.

Promoters are in charge of promoting the microcredit initiative but do not necessarily provide financial means directly. They often liaise with local entities such as associations of workers, migrants, and women, to allow proximity with clients. They can be either private or public, such as:

- Banks (e.g. Banca Popolare Etica with its network of 'flying officers'). Banks often enter the microfinance market as part of their social responsibility or for marketing purposes, but the involvement is limited if compared with their total portfolio;
- Bank foundations (e.g. Fondazione Cassa di Risparmio di Padova e Rovigo);
- Non-banking foundations;
- Associations (e.g. MAG);
- Religious entities (e.g. Caritas);
- Public entities and agencies (e.g. Invitalia).

According to the survey, the private sector (banking foundations) ranked first with 65 programmes, followed by banks (33), the public sector (21), and religious entities (20) (fig. 5.1) (ibid.).

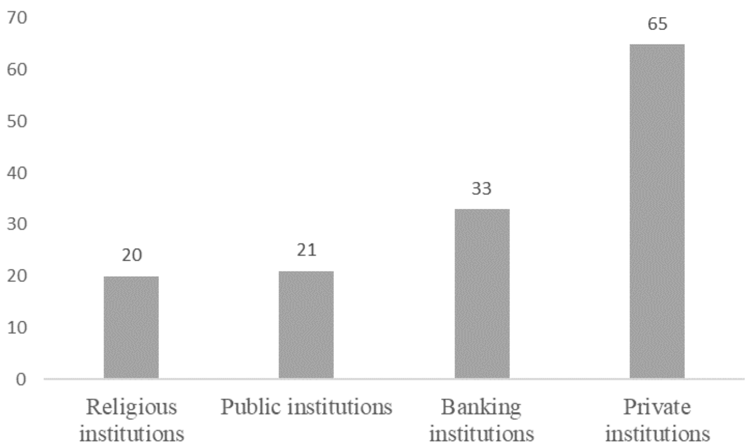


Figure 5.1 No. of programmes managed by type of promoter (N=139)
Source: cborgomeo&co, 2019.

Banking institutions serve the largest number of borrowers, followed by private, public and religious institutions (fig. 5.2) (ibid.).

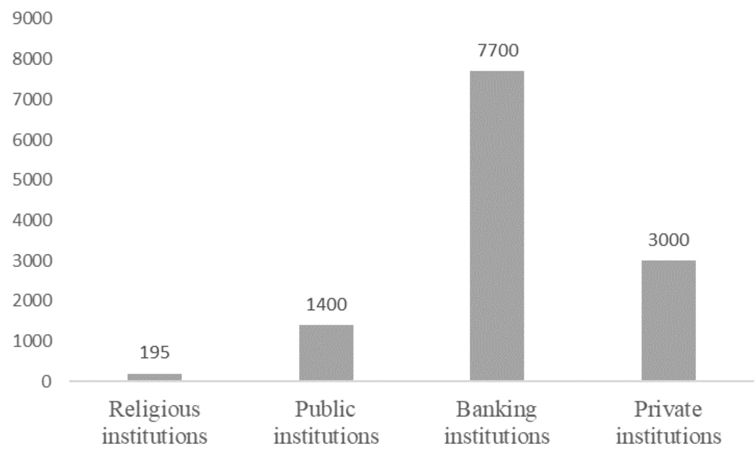


Figure 5.2 No. of borrowers by type of promoter
Source: cborgomeo&co, 2019.

As for the amounts of loans disbursed, the ranking follows the same pattern, with banking institutions playing the major role (fig. 5.3) (ibid.).

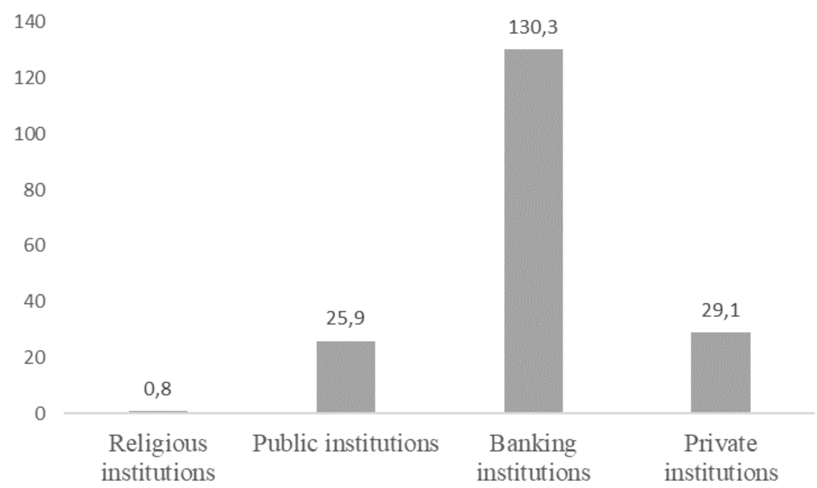


Figure 5.3 Amount of loans disbursed by type of promoter in €m.
Source: cborgomeo&co, 2019

Promoters generally coordinate the different subjects that implement the programmes, sometimes act as guarantor by creating special guarantee funds, often organise technical assistance before and after the lending process (ibid.).

In Italy, there are national/regional level funds to support microcredit provision in the form of guarantees. Furthermore, there are regional programmes funded by ESF and ERDF that, in principle, could support financial and non-financial services. However, to date, they do not fit the needs of non-bank MFIs.

The current context has no incentive support in the form of tax deductions for natural persons that provide financial support to microcredit providers in the country. The Italian Microfinance Network (RITMI) has promoted two legislative proposals to improve the provision of non-financial services and create a partnership between non-bank MFIs and local actors/ authorities. Challenges include enlarging the sector's eligible beneficiary base and creating specific schemes to invest and provide funds to non-bank MFIs, finding support for BDS, financial education, coaching and mentoring. To achieve a more efficient and measurable impact, coordination needs to be improved between European and national initiatives. In the Italian context, simplified administrative procedures, local one-window service and fiscal incentive frameworks have been put in place for young entrepreneurs to set up a limited liability company. Furthermore, there are some specific public initiatives supporting young entrepreneurs under the Youth Guarantee (Garanzia Giovani) scheme and there is a financial education plan for both youth and adult populations outside of the secondary educational curricula.

In terms of public support, there is no welfare bridge to support unemployed people in the transition towards self-employment and business development services are not publicly subsidised. However, the new initiative 'Reddito di Cittadinanza' (lit. 'Citizenship Income'), a subsidy resembling a universal basic income, opens some perspectives in terms of public measures supporting job seekers or self-employment. However, the implementing rules are not yet clearly established, and it seems open to abuse. Finally, there are local and regional initiatives for inclusive entrepreneurship awareness that are supported by private and social foundations for specific programmes.

5.2 The role of the Italian Microcredit Agency

The National Agency for Microcredit (ENM)[31]

The National Agency for Microcredit (ENM) is a subject of Italian public law that replaced the National Committee for Microcredit, created in 2005 in order to implement the purposes of the UN resolutions 53/197 and 58/221. Through these resolutions, the United Nations General Assembly proclaimed 2005 the 'International Year of Microcredit' and called on Member States to establish National Committees in order to achieve the so called 'Millennium Development Goals'. The National Committee was later converted into a Standing Committee and finally into an Agency through a process of institutional evolution[32].

The Agency pursues the goal of eradicating poverty and tackling social exclusion in Italy and internationally in developing countries and economies in transition. ENM aims to support those who have no access to credit on account of their belonging to vulnerable groups, such as former drug addicts, immigrants, unemployed youth, women, and people excluded from the labour market.

ENM supports the transition from a 'solidarity welfare' to a 'welfare of shared responsibility', in which all public, private, and third sector stakeholders work together to enable new schemes for a sustainable development that promotes the transition from assistance, grant, and charity to the credit and responsibility that microfinance brings about.

The Agency plays a concrete and pragmatic role towards the development of personal and professional qualities. The systemic action promoted and organised by the Agency goes beyond microcredit and microfinance, intended as a set of financial products and services for disadvantaged social groups. This is formulated into a new pragmatic humanism, based on two aspects: Personal responsibility and entrepreneurship, both founding pillars of a new social and economic playground. This is a context where the person reaffirms its central role and the State authority achieves legitimacy as guarantor of citizens' freedom.

ENM promotes initiatives to fund ethically and technically shared business development projects through funds provided by individual, public, national, EU and private

[31] The Agency presentation draws from https://www.microcredito.gov.it/.

[32] Law 244 of 24 December, 2007, article 2, paragraphs 185-186-1872; Directive of the President of the Council of Ministers of 2 July 2010 (published in the Official Gazette no. 220 of 20 September 2010); Law 106 of 12 July 2011 art. 1 paragraph 4 bis; Law of 22 December 2011, art. 39, paragraph 7 bis.

operators.

ENM's technical activities includes all the training (in cooperation with the university system), technical assistance, research, data collection and analysis, promotion of laws, grassroots actions, and dissemination of microfinance culture. ENM has formed fruitful partnerships (with the European Union, with ministries and local institutions, with Chambers of Commerce, the non-profit and banking sectors), pooling all the national and international forces working at various levels in the field to support a structural and sustainable economic development.

Among other things, the Agency has implemented two innovative projects: the 'Microwork' and the 'Selfiemployment' projects.

The 'Microwork' Project[33]

The 'MICRO-WORK: Networking for microcredit and employment' project was created with the aim of contributing to the strengthening of microcredit as an active labour policy tool, through the expansion of the network of territorial information desks already activated by ENM in some Italian regions in order to promote, inform, support and guide the citizen to the use of microcredit and self-employment tools active in the various territories. The project was co-financed by the two national operational programmes of the European Social Fund 2007-2013 as part of an institutional collaboration agreement between the National Microcredit Authority and the Ministry of Labour and Social Policies.

The project was developed in the wake of the public-private network intervention model already implemented and tested by the ENM through the project 'Microcredit and services for work', which between 2013 and 2014 implemented the orientation on the instrument of corporate microcredit and on incentives for self-employment in 95 local administrations and public bodies in the southern Italian regions of Campania, Calabria, Puglia, Sicily. Over 1000 non-bankable citizens were oriented to microcredit by the 120 operators of the branches (public employees specialized in consulting on microcredit and self-employment) also thanks to a dedicated service platform specifically created by the Agency.

It is on the basis of the results achieved and on the basis of the success obtained in the previous intervention that the Ministry of Labour and the Agency have decided to continue the intense path started by enhancing the work model developed, expanding its

[33] This paragraph draws from Progetto 'Micro-Work: Fare rete per il microcredito e l'occupazione'.

territorial reach to the regions of the Centre-North and improving the quality aspects of the service. The legacy of the project is a network of regional agents, a nationwide physical network of desks (*Sportelli*) and a virtual network on www.retemicrocredito.it, the dedicated IT platform placed in support of consultancy services.

Selfiemployment

SELFIEmployment is a fund launched in 2016 and managed by the public company Invitalia within the 'Youth Guarantee Programme' framework. It is still running to date.

The fund initially targeted young people up to 29 years of age, unemployed and not engaged in education or training (the so-called NEETs). From February 2021 beneficiaries include women of all ages and men unemployed for longer than one year.

SELFIEmployment, supervised by the Ministry of Labour, finances the creation and start-up of entrepreneurial activities[34], with investment plans between €5,000 and €50,000. The loans are grouped in three categories:

- microcredit, from €5,000 to €25,000;
- extended microcredit, from €25,001 to €35,000;
- small loans, from €35,001 to €50,000.

No interest is charged on the loans and no form of guarantee is required. Loans can be repaid in the following 7 years, with monthly instalments in arrears.

In order to help young NEETs prepare a business plan, special free-of-charge courses called 'Yes I Start Up' were launched across Italy. During the 2020 pandemic, courses were held online, allowing a higher participations rate.

By the end of 2020, SELFIEmployment generated 4,480 business plans with demand for €149m investments. By the same time, some 1,514 initiatives had been financed, disbursing €51m (I risultati di Selfiemployment, 2021).

[34] The sectors of fishing and aquaculture, primary production in agriculture and, in general, activities relating to economic sectors expressly excluded by Article 1 of Regulation (EU) 1407/2013 are excluded. Also excluded are activities relating to lotteries, betting, casinos (ATECO 2007, Section R Division 92) (Selfiemployment National Revolving Fund, 2021).

Microcredit for SMEs

Since May 2015, Italian SMEs can access a special fund called 'Microcredit for SMEs'[35] aimed at all those who intend to start or strengthen a micro-enterprise or self-employment activity. The bank loan amount, up to €40,000 (scalable up to 50,000)[36] and refundable within 84 months, is guaranteed for 80% of its amount without evaluation by the Guarantee Fund for SMEs, run by the Italian state. The other 20% of the guarantee amount is granted by the bank who extend the loan, after a risk assessment. The subjects eligible to the microcredit scheme are the following:

- self-employed persons who have been registered for VAT for no more than five years and have no more than five employees;
- sole proprietors who have held a VAT number for no more than five years and have no more than five employees;
- partnerships, professional societies, simplified limited liability companies and cooperative societies that have been registered for VAT for no more than five years and have a maximum of 10 employees.

Financing can be used for the following aims: Purchase of goods (including raw materials necessary for the production of the goods or services and goods for sale) or business-related services; payment of salaries of new employees that are working partners; company training courses; reconstitution of working capital; liquidity operations. Debt restructuring is excluded,

As of 31 December 2019, the applications submitted annually amounted to 125,918, of which 124,954 have been approved and 84.404 guaranteed, with a disbursement amounting to €19.4bn (Numeri del Fondo, 2020).

[35] With the decree of 24th December 2014, later supplemented by the ministerial decree of 18th March 2015, the Italian Ministry of Economic Development extended the operations of the Central Guarantee Fund to microcredit operations, particularly for the development of micro-entrepreneurship.

[36] Pursuant to Decree Law no. 137 of 28 October 2020, art.1 paragraph 14-quinques, coordinated with the conversion law of 18 December 2020 (DL Ristori), the maximum amount that can be granted for each individual microcredit operation has been increased from €25,000 to € 40,000. The possibility of a further increase up to € 50,000 remains unchanged, subject to the following conditions (contractually envisaged): fractional disbursement, with payment of the tranches conditional on the regularity of the loan repayment and the achievement of intermediate results of the business project.

6 Microfinance in numbers

In general, accessing information about the commercial banking sector is relatively easy, considering the set of stringent transparency rules it must observe. By contrast, even gathering information in the microfinance sector is a difficult task, given the general lack of compulsory rules that would compel MFIs make their data transparent and publicly accessible.

On a world scale, of the well-over 12,000 MFIs that are assumed to operate in more than 100 developing countries, only a limited number (about 3,000) are able to publish their data periodically. Those are stored in special databases that provide reliable data for a particular region (Microfinance Barometer, 2019).

The most well-known microfinance database is the MixMarket Exchange[37], which collects data related to loans and savings from MFIs operating in developing countries. The countries mapped are grouped in six macro-areas: Africa, EAP (East Asia and the Pacific), ECA (Eastern Europe, Caucasus and Central Asia), LAC (Latin America and the Caribbean), MENA (Middle East and North Africa), and South Asia (Fig. 6.1).

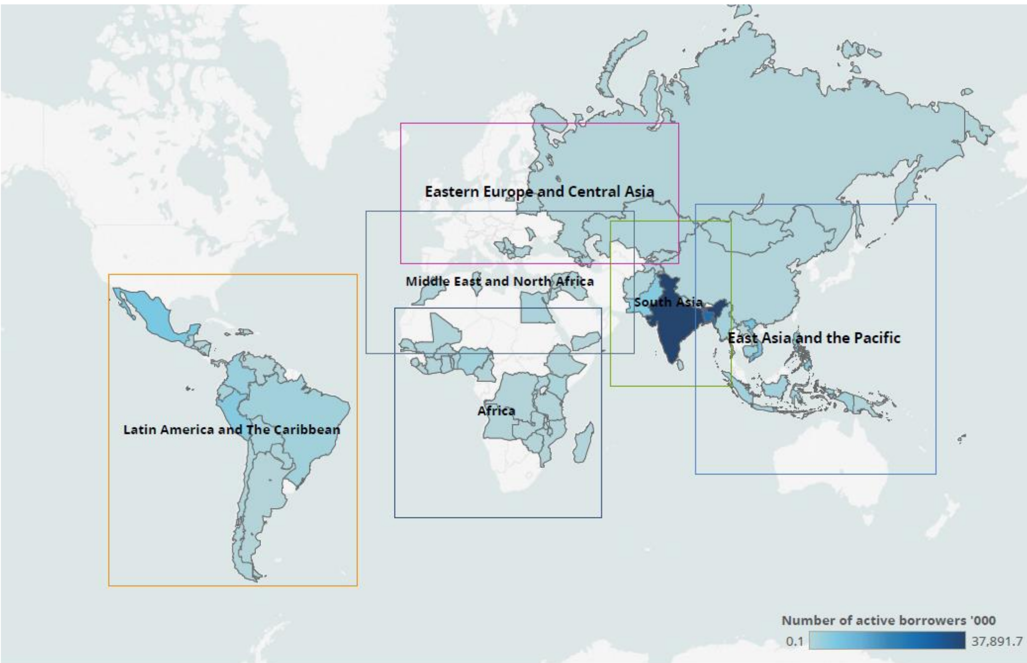


Figure 6.1 The areas covered by MixMarket Exchange database
Source: MIX, 2019

[37] In 2002, the World Bank helped establish the MIX Market (commonly known as the MIX) through CGAP. In 2019, the MIX Market dataset moved to the World Bank Open Data Catalog. (Hadi O., Cull B., 2020).

As far as the European Continent is concerned, the geographical remit of this database is limited to ten countries of eastern Europe that are lumped together with the Caucasian Region and Central Asian countries (ECA) (fig. 6.2).

Figure 6.2 The ECA area
Source: MIX, 2019

With reference to 10 eastern European countries belonging to the ECA area[38] – labelled as 'ECA 10' – we will examine MFIs' outreach and performance in fiscal year 2017 through 20 selected operational indicators out of 31, as reported by the latest MIX data available (table 6.1) (MIX, 2019).

The key indicators are:

1. Financial services provider (FSP) count
2. Offices
3. Personnel
4. Loan officers
5. № of active borrowers '000
6. Rural Borrowers '000
7. Female borrowers %
8. № of loans outstanding '000
9. Gross Loan Portfolio (GLP) USD m.
10. № of depositors '000
11. Deposits (USD) m.
12. Assets USD m.
13. Equity
14. ROA %
15. ROE %
16. Operating expenses/LP %
17. Yield on GLP %
18. Cost per borrower
19. PAR30 %
20. Risk coverage %

Other indicators that are not reported can be deducted, e.g.: Urban borrowers equals the no. of active borrowers minus the no. of rural borrowers (5. – 6.).

[38] ECA area as a whole comprises 18 countries, namely: Armenia, Azerbaijan, Belarus, Bosnia and Hercegovina (BiH), Bulgaria, Georgia, Kazakhstan, Kosovo (status disputed), Kyrgyzstan, Macedonia, Moldova, Mongolia, Montenegro, Romania, the Russian Federation, Serbia, Tajikistan and Uzbekistan. The ten chosen countries lie at least partly in Europe proper (excluding Turkey which is not included by MIX in any macro-area).

Table 6.1 Key operational metrics by country (2017)

Indicator / Country	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
Belarus	1	17	700	103	3,9	0.0	30	5,3	0.0	75,5	0.0	0.0	0.0	2,3	17,3	6,9	14,3	0.0	9,7	89,3
BiH	2	107	457	289	79,4	26,4	43	88,8	139,8	NA	NA	171	67.9	2,9	7,6	15,8	21,7	217	1.9	-27
Bulgaria	2	3	14	4	3.9	0.0	23	0.0	0.3	0.0	0.0	1.4	1.0	-22.4	-30.6	492.7	11.4	12.281	2.4	0.0
Kosovo	3	46	406	231	79.4	20.8	28	16.1	69.1	0.0	0.0	74.8	47.7	3.9	7.6	11.6	22.4	231.9	1.0	177.9
Macedonia	2	21	162	80	0.1	4.7	48	10.1	35.6	20.9	14.1	40.1	11.0	1.2	4.3	10.3	14.1	349.1	4.5	70.4
Moldova	6	30	208	72	23.0	14.1	54	24.6	48.3	0.2	0.6	68.6	18.7	4.8	16.7	10.9	30.1	204.5	4.4	49.9
Montenegro	1	8	46	14	3.8	2.5	56	3.8	7.0	0.0	0.2	7.5	6.3	NA	NA	NA	NA	NA	0.9	71.4
Romania 2016	1	9	22	9	1.1	0.8	NA	1.2	8.2	NA	NA	8.2	2.0	2.8	11.8	8.3	16.8	629.0	12.6	30.7
Russia	15	42	269	81	3.0	1.0	33	3.5	51.4	1.0	22.2	76.8	48.2	-0.4	-0.5	8.7	12.7	2,984.9	7.1	52.6
Serbia	1	19	152	85	17.5	13.7	49	17.5	4.5	0.0	0.0	5.7	3.9	-0.9	-4.3	44.6	45.3	245.0	5.1	71.7

Source: MIX, 2019 (adapted)

Data are based on self-reported financial and operating numbers of the FSPs for fiscal year 2017. The financial analysis is based on the audited financial statements for FY 2017, if submitted. The sample of FSPs reporting to MIX may vary each year, so the results should not be used for trend analysis without balancing the sample across the years (MIX, 2019).

From table 6.1 we can draw the following considerations:

- the financial services providers (FSPs) count (1) seems to be underestimated. As an example, the count for Russia is set at 15 while other sources report 2,271 for the same fiscal year (Tsvetkov et al., 2019). An explanation may be that MIX considers only FSPs that are connected somehow to international donors, while the Bank of Russia cited by Tsvetkov et al. might have run a more thorough national research;
- all subsequent indicators (2-20) logically suffer from the same underestimation;
- the number of offices is the number of staffed points of service and administrative sites used to support the delivery of financial services to microfinance clients;
- the number of active borrowers (5) is the number of individuals who currently have an outstanding loan balance with the FSP;
- the rural borrowers (6) in Bosnia and Hercegovina (BiH) and Bulgaria equals zero.
- the female quota of borrowers (7) varies within a range of 23-56%;
- the numbers of loans outstanding (8) varies strikingly from one country to another, irrespective of their size and population; as an example, BiH counts 88,800 loans while the Russian Federation only 3,500;
- the Gross Loan Portfolio (GLP) (9) is likewise unrealistically reported: the republic of Moldova scores USD 48.3 m while the Russian Federation only USD 51.4m, when Tsvetkov et al. report RUR112,800m (approximately USD 1,485m at the time of writing). (Tsvetkov et al., 2019, p. 102).
- the number of depositors (10) and the amount of deposits (11) in some countries such as Bulgaria, Kosovo and Serbia equal zero, likely due to local legislations denying deposit operations.
- MIX makes no distinction between loans disbursed for business and personal purpose;
- ROA (14) and ROE (15) indicators show different situations, from satisfactory (Moldova: ROA = 4.8; ROE=16.7) to disappointing (Bulgaria: ROA = -22.4;

ROE=-30.6);

- the efficiency indicator (16), i.e. operating expenses/loan portfolio, ranges from 6.9% (Belarus) to a stunning 492.7% (Bulgaria) – which seems to explain relevant indicators (14) and (15);
- the Yield on Gross Loan Portfolio (17) ranges from 11.4% (Bulgaria) to 45.3% (Serbia);
- the cost per borrower (18) ranges from a USD 0.00 (Belarus) – explained by noting that borrowings in value (metric not reported in table 6.39) equal 0 in 2017 – to a staggering USD 2,984 (Russian Federation);
- the indicator (19), Portfolio at Risk > 30 days, aka PAR30, is the value of all loans outstanding that have one or more instalments of principal past due more than 30 day. It ranges from 0,9 in Montenegro to 12.6 in Romania (sole country with data pertaining to 2016);
- the risk coverage (20) is defined as the Impairment Loss Allowance / PAR30. It ranges from -27 (Bosnia and Hercegovina) to 70.4 (Macedonia) (MIX, 2019).

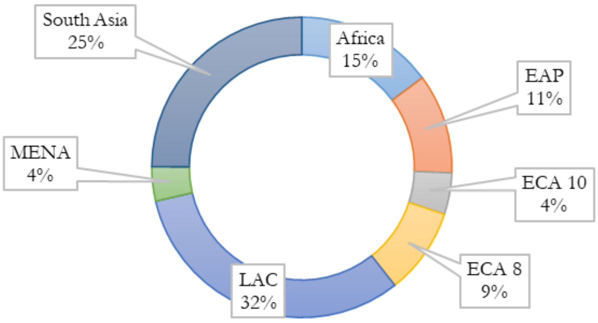
In table 6.2, where the ECA area is split in ECA 10 (countries listed in table 6.1) and ECA 8 (remaining Caucasian and Central Asian countries), we consider the five indicators of outreach:

Table 6.2 Outreach in fiscal year 2017

Region /Indicator	1	5	9	10	11
Africa	113	5,399.1	9,453.2	*26,770.5*	*13,098.1*
EAP	82	18,401.4	19,295.2	23,380.8	10,991.0
ECA 10	34	215.10	364.20	97.60	37.10
ECA 8	71	1,822.1	4,270.3	4,270.8	3,944.4
LAC	244	20,706.7	45,246,4	27,510.2	38,401.3
MENA	28	2,315.8	1,297.3	750.7	432.9
South Asia	190	71,125.1	31,641.7	57,831.2	13,506.2
TOTAL	762,00	119.985,30	111.568,30	140.611, 80	80.411,00

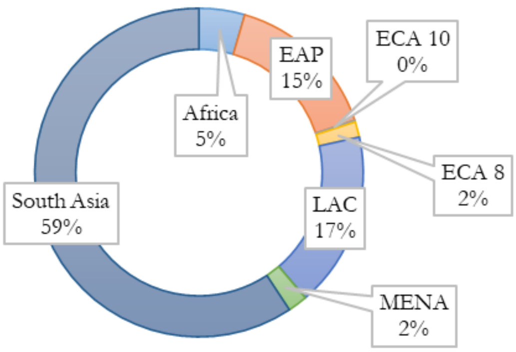
Source: MIX, 2019 (adapted)

As displayed in the following graphs, the ECA 10 area (9 countries of eastern Europe and the Russian Federation) accounts for only a small fraction of the global microfinance output. In fact, although the situation may vary significantly between different parts of the world and within regions, based on the aggregate data at hand, we may conclude that the contribution of the selected area to global microfinance is negligible (figs. 6.3-6.7).



Over half of the financial service providers are situated in Latin America, the Caribbean and South Asia (fig. 6.5).

Figure 6.3 Financial service providers count (1) across MIX areas (own elaboration)
Source: MIX, 2019



Most clients (59% of the total) live in South Asia and have average loans of €378 each (fig. 6.4).

Figure 6.4 No. of active borrowers (5) across MIX areas (own elaboration)
Source: MIX, 2019

The greatest volume of loans relates to Latina America and the Caribbean (41%) (fig. 6.5)

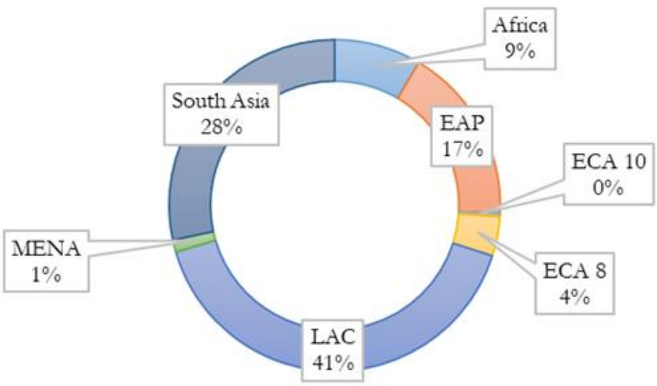
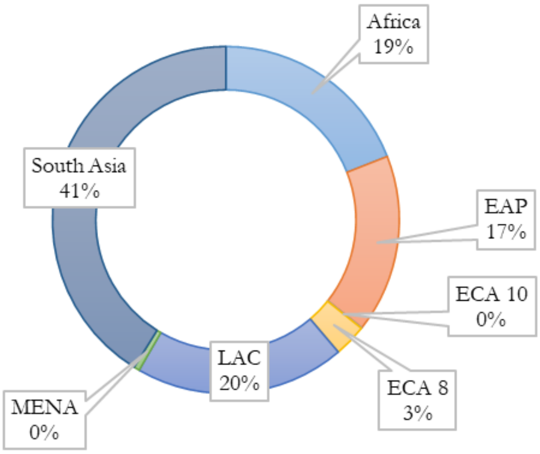
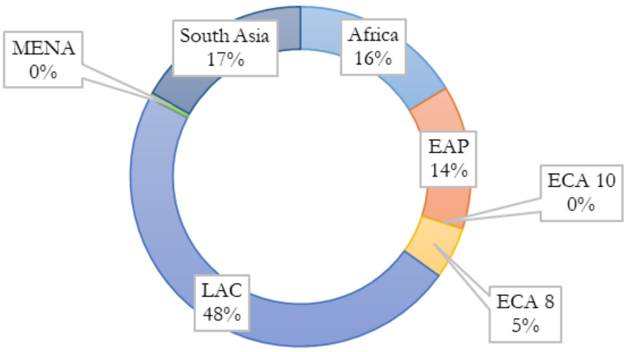


Figure 6.5 Gross Loan Portfolio (GLP) (9) across MIX areas (own elaboration)
Source: MIX, 2019



The greatest number of depositors lies in South Asia, followed by Latin America and the Caribbean, and Africa (fig. 6.6).

Figure 6.6 No. of depositors (10) across MIX areas (own elaboration)
Source: MIX, 2019



Nearly half of the deposits are concentrated in Latina America and the Caribbean (fig. 6.7).

Figure 6.7 Deposits (11) across MIX areas (own elaboration)
Source: MIX, 2019

For other indicators hereinafter we will consider the ECA area as a whole (table 6.3).

Table 6.3 Other indicators in fiscal year 2017

Region / Indicator	*6*	*7*	*18*	*19*
Africa	60%	64%	198.1	13,6%
EAP	79%	73%	70.1	3,5%
ECA	62%	49%	198.1	15,1%
LAC	23%	63%	267.2	6,1%
MENA	47%	60%	80.6	4,4%
South Asia	72%	89%	32.7	3,3%

Source: MIX, 2019 (adapted)

The indicator 6 of table 6.3 (no. of rural borrowers as a percentage) is portrayed against the no. of urban borrowers, whereas rural and urban attribution is based on FSPs discretion (fig. 6.8). With 62% of rural borrowers, the ECA area, much like Africa, scores a balanced proportion between rural and urban borrowers, as opposed to South Asia (72% rural) or Latin America (23% rural).

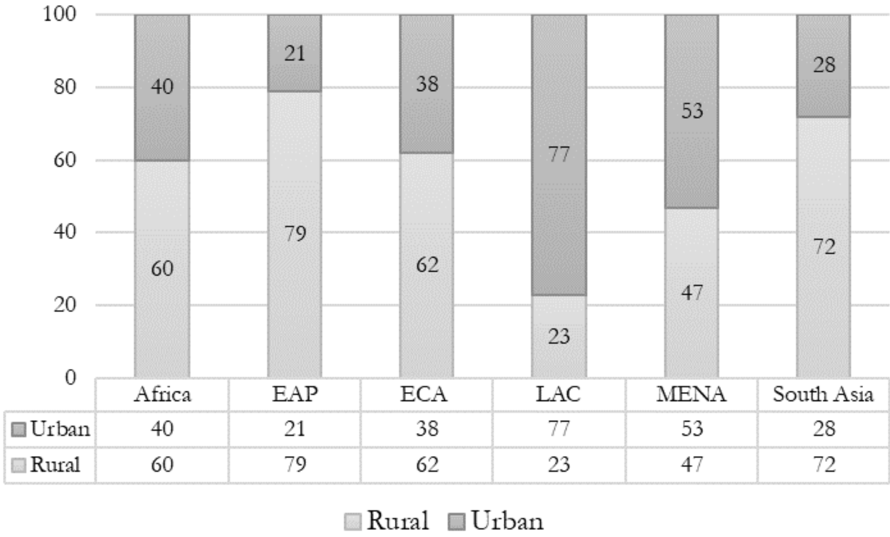


Figure 6.8 Percentage of urban and rural borrowers (6)
Source: MIX, 2019

The indicator no. 7 – Percentage of female borrowers is illustrated in fig. 6.9. The ECA area displays the lowest percentage of female borrowers (49%), as opposed to South Asia (89%).

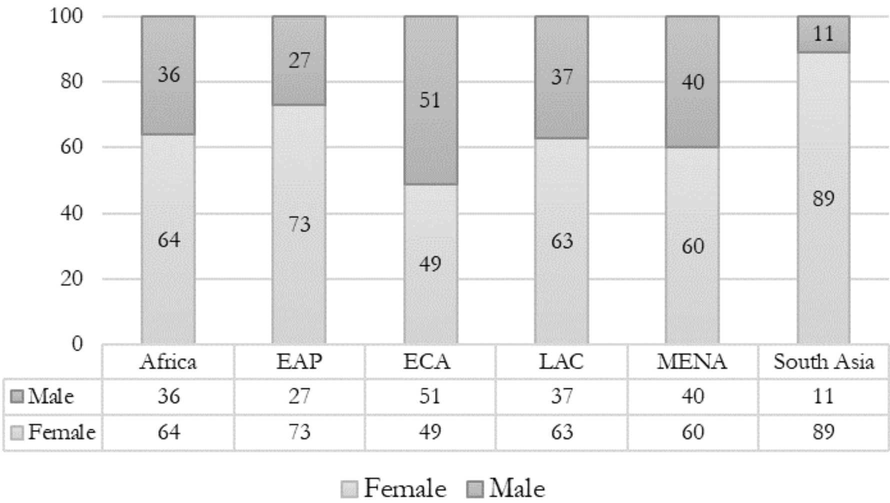


Figure 6.9 Percentage of female borrowers (7)
Source: MIX, 2019

In the last two graphs we will consider two *efficiency indicators*.

The *cost per borrower*, defined as Operating Expense / Number of Active Borrowers (average). It is lowest in the East Asian Pacific area, due to the high number of active borrowers that squeezes the ratio (fig. 6.10).

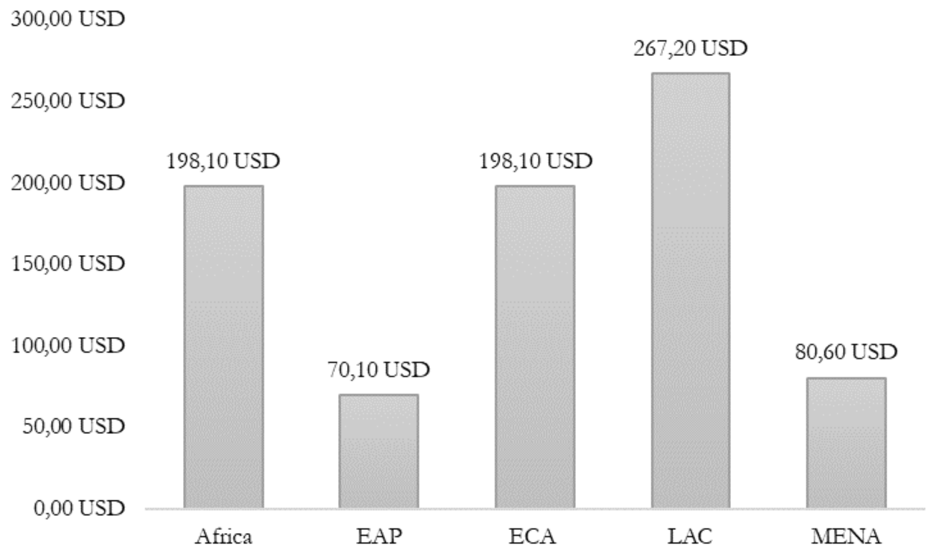


Figure 6.10 Cost per borrower (18)
Source: MIX, 2019

FSPs in ECA continue to report the highest *portfolio at risk > 30 days* among all regions as delinquency has been a primary obstacle for growth in the region, as a result of the economic crisis and currency fluctuations in recent years (MIX, 2019).

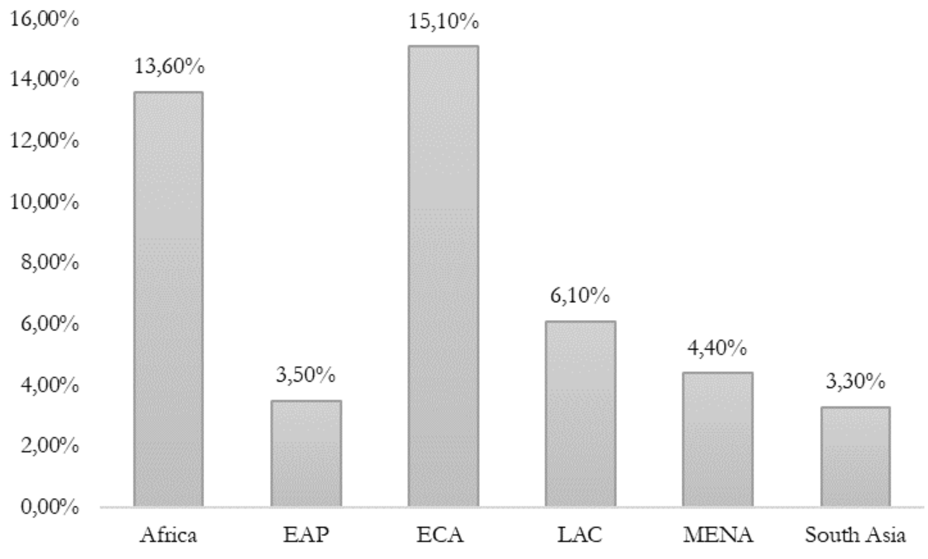


Figure 6.11 Portfolio at risk >30 days (19)
Source: MIX, 2019

The EMN-MFC Survey Report (2021)[39]: a snapshot of the sector

While the MIX analyses the microfinance sector on a global scale, leaving out much of Europe, other regional databases such as that of the European Microfinance Network (EMN) come to the rescue. EMN publishes a biennial European Microfinance Survey containing data about the performance of MFIs that are members of their network.

The latest edition of the EMN Survey Report (the ninth edition and the third jointly carried out by EMN and MFC[40]), issued on 9th February 2021, is an account of the situation of the microfinance sector in Europe capturing data collected in May-August 2020 for the period 2018-2019, before the start of the Covid-19 pandemic. The study covered 143 institutions from 29 countries – with the largest number of institutions operating in Romania (30) and Italy (15). As shown in fig. 6.12, unlike the MIX survey, both western European countries (in light blue) and easter European countries (dark blue) are represented.

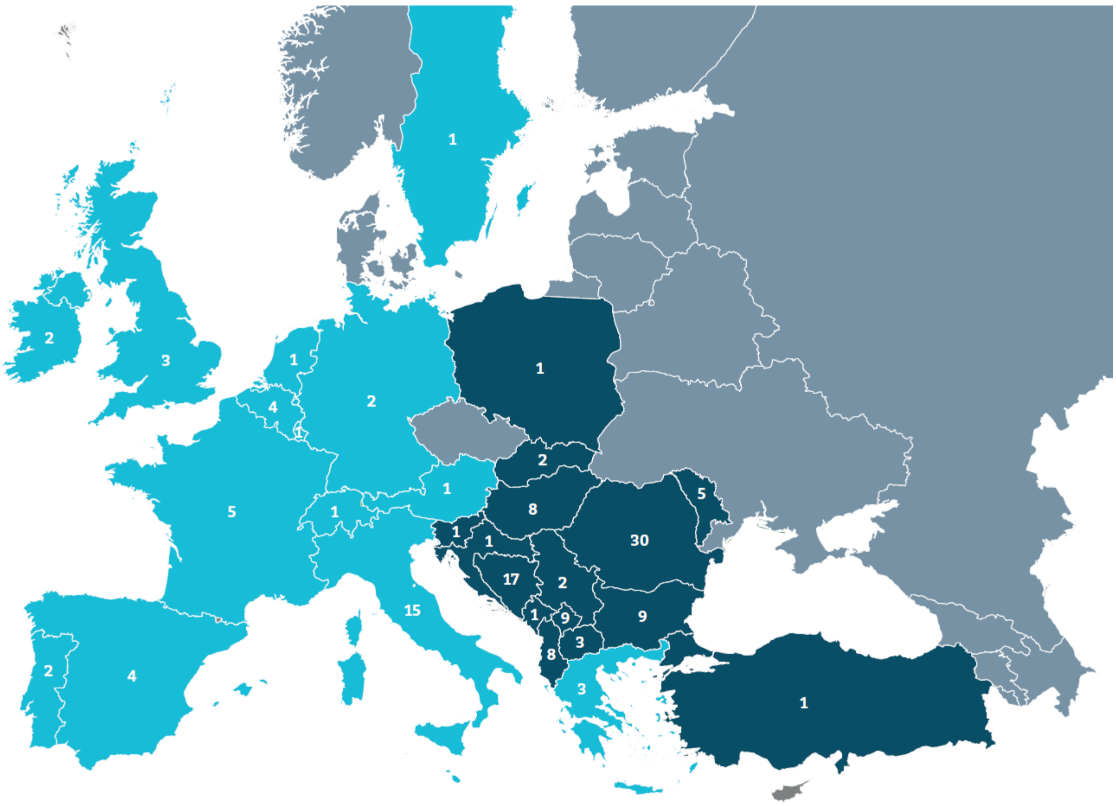


Figure 6.12 Distribution of MFIs surveyed in Europe
Source: Pytkowska, 2021

[39] This section draws from Pytkowska, 2021 and extra material released by ENM on occasion of the webinar presentation of 'Microfinance in Europe: Survey Report – 2020 edition' (9th February 2021).
[40] See 4.1.3

The methodology chosen included an online survey, secondary data collection and interviews with key experts and covered members of EMN, MFC, national networks and other institutions engaged in microlending activities in Europe. The response rate was 143 MFIs out of 521 (27%). During the study, due to the pandemic situation, the following challenges were encountered: Low response rate, less support from national microfinance networks, self-reported data and missing data (many institutions did not provide answers to all questions) (Pytkowska, 2021).

The *sector composition* sees a similar presence of NGOs (37%), cooperatives/credit unions (27%) and NBFIs (26%). Eastern European countries made up 69% of the MFIs in the sample, in particular for cooperatives/credit unions and NBFIs. In western European countries, relatively more banks and NGOs engage in microfinance than in the East (fig. 6.12) (ibid).

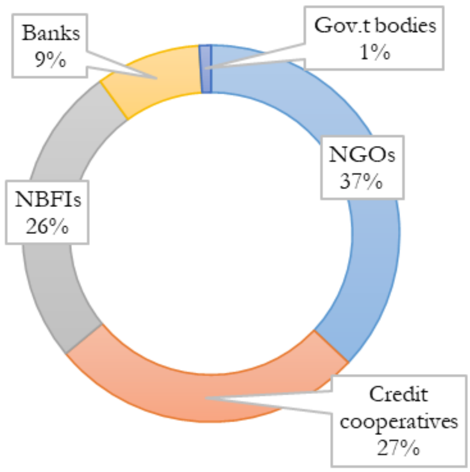


Figure 6.13 Distribution of MFIs by institutional type (N=143)
Source: Pytkowska, 2021

As for *human resources*, microcredit providers employed approximately 11,000 staff, 22% thereof volunteers, especially in western European NGOs and banks. Most MFIs have a small workforce: A third of the institutions have fewer than 10 paid staff or volunteers while another third have between 10 and 50 people. There is a clear gender skew, with 65% of paid staff being female, particularly among cooperatives and credit unions. Fig 6.14 highlights the percentage of volunteers among total staff while fig. 6.15 shows the average share of women among paid staff by institutional type. In both graphs the government bodies score zero (ibid.).

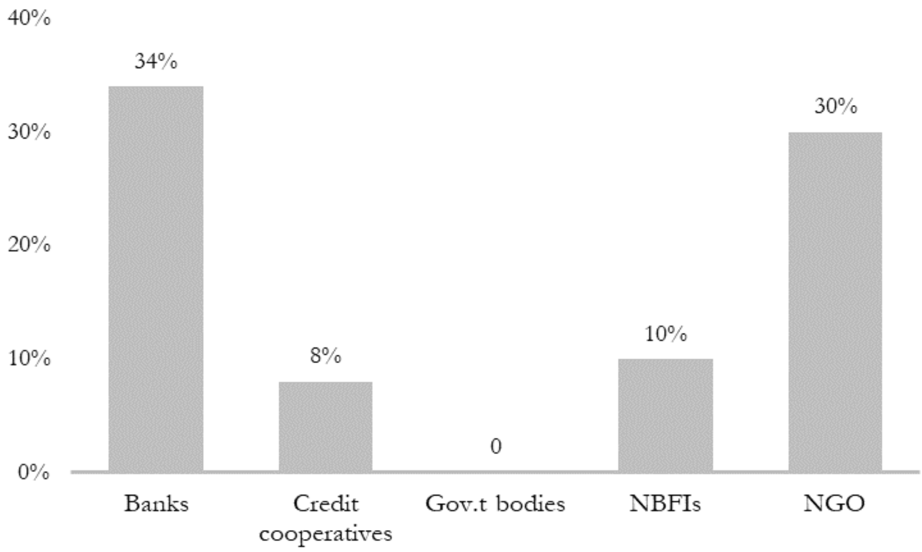


Figure 6.14 Average share of volunteers among total staff by institutional type.
Source: Pytkowska, 2021

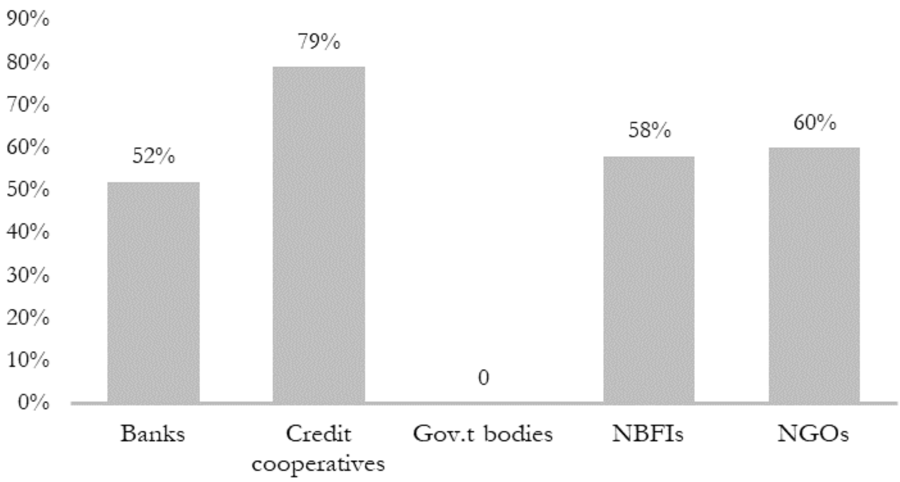


Figure 6.15 Average share of women among paid staff by institutional type.
Source: Pytkowska, 2021

Most MFIs (63%) arrange the *provision of non-financial services*, particularly in western Europe (fig. 6.15). As expected, institutions serving personal loans tend to have client development services, such as financial education, while MFIs who do not offer personal loans tend to deliver business development services. Fig. 6.16 shows the distribution of MFIs by the delivery channel of non-financial services. Only 28% of MFIs (mostly large ones) used digital channels to deliver non-financial services, a relevant information in view of the COVID-19 crisis (ibid.).

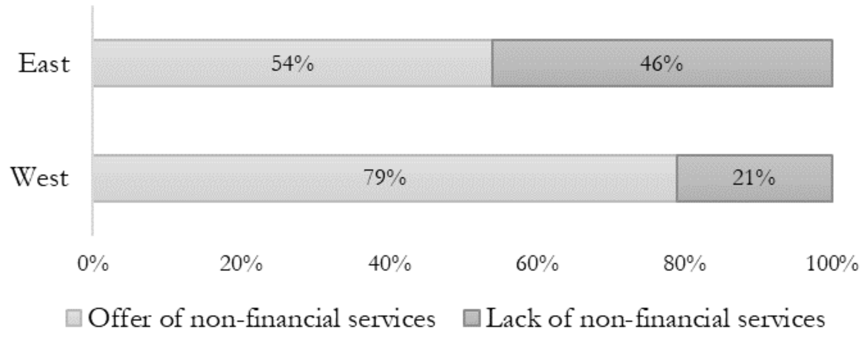


Figure 6.16 Offer of non-financial services in eastern and western Europe
Source: Pytkowska, 2021

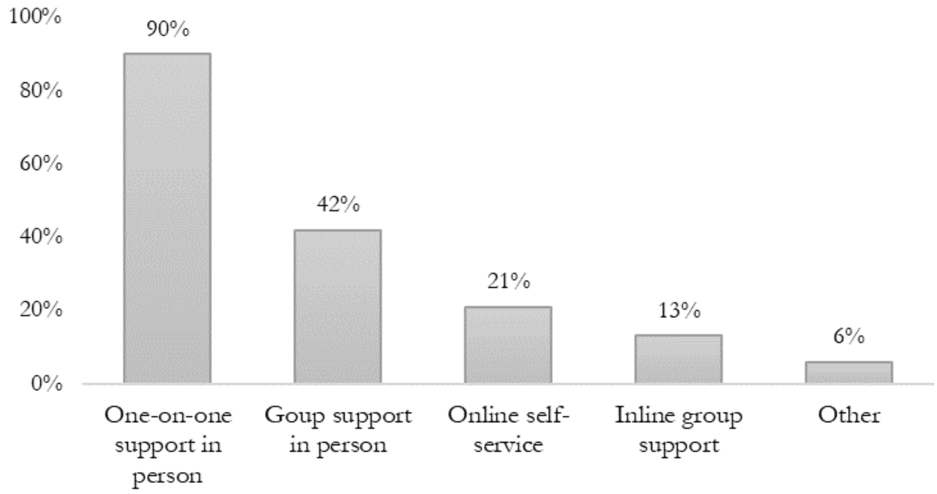


Figure 6.17 Distribution of MFIs by the delivery channel of non-financial services
Source: Pytkowska, 2021

As far as *scale and outreach* are concerned, at the end of 2019, the gross microloan portfolio outstanding amounted to €3.7bn (+15% compared to 2018) while the total number of active borrowers was 1.26m (+14%) (ibid.).

As shown in fig. 6.18, a sample of 129 microfinance providers highlighted that the bulk of the gross loan portfolio was owned by banks or their foundations, while eastern European government bodies owned a tiny amount (€0,05bn) and western counterparts none.

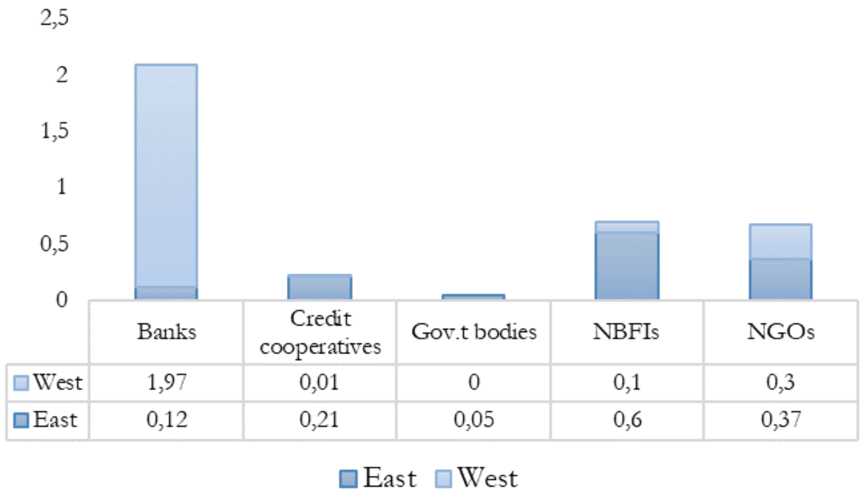


Figure 6.18 Distribution of the total GLP by region and institutional type in €bn
Source: Pytkowska, 2021

As regards *financial products*, business loans constitute 55% of the total microloan portfolio while personal loans make up 45% of the portfolio. The personal loan segment observed higher growth (23%) than business loan segment (12%). Personal loans are mostly used for family needs, and only 13% are used for professional development (ibid.). Fig. 6.19 shows the partition between business and personal loans in a sample of 129 microfinance providers.

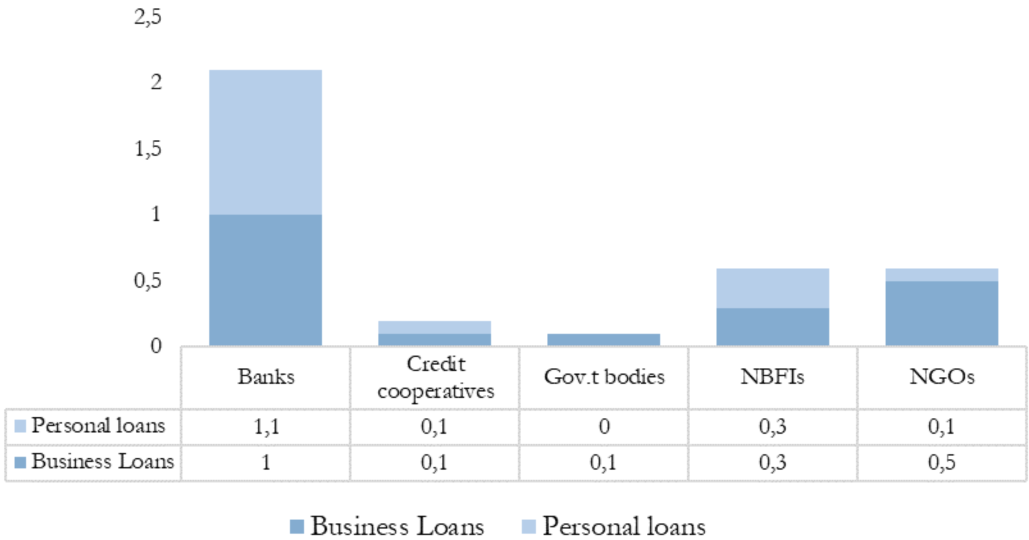


Figure 6.19 Distribution of the total GLP by loan type and institutional type in €bn
Source: Pytkowska, 2021

In particular, as fig. 6.20 shows, business loans for micro-enterprises (79% of MFIs) and personal loans (64% of MFIs) are the two most popular products. In total, 52% of

MFIs provide both business (micro, SME or agricultural loans) and personal or housing loans. Only 13% of MFIs provide strictly personal or housing loans without offering any business loan products (ibid.).

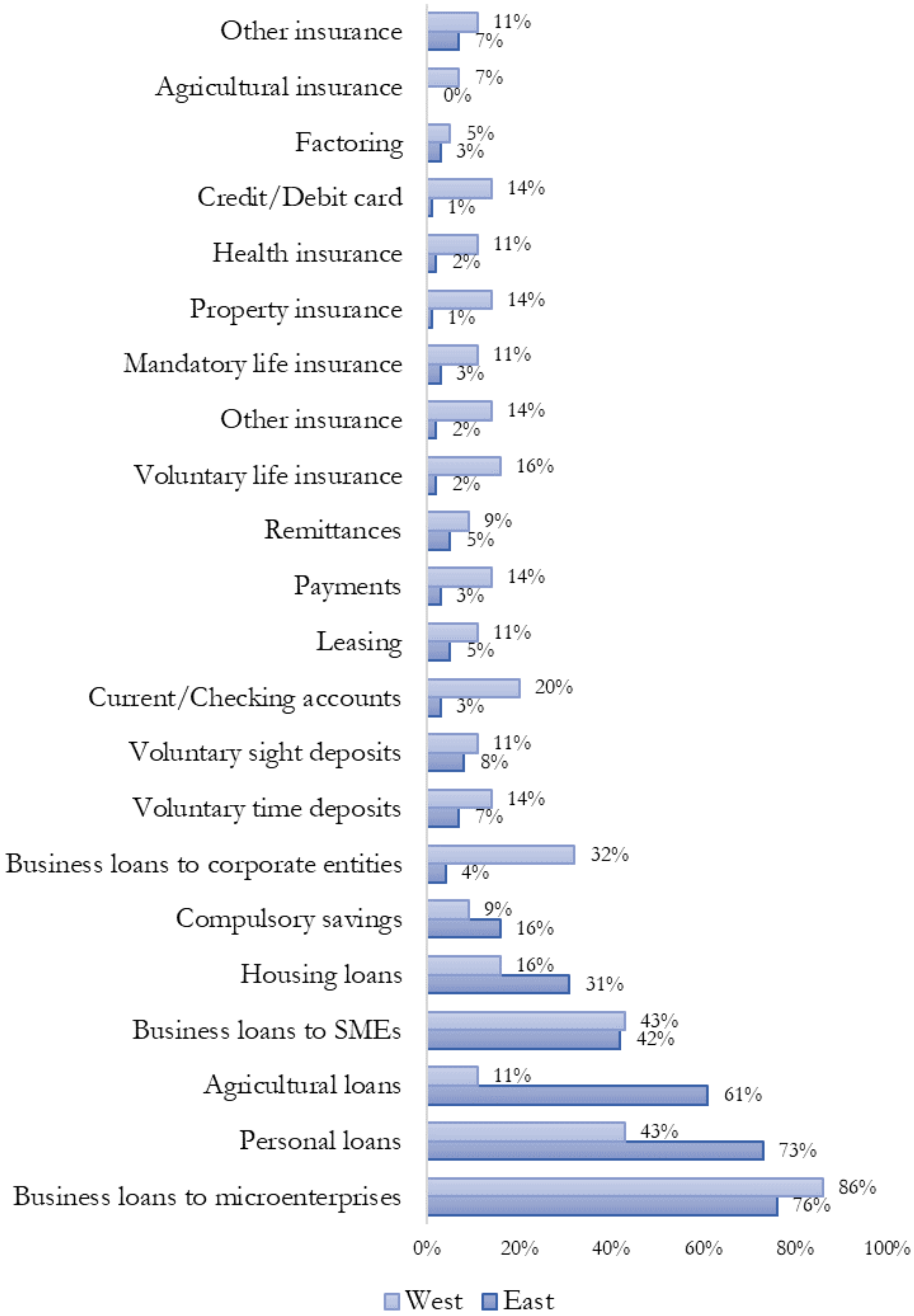


Figure 6.20 Share of MFIs providing various financial products in the regions.
Source: Pytkowska, 2021

A closer look at the loan characteristics (table 6.4), highlights that business microloans are larger on average, with longer maturity and lower APR (Annual Percentage Rate) compared to personal loans. APRs vary substantially between institutional types and region. NBFIs and eastern European MFIs charge the highest interest rates (ibid.).

Table 6.4 Business and personal microloans characteristics

	Business Microloans	Personal Microloans
Average outstanding loan balance	42.5	33.5
Average term (months)	6,45	2,42
Average interest rate APR	13.0%	16.3%

Source: Pytkowska, 2021

As far as *social performance* is concerned, financial inclusion remains the first purpose of MFI operations, as shown in fig. 6.21. In fact, 59% of surveyed MFIs consider facilitating access to financial products and services as their primary goal. Only 7% of MFIs aim to stimulate business growth while another 7% specifically focus on helping their clients to create employment. Another 6% prioritise support for rural development. Other goals included improving the quality of life, the financial or economic situation of clients, or the financial assistance to members (ibid.).

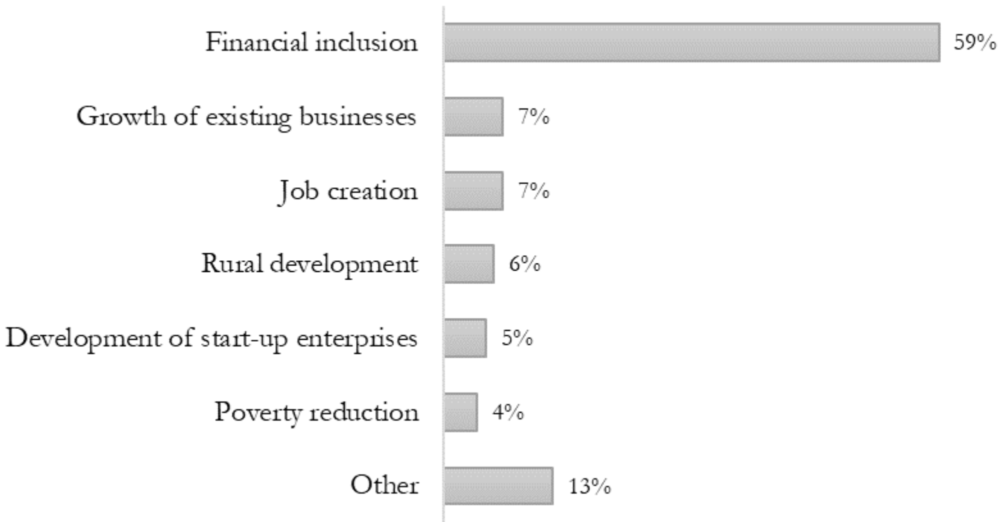


Figure 6.21 Distribution of MFIs by the primary goal of operations.
Source: Pytkowska, 2021

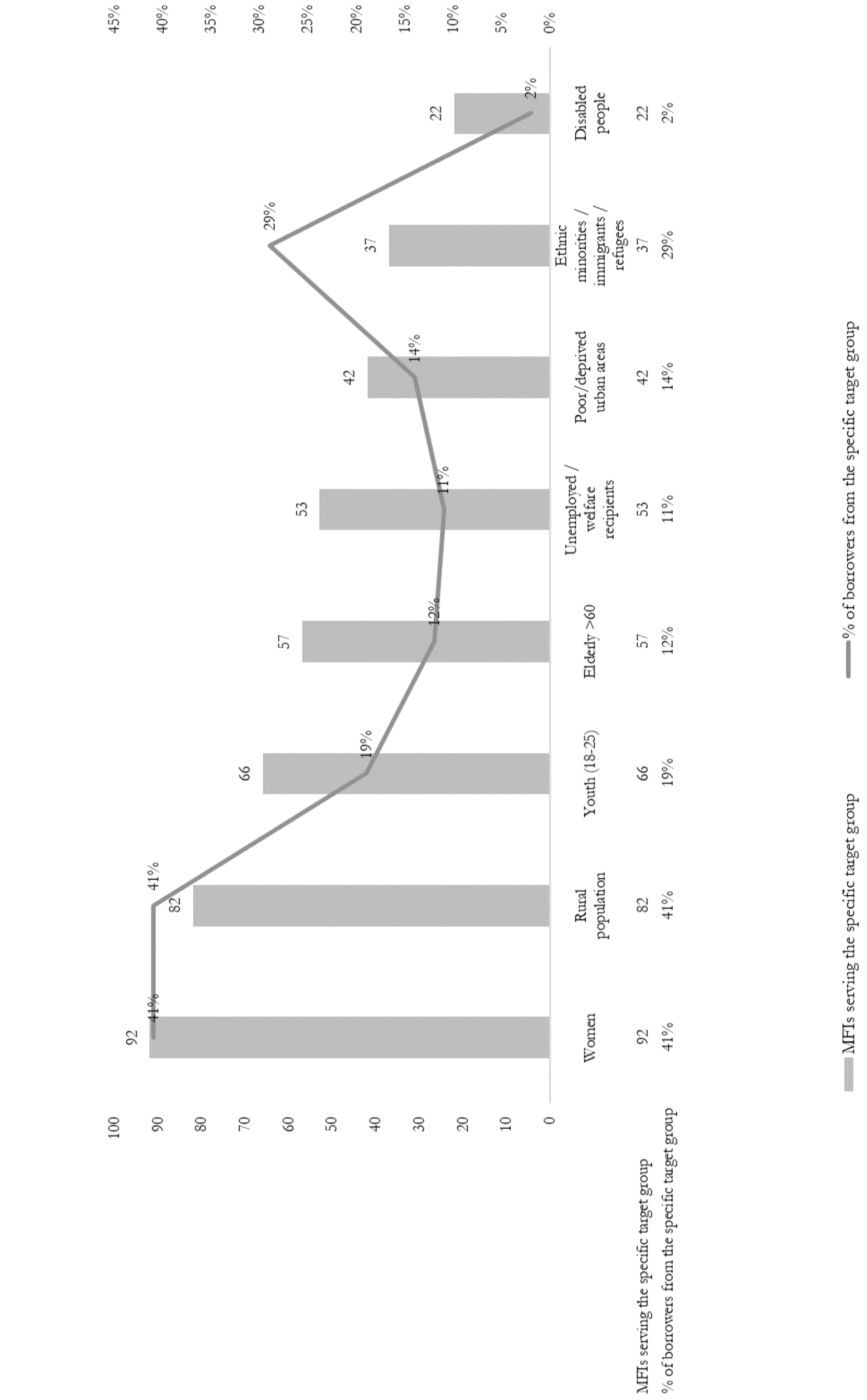


Figure 6.22 Target groups served by MFIs
Source: Pytkowska, 2021

The chart in fig. 6.22, on the previous page, illustrates the number of MFIs targeting each *target group* and the share of the targeted clients among the borrowers. Women and the rural population are the two main target groups. Women are the most common target group (92 MFIs target women). On the other hand, women make up less than half of the clients among MFIs targeting this group (41% of borrowers). Rural clients are the second most popular target group (82 MFIs) and constitute 41% of the client base for these MFIs. A third of institutions address the financial inclusion of ethnic minorities, migrants, and refugees (ibid.).

The *financial indicators* used in the survey were the following[41]:

- *Operational self-sufficiency (OSS):* banks have the highest OSS and NGOs the lowest, but above 100% on average (table 6.5).
- *Portfolio yield:* On average, the loan portfolio yield was 16% in 2019. NBFIs and cooperatives/credit unions reported the highest portfolio yields (18% and 17%, respectively). Institutions in the large outreach category had higher yields (20%). MFIs from eastern Europe reported higher yields that their western counterparts (18% vs. 8%) (table 6.6).
- *Operating expense ratio:* This ratio differed by institutional type: NGOs reported the highest operating expense ratio (19%), while banks reported the lowest (6%). Ratios were similar across the East and the West (table 6.6).
- *Loan loss provision expense:* This ratio was 2% on average. The highest responses of surveyed MFIs belonged to MFIs in the small category (3.8%) and young MFI category (4.5%). Loan losses in the West (3.9%) were nearly double than those in the East (1.5%) (table 6.6).
- *Financial expense ratio:* It was 3.5% and was highest among new MFIs (5.9%), NBFIs (4.4%) and MFIs with large outreach (4.1%). Eastern Europe MFIs

[41] OSS = operating revenues / (financial expenses + operating expenses + impairment expense). It measures the ability of the MFI in generating operating revenues to cover the total cost incurred in running the business.

Portfolio yield = Cash Financial Revenue / Average Gross Portfolio. It measures how much the MFI actually received in cash interest payments from its clients during the period, in other words, its efficiency in collecting from its clients.

Operating expense ratio = Operating Expenses / Average Gross Portfolio. It is the best indicator of the overall efficiency of an MFI.

Loan loss provision expense = The portion of the GLP that has been provisioned for in anticipation of losses.

Financial expense ratio = It provides a measure of the financial expense a lending institution incurs to fund its loan portfolio (Jansson et al., 2003).

reported financial expenses more than double than that of western European MFIs (3.9% vs. 1.2%) (table 6.6) (ibid.).

Table 6.5 Average OSS by institutional type

	Average OSS
Banks	136%
Credit cooperatives	117%
Gov.t bodies	105%
NBFIs	105%
NGOs	103%

Source: Pytkowska, 2021

Table 6.6 Financial efficiency indicators

Portfolio Yield	Operating expense ratio	Loan loss provision expense	Financial expense ratio
N=83	N=82	N=66	N=72
16%	15%	2.0%	3.5%

Source: Pytkowska, 2021

To assess the *quality of the microloan portfolio*, the survey used three indicators: PAR30, restructured portfolio and write-off ratio.

PAR30 indicates the share of the microloan portfolio that is overdue for more than 30 days. In 2019, the average PAR30 value was 10.6%. Banks reported the healthiest portfolio while cooperatives/credit unions had the worst portfolio quality.

The restructured portfolio ratio shows the share of microloans whose original contract has been changed. The average value of the restructured portfolio was 1.6%. The average restructured portfolio ratio was higher for business microloans than personal microloans (1.6% and 0.9%, respectively). By institutional type, NBFIs and NGOs reported higher restructured loans ratios. Significant differences were observed between the two regions: more MFIs in the West had higher restructured loan ratios than in the East (ibid.).

The write-off ratio reports the share of the portfolio that was removed from the books as unrecoverable or as a loss. The average write-off ratio was 5% and 70% of surveyed MFIs wrote-off less than 5% of the microloan portfolio. However, some 12% of MFIs had write-offs in excess of 15%. By institutional type, banks and cooperatives/credit unions had smaller write-offs than NBFIs and NGOs. Write-offs for business microloans exceeded personal microloans (6.5% vs. 2.2%) (ibid.).

Profitability and sustainability ratios which measure the overall performance of microfinance providers are measured by three indicators: Return on equity (ROE), return on shareholders' investments or, in case of non-profit institutions, the ability to build equity from retained earnings; return on assets (ROA), the ability of an institution to use its assets; and operational self-sufficiency (OSS), which measures revenues over the main expenses.

From the sampling of 90 MFIs that provided data to calculate the profitability ratios, 79% generated positive returns and 21% reported losses. The average ROA was 0.18%, which was heavily influenced by a few young MFIs that reported large losses. If outliers are removed, average ROA increases to 1.5%.

Average ROE was 4.2% after removing outliers, which was also close to the median of 4.5%. Among the institutional types, the cooperatives were most profitable, while NGOs had on average negative returns (ibid.).

Table 6.7 Average ROE and ROA by institutional type

	ROA	ROE
Banks	1.8%	9.2%
Cooperatives / Credit unions	3.7%	12.2%
NBFIs	0.8%	4.2%
NGOs	-0.3%	-4.2%

Source: Pytkowska, 2021

Microcredit providers have *funded themselves* resorting to various sources, such as:

- Long term deposit (>1 year);
- Long-term borrowed funds (>1 year): 48% of total funds;
- Subordinated debt;
- Other long-term liabilities (including conditional debts);
- Short-term liabilities: 16% of total funds;
- Paid-up share capital;
- Donated equity;
- Reserved/retained earnings/accumulated losses: 12% of total funds;
- Other equity.

Long-term borrowed funds remain the main source of financing of the loan portfolio (on average 46%) especially for banks (68%), followed by short-term liabilities and accumulated reserves and earnings. Cooperatives and credit unions use long-term client deposits as a source of funding for microlending operations (15%) (ibid.).

The survey ascertained *funding needs* for a total value of €800m, higher in eastern Europe (€482m) than in the West (€356m). Fig. 6.23 shows the distribution of the value of funding needs in a sampling of 61 MFIs by type of instrument and region in €m (ibid.).

Figure 6.23 Distribution of the value of funding needs of MFIs in €m
Source: Pytkowska, 2021

Green microfinance is the new frontier of financial inclusion and combines lending with the challenge of environmental protection and climate change[42]. From a sample of 115 microfinance providers, Pytkowska concluded that many of them engage in green technologies, with 16% of institutions offering specific energy-efficiency loan products and 23% are planning to introduce or enlarge the offer of such products in the future. Financing green solutions is more prevalent in western Europe, with 62% of MFIs financing environmentally friendly technologies through general or specific loans. The share is smaller in the East (52% of MFIs). Additionally, eastern Europeans MFIs are more inclined to start financing green technologies in the future (32%) than western ones (5%) (fig. 6.24) (ibid.).

[42]Cfr. Allet M., Battaggia S., (2013) on the green trend in microfinance.

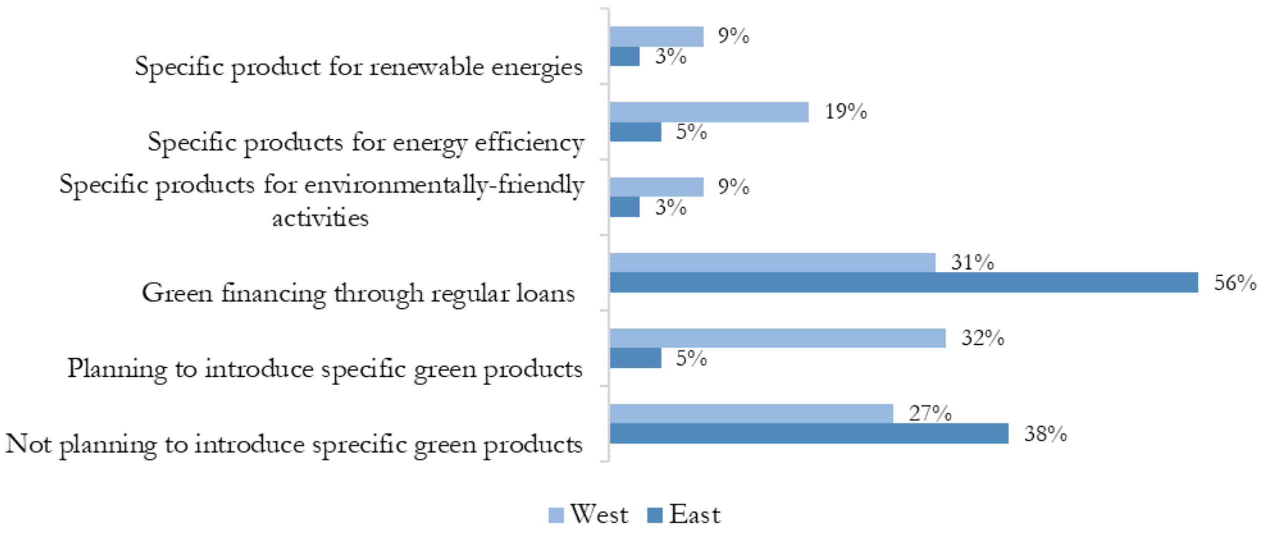


Figure 6.24 Distribution of MFIs by region and engagement in green microlending
Source: Pytkowska, 2021

Most providers avail themselves with *digital solutions* to support clients during the loan lifecycle[43]. About half of MFIs plan to introduce new digital solutions in the next three years (fig. 6.25) (ibid.).

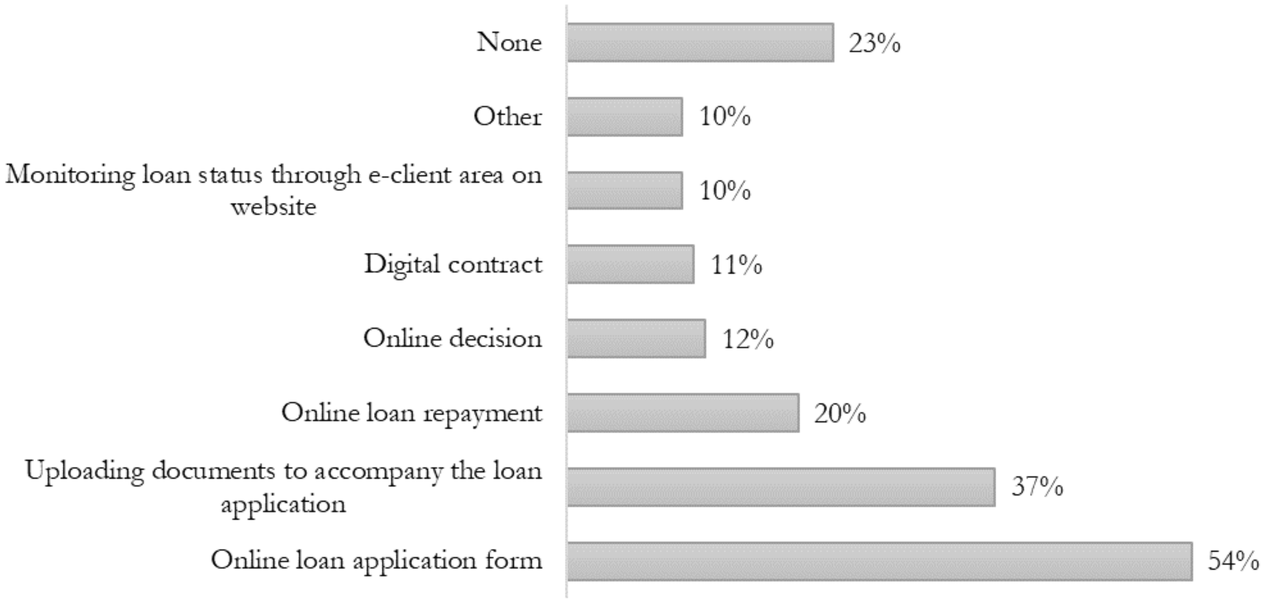


Figure 6.25 Distribution of MFIs by digital solutions for clients (N=115)
Source: Pytkowska, 2021

Although the survey considered data related to 2018-2019, it was actually performed during May-August 2020, in the midst of the COVID-19 pandemic. Therefore, the survey

[43] Cfr. Tan (2018).

could also gather information about the challenges that microfinance providers were experiencing.

Pytkowska reported that in May 2020, nearly 70% of MFIs considered themselves to be in a good situation while only 6% assessed their situation as bad. The key challenges identified by MFIs are associated with clients' income volatility coupled with low digital and financial capabilities. MFIs are optimistic about the future: More than half of institutions think that business prospects will improve in the next 12 months. MFIs that operate in countries with strong government support for micro and small businesses felt the impact of the pandemic less strongly, as did MFIs with strong partners and supportive stakeholders. Institutions that completed their digital transformation could more easily adapt to safety requirements and were more ready to use digital tools to communicate with clients, process loans and implement options for remote work. Figure 6.26 shows the average rating of the severity of challenges judged by a sample of 108 microfinance providers (from 1-negligible to 5-very significant) (ibid.).

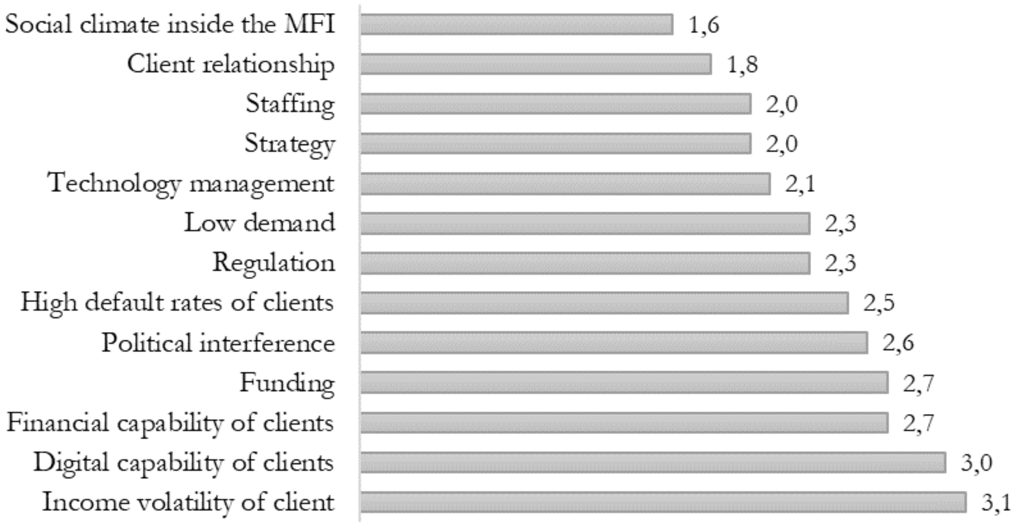


Figure 6.26 Average rating of the severity of challenges
Source: Pytkowska, 2021

In her survey, Pytkowska drew the following conclusions:

- High concentration of the sector – small number of large MFIs and numerous small MFIs more vulnerable to the impact of the pandemic.
- Continued growth of personal loans segment, with purpose of financing general family needs – not in line with new ESF+ definition of microfinance.
- Growing demand from microenterprises for loans above €25,000.

– Continued engagement of MFIs in provision of non-financial services, more often in the West than in the East.
– On-going digitalization of MFI-client interactions, mainly in the lending process; delivery of non-financial services through personal interaction.
– MFI situation perceived optimistically in May 2020, with expectations for further improvement.
– Key clients problems are income volatility and low digital and financial capabilities. (ibid.).

Long-term trends of the microfinance sector in Europe

As we have already mentioned, the microfinance sector in Europe is relatively young, and started in the early 90s in eastern Europe and the early 2000s in its western part. The event that equally hit both regions of Europe was the world financial crisis of 2007-2008, followed by an economic downturn that lasted well into the early 2010s, with a more profound impact on the so-called 'PIGS countries' (Portugal, Ireland, Greece and Spain), and with varying degrees all other countries.

One of the main features of the afore-mentioned crisis was the decline in the provision of credit to businesses, the so-called 'credit crunch', as banks adopted more cautious credit policies. SMEs were particularly hit by the phenomenon.

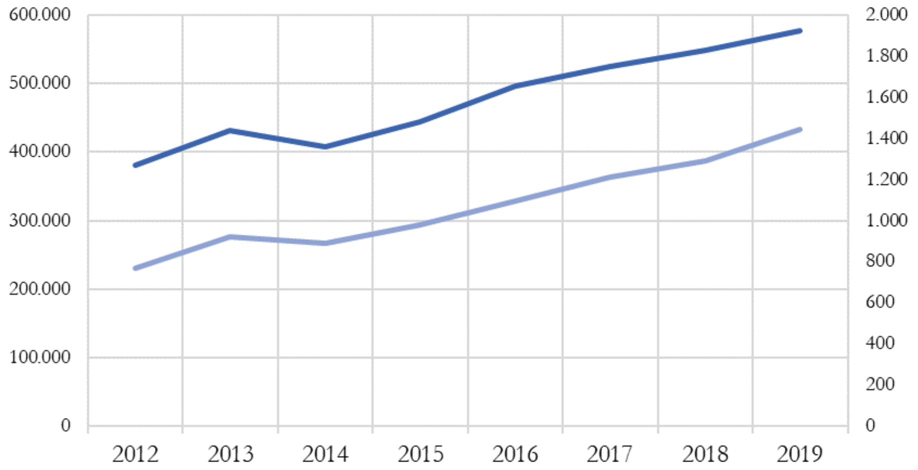
The credit crunch, combined with mass layoffs due to the economic restructuring (further spurred by globalisation, delocalisation and deindustrialisation processes) led to a potentially explosive labour market situation.

Unsurprisingly, microfinance became a tool of public policy to address the issue of access to finance, especially in western Europe. (Minnetti et al., 2016). Both at European Union and country level, policy makers enhanced their involvement in microfinance schemes. As an example, in Germany, a €100mln fund was earmarked to establish a network of microfinance providers (Bendig et al., 2012, p. 53).

As conventional banks cut their loans to underbanked people, start-ups and SMEs, microfinance providers were able to use EU funding instruments to expand their outreach and serve as a complementary source of financing (ibid., p. 54).

Notwithstanding the methodological hurdles involving multiannual comparisons, the sector does not cease to expand in terms of beneficiaries and value (fig. 6.27) (ibid.).

In particular, fig. 6.27 shows the result of an analysis conducted in a sample of 34 microfinance providers that have shared their data since 2012. Analysis of the microloan portfolio and active borrower growth was conducted for a sub-sample of 34 MFIs that have participated in the survey since 2012. As of 2019, these 34 institutions managed 39% of the gross microloan portfolio of all institutions covered by this study and served 47% of active borrowers (ibid.).



	2012	2013	2014	2015	2016	2017	2018	2019
Active borrowers (.000)	380.373	431.107	407.614	444.429	495.766	525.775	549.286	577.943
Gross loan portfolio (€mln)	767	922	889	978	1.096	1.214	1.292	1.446

Figure 6.27 GLP and no. of active borrowers in a sample of 34 MFIs (2012-2019).
Source: Pytkowska, 2021

The results show that between 2012 and 2019, the value of the gross microloan portfolio (GLP) grew by 89% while the number of active borrowers increased by 52%. The growth rates in the last two years were lower than in the previous periods: Approximately +5% borrowers and +11% GLP between 2018-2019 compared to +13% borrowers and +20% GLP increase between 2012-2013) (ibid.).

Conclusions

This study sought to reply to the question: "What is microfinance in Europe?" and meet the need to consult a document outlining the microfinance sector in this region over the past two decades (2000-2020), with emphasis on its salient features vis-a-vis the global microfinance sector. To this end, a research on existing literature has been conducted, resorting whenever possible to direct sources of actors and networks involved in the front-line to obtain the most updated information.

This work has highlighted the overall heterogeneous nature of European microfinance actors and practices, to the extent that we can speak of different European ‘microfinance ways’ through which the need for financial inclusion has been addressed in the time frame considered.

Financial inclusion – meant as the ability to access basic financial services – is at the core of microfinance, its final scope, both in the North and the South of the world. However, its significance carries different connotations: In the South it is considered as a tool to address and eradicate poverty, while in Europe it is a tool policy makers use to prevent marginalised people (the unemployed, women, youth, etc.) to spiral into poverty and build an inclusive society, leaving nobody behind.

Microfinance is a broad and growing concept that include lending and saving schemes, micro-insurance, and money transfer services. Lending schemes pertain to microcredit, the most wide-spread form of microfinance. Microloans, the financial product of microcredit, can be used for both personal and business purposes. While personal microloans are provided by charity foundations, business microloans are target of national and transnational policies aimed at reducing labour market shortcomings and contain unemployment.

As Armendáriz & Morduch (2010) underlined, the salient characteristic of a microcredit financial transaction is the absence of collateral, which is the main reason ‘active poor’ people are barred from obtaining credit from commercial banks, unwilling to put their portfolio at risk. In a perfect financial market, demand and supply of capital should meet at an equilibrium point so that no demand is left unmet. However, once collateral is relativised, a gap is created (Armendáriz & Morduch, 2010).

This market failure is the starting point of microfinance. The burden of asymmetric information leads the supply side to credit rationing and adverse selection and the demand side to moral hazard. To address this shortcomings, global microfinance providers have devised original solutions, such as group lending, step lending, frequent and public repayments and flexible approaches to collateral. In Europe, national and EU microfinance programmes have been backing the supply side with capital and guarantee schemes.

Although the time frame considered is restricted to the last two decades, microfinance in Europe boasts a long history, with consequences that influence the present (e.g. the survival of credit unions and cooperative banks). Credit activities in Europe had been challenged by the Church authorities throughout the Middle Ages and Shakespeare's famous saying 'Neither a borrower nor a lender be' in his 'Merchant of Venice' may well epitomise the spirit of the age. However, in the Lower Middle Ages, some Italian friar orders started to compete with Jewish moneylenders and established 'montes pietatis' – financial institutions resembling pawnshops – to assist poor people. In the late 18th century, charitable institutions offering loans to the poor flourished in famine-plagued Ireland, and in mid-19th century Germany the movement of the cooperative financial institutions took eventually off. The second half of the 20th century saw European microfinance traditions spawn initiatives across former colonies and developing countries, where also original models were elaborated, such as prof. Yunus' Grameen Bank in Bangladesh.

By a twist of destiny, some recent events generated a revival of microfinance back in its cradle: After the fall of the Berlin Wall, eastern Europe witnessed a collapse of the planned economies and soon international foundations launched microfinance programmes aimed at curbing the subsequent upsurge of unemployment. During the Great Recession (2007-2009), the whole of Europe was shaken by the global financial crisis which provoked mass layoffs and a crunch credit that hit hardest small and medium-sized enterprises, the backbone of Europe's economy. To address this unprecedented challenge, the European Commission reacted with a row of initiatives which included the funding of microfinance programmes described in detail in par. 4.1.1. Along with transnational programmes, some countries, such as France, Italy and Romania, emphasised the role of microfinance by adopting a microcredit regulation aimed at bringing the scale of operations to the next level. Italy, in particular, as the first country in the world hosting a National Agency for Microcredit, is playing a crucial role in alleviating its staggering number of unemployed youth by mobilising microcredit schemes to create self-employment.

As we have ascertained throughout this writing, the environment that these 'necessity entrepreneurs' face is very different from the one 'active poors' experience in developing countries: The supply side in Europe is represented by small and highly subsidised microfinance providers that extend relatively large loans as opposed to commercialised microfinance giants who lend small loans in the South; lending methodologies differ (individual lending in the urban North vs. group lending in the rural South); the European demand side is over-represented by women, youth, people aged over 50, the long-term unemployed, minority groups, migrants, disabled people, persons that face discrimination at work, and vulnerable people in general.

Other elements of comparison between European and global microfinance are highlighted in a qualitative perspective in chapter 1, and in a quantitative dimension in chapter 6. The features described represent the European microfinance industry as a mosaic of fragmented initiatives that trickle down positive effects but fail to achieve a critical mass and exert a strong impact: as we have seen in chapter 6, although in the past two decades statistics confirm a steady growth in the number of borrowers and gross loan portfolio, the weight of the European sector within global microfinance is still negligible.

The uniqueness of European microfinance goes beyond the scientific interest and calls for a change in public policies that have an impact on the life of people. Some policy suggestions that could increase the role of European microfinance may include: The promotion of the microfinance outreach among potential beneficiaries, so as to appraise the real gap between the demand and the offer (estimated in €24bn in 2019), and advocate for the implementation of appropriate measures by policy-makers; the coverage and improvement of a pan-European regulatory framework, allowing larger microfinance providers to operate across countries and reach economies of scale; the spread of good practices within Europe (some of which have been illustrated); the institutionalised exchange of expertise between European and global microfinance (e.g. by learning from *Fintech* solutions that have proved successful in the South, such as the Kenyan digitised microloans via mobile phones); the support of financial literacy at all levels of education; the systematic provision of business development services; the establishment of a pan-European credit bureau network; the coordination of welfare policies with microfinance networks so as to build a level playing field. Such policies are perceived all the more relevant, as recurring crises cast a shadow over Europe's future generations, threatening underdevelopment and the escalation of poverty.

True enough, the slow pace of economic growth, globalisation, deindustrialisation and red tape, combined with an aging population and technological shifts, are unlikely to generate illusions of a quick path to wealth among European underbanked people. However, despite the grim prospects in the offing – we're writing during an unprecedented pandemic and microcredit is no anti-cyclic policy tool – here's hoping that more novel businesspeople will bridge the gap of the missing entrepreneurs.

Given that European microfinance is an understudied field of research, this study complements the existing literature with its unique comprehensiveness and its reflecting the latest information available; its limits range from the deliberate short descriptions (compensated by the generous reference part) to the likewise necessary personal approach (vs. a group work approach). One of the difficulties encountered was obtaining comprehensive and comparable data, given that they were gathered by different sources from a limited number of microfinance institutions which provided their transmission on a voluntary basis. However, data were sufficiently consistent to allow drawing overall sound conclusions.

Recommendations for future research may include designing a theoretic model highlighting the relations between microfinance and welfare policies, conducting cross-country research activity to select good practices from developing countries that can be transferred to the North, and providing a rolling review on the long-term sustainability and purpose of the European microfinance sector.

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Acknowledgements

Throughout the writing of this thesis I have received a great deal of support and assistance.

First, I wish to thank Mr Mario Baccini, President of the Italian Microcredit Agency, who sparked in me an interest in microcredit back in 2007: the flame is still alive.

Then, I would like to acknowledge all the teaching and administrative staff at Ca' Foscari University. In particular, I wish to thank prof. Elisa Barbieri, who accepted to be my supervisor and supplied me with impeccable guidance and continuous support.

In addition, I would like to thank prof. Mario La Torre of La Sapienza University in Rome for his useful suggestions and supply of informative material; Dr Joana Afonso, Financial Inclusion Specialist at the European Microfinance Platform (e-MFP); Mr Nicola Benaglio, Senior Research Officer at European Microfinance Network and others, too many too mention here.

Finally, I would like to thank my friend Ms Fei Ling Tan for her unfailing moral support and my former course fellows and now friends Mr Stefano Morelli for his stimulating discussions and proofreading, and Mr Tudor Enache for his highly competitive spirit, which spurred me on to give my best.