THE MICROFINANCE SECTOR IN EUROPE

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Abstract:

Microfinance in Europe is gradually being consolidated as an essential tool of social policy, for the promotion of self-employment, microenterprise support and the fight against social and financial exclusion. This is demonstrated by the renovation of the initiatives in support for the sector by the European Commission in the framework of the Program for Employment and Social Innovation (EaSI) 2014-2020. This work is intended to present the main characteristics of the European microfinance sector and how the provision of financial and non-financial services could help entrepreneurs to overcome the challenges to rural development, thereby supporting their businesses and boosting the local economy. In this regard, microfinance often targets unemployed or people excluded from the traditional banking system who wish to start their own business, significantly contributing to self-employment and job creation.

Key words: Microfinance, European Union, microcredit, business, rural areas

JEL classification codes: G20, G21, Q01, Q14

Scale and development of the microfinance sector in Europe

During 2012-2013 both the overall total volume and the number of microloans (Microloans for both personal and business purpose) show a steady growth of microcredit provision among the MFIs surveyed in Europe compared to past years. MFIs covered from the 24 countries disbursed a total of 387,812 microloans with a total volume 1.53 billion EUR in 2013 (benchmark from 2011: 204,080 microloans with a volume of 1.05 billion EUR). The trend is the same for organizations based in EU member states only: 207,335 microloans with a total volume of 1.26 billion EUR (benchmark from 2011: 122,370 loans with a total volume of 872 million EUR). Compared to the data from 2011, this translates to an increase of 45% of the total value of microloans and 69% of the number of loans reported by the EU-based participants of the survey in 2013. This indicates remarkable growth of the observed micro–lending activities among the MFIs surveyed in Europe since 2009. The number of loans disbursed increased by more than 400%, the reported total loan volume has more than doubled since 2009. The overall allocation between microloans for business and personal purpose has slightly shifted towards loans for business purpose. In 2013, 79% of the total value of microloans was issued for business purpose, i.e. 21% for personal consumption purpose (2011: 74% for microloans for business purpose, 26% for microloans for personal consumption purpose). Overall these results indicate a steadily increasing trend of the scale (both in terms of numbers as well as total volume) of microfinance provision in the EU in 2012 and 2013, compared to 2011. Three aspects contributed to this development: an increased coverage of organizations in certain EU-member states, more loans provided per institution covered (e.g. in France) and a higher average loan size per institution. In regard to the latter point the average volume of loans disbursed in 2013 was 8,507 EUR (2011: 5,135). In the covered EU member states the average volume was 9,234 EUR, which is an increase compared to the results from the previous edition (2011: 7,129 EUR).

Institutional types and missions

The institutional diversity in the sector is still high. Non-governmental organizations (NGOs) or foundations, non-bank financial institutions (NBFIs), governmental bodies, savings and commercial banks, credit unions, cooperatives, community development financial institutions, microfinance associations and religious institutions are active in microcredit provision in Europe. The distribution in the year 2013 among the institutional types shows that the highest shares of institutions surveyed are NBFIs (29%) and NGOs or foundations (23%), accounting for more than half of all surveyed organizations. While the share of NGOs and foundations is similar to the share identified

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by the last survey in 2011 (22%) the share of NBFIs in the sample has risen compared to 2011 (20%). The prevalence of both institutional types is observable as well in the subgroups of small, medium and large MFIs. The stated missions of the surveyed organizations also show a high diversity with regard to economical and societal policy goals. Microenterprise promotion is the most widespread goal, with more than two thirds of all surveyed organizations including it as part of their mission, followed by job creation (58%), social (56%) and financial inclusion (50%). Organizations with a specific focus on women and migrant empowerment form a smaller part of the surveyed organizations (29% and 20% respectively). The vast majority of the surveyed MFIs (85%) include at least one dedicated employment goal in their mission (microenterprise/SME promotion and/or job creation).

Financial performance and sustainability

One of the major issues of the European microfinance sector is the question of organisational sustainability. In terms of portfolio quality the total value of the microcredit portfolio affected by overdue loans for more than 30 days was lower for both 2012 and 2013 (2012: 12.8%, 2013: 13.1%) compared to 2009 (16%), although a bit higher than in 2011 (12%). Nevertheless, this illustrates an ongoing positive trend in the microloans sector, as institutions with lower portfolio at risk have lower impairment loss expenses and higher return on assets. Although the overall situation for portfolio at risk shows a positive evolution, PAR30 remains quite high in some of the covered countries. Regarding the profitability the microfinance providers manage to achieve overall positive return on assets (2012: 6.7%, 2013: 5.6%). As for the cost structure the participating institutions managed to decrease their expenses compared to 2011 with an operating expense ratio of approximately 18% in 2013. In combination with lower impairment loss expenses, this indicates overall decreasing expenses, which might lead to an improvement of the financial sustainability in the sector. Overall in the sector there is an ongoing trend of decreasing impairment loss and operating expenses, which might lead to improvements in financial sustainability.

Outreach to target groups

The availability of data on the outreach of European MFIs to specific target groups and social performance indicators remains limited. The results of the survey indicate that women continue to be underrepresented as a target group (compared to the gender balance in the total population), although to a lesser extent than in the previous years. Information on the outreach to ethnic minorities and immigrants is even scarcer. With regard to the target group that will be specifically addressed in this publication the data available show that only 24.3% of the MFIs involved reported to serve rural populations in 2013. In general, the country with the highest share of loans disbursed to rural populations is Bosnia-Herzegovina with over 123m EUR in 2013 or 64% of the total value of microloans disbursed in the country by surveyed MFIs. The ten institutions surveyed from Poland provide the second highest value of rural microloans disbursed with over 90m EUR in 2013 (46% of the total value of microloans). This outcome might be related to higher agricultural activities in those countries relative to the overall economy. Romania with its 17 MFIs surveyed disbursed to rural clients+ more than 37m EUR in 2013, the 36% of the total value of microloans disbursed by surveyed institutions in the country.

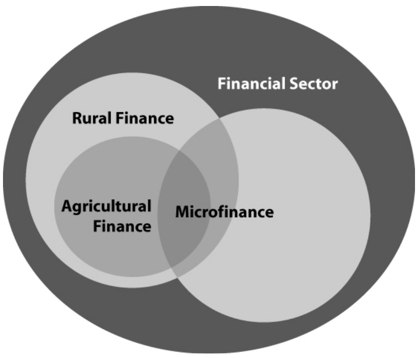
The rural entrepreneurial environment in Europe

The promotion of entrepreneurship depends not only on the presence of entrepreneurial individuals in an area or community but is also strongly reliant on the specificities of the socio-economic context. According to the EU Rural Review (EU Rural Review n. 10, 2011, European Network of Rural Development) the entrepreneurial environment can be seen as “the inter-connected set of factors that encourage innovation, promote risk-taking and foster the emergence and growth of new enterprises” including “various sources of information, different resource providers, markets, technologies and numerous intermediaries that facilitate the processes associated with business start-up and development”. To foster the entrepreneurship the presence of all these factors is not enough. In fact it’s also fundamental the way they combine and their proper interaction. Within rural areas the entrepreneurial initiative is confronted with the combination of the specific economic conditions of rural environments and the characteristics of the rural entrepreneurs. Therefore in rural areas, a deep understanding of the challenges of the entrepreneurial environment is even more important. On this subject the ESoF research project (*Developing the Entrepreneurial Skills* *of Farmers (ESoF), 2008, EU 6th Framework Programme*) has further developed the concept of entrepreneurial environment focusing on rural areas. The project analyses the economic, social and cultural factors that influence the development of entrepreneurial skills in rural areas with particular reference to farmers. Generalising the main findings of the project is possible to draw a distinction among external and internal entrepreneurial environment applicable to the rural setting as a whole. Accordingly, on one side the external entrepreneurial environment is represented by the social and business context in which the rural entrepreneurs are operating. This include the repercussions of the globalisation processes and of the policies adopted at EU and national level, the demand from consumers, the supply chains structures in place, climate and energy trends and environmental issues. On the other side, the internal entrepreneurial environment is associated with the skills and competences of the rural entrepreneur. This refers on one side to the business skills necessary to run an enterprise (sectorial expertise and managerial competency) and on the other side to the skills needed to deal with changes and innovate the business (opportunity, strategic and networking skills). In order to boost the variety of entrepreneurial business in rural areas, it is fundamental to improve both external and internal entrepreneurial environment. The EU Rural Review (2011) highlights three categories of obstacles to rural entrepreneurship in EU. The first category is connected with the small size, low population densities and remoteness of rural communities. The second category is associated with the social and economic composition of rural communities. Finally the nature of internal and external linkages also strongly affects the rural entrepreneurial initiative. Given these main constraints, the provision of microfinance emerges as a powerful tool to support and empower rural entrepreneurs improving both the internal and external entrepreneurial environment.

Microfinance in rural areas

The provision of financial and non-financial services could support new or established entrepreneurs to overcome the rural challenges supporting their businesses and boosting the local economy. In this regard microfinance often targets unemployed or people excluded from the traditional banking system who wishes to start their own business, significantly contributing to self-employment and job creation. According to CGAP (*CGAP Donor Brief No. 15 October 2003)* rural microfinance encompasses the provision of a range of financial services such as savings, credit, payments and insurance to rural individuals, households, and enterprises, both farm and non-farm. It includes as well the financing for agriculture and agro-processing funding input supply, production, distribution, wholesale, processing and marketing (Figure 1).

Figure 1 - Rural microfinance



Source: CGAP Donor Brief No. 15 October 2003

Nowadays the successful implementation of effective delivery of services and outreach are still important challenges in the provision of microfinance in rural areas. Each rural area has its own characteristics and as a consequence, institutional design, methodology, products and delivery of services need to be adapted accordingly. Some challenges faced by rural MFIs are similar to those facing any MFI while others are specific to rural organisation providing loans for farm-based activities. According to USAID (*USAID RAFI Notes Issue 1)* the following are some of the factors that constrain both the supply and demand for finance in rural and agricultural areas:

•High transaction costs for both borrowers and lenders;

•Generally lower population density and dispersed demand;

•Often limited economic opportunities available to local populations;

•High risks faced by potential borrowers and depositors due to the variability of incomes, exogenous economic shocks and limited tools to manage risk;

•Seasonality – potentially affecting both the client and the institution;

•Heavy concentration on agriculture and agriculture related activities exposes clients and institutions to multiple risks;

•Lack of reliable information about borrowers;

•Lack of market information and/or market access;

•Weak institutional capacity;

•“Crowding out” effect due to subsidies and directed credit;

•Lack of adequate or usable collateral (lack of assets, unclear property rights);

•Inhospitable policy, legal and regulatory frameworks;

•Undeveloped legal systems, inadequate contract enforcement mechanisms;

•Undeveloped or inadequate infrastructure;

Even if this extensive list of constraints relies mainly on experiences in developing countries it provides in any case a useful and comprehensive insight into the main challenges that also a European MFIs could be confronted with. Obviously MFIs operating in rural context do not have the possibility to choose the challenges they will face and many times the various challenges reinforce and compound each other. The following section presents examples of European MFIs able to overcome some of the constraints mentioned above with the adoption of innovative methodologies and strategies.

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