Microcredit and EU Cohesion Policy

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After nearly four years of the most serious financial and economic crisis Europe has seen in 80 years, most EU Member States are facing high budget deficits, growing public debts, while most entrepreneurs are facing difficulties in accessing finance due to the credit crunch. Meanwhile there are more than 23 million unemployed in the EU and unemployment rates have reached an average of 10% and more than 20% in Greece and Spain[1]. Microcredit can provide an answer to the employment challenges caused by the current economic crisis and to reach the 75% employment target rate set in the Europe 2020 strategy.

Introduction

Microcredit is receiving increasing attention from policy-makers as the financial and economic crisis advances. Several Member States have introduced it within their operational programmes while at the EU level specific schemes have been launched. This article reviews briefly the experiences of various microcredit schemes implemented so far, focusing on the specific framework of EU cohesion policy. It also highlights current challenges of implementing microcredit schemes within structural funds and comments on related proposals of the structural funds regulations for 2014-2020.

Microcredit as a response to the economic and financial crisis

Microcredit aims at micro-entrepreneurs and disadvantaged people who wish to enter into self-employment but face obstacles in accessing traditional banking services due to banks' lending conditions (significant down-payment capacity and high quality collaterals). Indeed, the prospects for many, in particular those unemployed, could be to start up a new enterprise taking into account that some of the new businesses do not require specific business skills – for example small shops and services. These issues have been studied worldwide and are well know in less developed countries as well as in EU development policy[2].

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Although the EU is lagging behind in terms of business creation rate compared to the US, microcredit can encourage new businesses, self-employment and stimulate economic growth[3]. Even before the crisis, Eurostat estimated the potential demand for microcredit in the EU is at least 700 000 loans, totalling around €6 296 million[4].

The contribution of Cohesion policy

Microcredit is not a completely new area of intervention for cohesion policy. It dates back at least to the previous 2000-2006 programming period when several initiatives were launched. Under the Community Initiative of EQUAL an initiative was run in Germany to develop microfinance institutions (MFI), and a national microcredit campaign '*Mikrofinanzfonds Deutschland*' was launched in 2006 with ESF support[5]. Spain started using the specific of Global Grants to create cooperations between NGO sector and the banking sector in developing a specific service to provide business support measures and provision of microcredits requiring no collaterals for members of the Roma community[6]. In the region of Tuscany, experiments in regional ESF programmes have funded a network of information desk points at local level for microcredit and underlined the importance of building up a regional microcredit system (SMOAT). More locally in Brussels a scheme was launched in 2001 financed from the ERDF and ESF to provide microcredit for the would-be self-employed[7].

For the current programming period 2007-2013 some Member States have foreseen microcredit schemes from the start; but others have had to introduce them following the economic and financial crisis and therefore are revising their operational programmes. In general, financial engineering has attracted interest because of its revolving character as resources can be used over and over again, whilst it helps by moving away from the one-off grant culture and therefore increasing the efficiency of cohesion policy. Financial instruments also have shorter routing time (from submission to payment), constitute less of a risk for deadweight and make more sense for projects that can have a financial return.

On the other hand, these instruments can be notoriously complicated and require specialist management teams. Thus a usual management structure involves a cascade system whereby a Managing Authority selects a holding fund manager. The fund manager is responsible for launching a 'call of interest' looking for possible financial intermediaries who will then reach beneficiaries on the ground. The EC has promoted the JEREMIE initiative (Joint European Resources for Micro to Medium Enterprise). JEREMIE taps into structural

Figure 1: Examples of national microcredit schemes financed by Structural Funds 2007-2013

Name of the fund	Member State	Fund Manager	Size of the fund	Characteristics
Széchenyi Kombinált Mikrohitel[8]	Hungary	Magyar Vállalkozásfinanszírozási Zrt. (Venture Finance Hungary Plc.)	€150 million	It includes €85 million for microcredit: up to €17200 (with interest rate: up to 9%) and €75 million for grants (€3400-13600) to finance investments and establishing start-up businesses as well. ERDF source.
Mikrokreditfonds Deutschland[9]	Germany	GLS bank	€100 million	ESF source Interlocking financing and consultancy services
Entrepreneurship Promotion Fund[10]	Lithuania	INVEGA	€15.5 million	ESF-based it focuses on the unemployed, disabled, young people and older people (over 50) 5.5% interest rate. State guarantee for 80% credit and interest rate rebates from ERDF measures.
Microcredit Initiative	Spain	INCYDE (Instituto Cameral para la Creación y Desarrollo de la Empresa) Founded as a Chamber of Commerce initiative	€10 million (planned allocation)	JEREMIE ERDF

funds to promote the use of financial engineering instruments and improve access to finance for SMEs.

Several Member States and regions have also taken this opportunity to launch microcredit schemes at national and regional level within their operational programmes by fitting them at their own specific territorial needs (Figure 1 and 2). All have followed different organisational models and more than 10 Managing Authorities have called upon the expertise of the EIF to manage these instruments.

Figure 2: Examples of Italian regional microcredit schemes financed by ESF 2007-2013

Member State/Region	Fund Manager	Size of the fund
Region Sicily	EIF	€15 million
Region Basilicata	Sviluppo Basilicata	€15 million
Region Sardegna	SFIRS[11]	€41 million
Region Puglia	Puglia Sviluppo S.p.A.	€30 million
Region Lombardy	Finlombarda Spa	€20 million
Region Calabria	Fincalabra	€37 million
Region Abruzzo	Abruzzo Sviluppo Spa	€14 million
Region Marche	Unicredit	€1.5 million

The EU has added further tools to the Member States' initiatives to support and increase the availability of microcredit.

The Joint Action to support Micro Finance Institution (JASMINE) managed by the EIB/EIF has been aiming since 2010 to enhance the capacity of non-bank microcredit providers/microfinance institutions in various fields such as institutional governance, information systems, risk management and strategic planning. Technical assistance (evaluation and training) is used to help them become sustainable and viable operators in the market. JASMINE works on a competitive basis and has so far concentrated its projects in Romania (7), Bulgaria (4), Hungary and the UK (3 each), Italy (2), Spain, Belgium and the Netherlands. JASMINE and DG Enterprise have also published a flexible European Code of Good Conduct for microcredit provision in order to support the microcredit sector itself in increasing quality and moving towards sustainability. The code is not a mandatory requirement but rather a voluntary endorsement by providers.

Besides JASMINE, the EC and EIB have launched the European Progress Microfinance Facility (EPMF) to reach particular at-risk groups. The Facility also works on a competitive basis with no pre-allocation of funds to specific Member States or regions in order to respond to specific emerging needs. Hence, the facility must ensure coherence and compatibility with cohesion policy regions, for instance when microcredit is provided to people living in rural areas (*e.g.* for Roma population through *Mikrofond Bulgaria*). The Facility operates in a cascade system from the EU level to 18 microfinance institutions selected in 12 Member States so far. A successful example is a microcredit scheme operating in deprived communities of Brussels (Saint-Gilles, Schaerbeek) where the unemployment rate reaches 30%[12]. The scheme is geared towards the unemployed and independent workers. Its success factors lie both in the proximity approach, links to growing immigrant communities and reduced formalities in line.

Challenges for development of microcredit within cohesion policy

Compliance with EU rules

The process of selecting the manager of the holding fund has raised legal questions since many schemes have opted to entrust the management to an in-house body. This option requires thorough checks and has led to the revision of statutes in some cases in order to adhere to EU public procurement rules. The following step concerns the agreements between the Managing Authority and the holding fund manager. Fund managers also have to be monitored thoroughly to ensure bank culture converges on respecting EU rules. A proper territorial coverage, adequate information and publicity as well as justified management costs are among the requirements.

Eligibility of expenditures within microcredit schemes imply adhering to detailed rules on the EU definition of microenterprises[13], *de minimis*, the possibility of financing working capital in early stages or as part of the expansion of a business activity, and spending before the end of 2015[14]. Firms in difficulty and firms supported by other EU funds should be excluded, as well as in certain sectors such as lotteries. The amending regulation on 'durability' of investments clarified that the obligation to keep SME investments for three years does not apply in cases of non-fraudulent bankruptcy or to financial engineering[15].

Some Members States had initially opted to introduce a bonus element within the loan provision. This premium-based system would have permitted a discount on the loan in case the beneficiary maintained workforce for at least two more years. However, this kind of mixed model has been withdrawn as repayable investments need to be distinguished from non-repayable assistance or grants[16].

Finally, microcredit schemes need to comply with proper monitoring and evaluation requirements, and not to underestimate the required reporting and administrative burden.

N+2/N+3

Managing Authorities could be tempted to make oversized allocations to financial instruments for the purpose of increasing 'absorption' and avoiding N+2/N+3 automatic decommitments. The risk is that there might not be enough capacity on the ground, which would lead to difficulties of absorption later on. Hence, fund size should neither be overproportionate nor below critical mass. Thorough gap assessment needs to be carried out based on knowledge of the demand of the market and supported by a proper *ex ante* evaluation of the SMEs' financing needs.

To increase absorption, microcredit should be strongly connected to local development policies[17] and must not suffer from competition due to a large availability of non-refundable grants. Indeed, competition could arise between grants and loans, or between loans at market rates or at reduced interest rates, thereby pushing beneficiaries to 'shop around' for different types of funding. Generally, a mix of non-reimbursable grants and financial instruments is welcome, but coordination between different funding sources and programmes must mitigate any distortions.

Case study: In Hungary, both the Central Hungarian and the Economic Development Operational Programmes are supporting microenterprises which represent 85% of Hungarian enterprises, although the Central Hungarian OP has already been overwhelmed by high demand. The most popular scheme is a microcredit scheme (**Széchenyi Combined MicroLoan**) which has favourable conditions and is also open for start-up businesses. Microenterprises are asked to submit in a single application process a request for receiving both, a grant as well as a loan – the latter is meant to cover the co-financing required by the grant. The Hungarian state contributes to the financing of the microloan under the *de minimis* principle. Decisions on financing are taken within 30 days; the amount can then be used to buy equipment, ICT tools and basic infrastructure for start-up businesses[18]. Applying for a loan is a mandatory part of the scheme even if microentreprises have enough of their own resources to cover the amount of the co-financing. Therefore, in combining a refundable microloan and a non-refundable grant, this feature makes it a unique structure for providing microcredits.

The added value of microfinance lies in tackling specific target groups.

EU added value and leverage effect

Microcredit schemes need to deliver high added value and this can be measured in terms of leverage from the private sector. The European Court of Auditors (ECA) highlights weaknesses and inefficiency in leveraging private investments, as structural funds do not stipulate any requirements as per leverage ratio, frequency and reutilisation of legacy funding[19]. In their audit, the ECA found that for loan instruments the leverage ratio ranged from 1.33 in Hungary to 1.67 in the UK; but for guarantee instruments it ranged from 4.16 in Hungary to 171 in Portugal. For the next programming period a suggestion could be that the European Commission requires contractually binding minimum leverage ratios, minimum revolving periods and data for calculation of leverage indicators.

Added value is not only to be found in the leverage effect, but by tackling specific target groups and taking into account that both ESF and ERDF funds have their own specific objectives and focus when investing in microcredit. Integrated projects in the Region Emilia Romagna tapped into the potential of female entrepreneurship in the *Datecicredito* project; while in Sicily the JEREMIE pilot scheme focuses on helping to find alternatives to the long-standing problem of usury.

Hungary and Spain have specialised in the integration of the Roma community, as self-employment fits better with the lifestyle of the Roma community rather than the prospects as salaried workers. In Hungary, microcredit has helped bring activities from the non-formal to the formal sector by financing small businesses, for examples mobile vendor business of clothing, plastic items and groceries, second-hand shops, flower shops, or even wood processing. The Hungarian *Kiut* programme – financed directly by the European Commission in 2009 – has also underlined how complex microcredit to Roma communities can be if there is insufficient integration with government policies, or weak links with operational programmes; meanwhile, the need for training of these specific communities is constant[20].

Finally, networking among EU countries is crucial since good practices should be shared and exchanged from other countries as well as from previous programming periods[21]. Therefore the European Commission is supporting a network among Managing Authorities and stakeholders through a Community of Practice on Inclusive entrepreneurship (Copie). Exchanges of experience should extend further to EARDF funds when supporting small-scale farmers or to the EFF fund for young fishermen. The EPMF facility and structural funds should integrate further for interest rates rebates, training and coaching as well as further promotion through Public Employment Services. Finally, we should link to successes achieved outside cohesion policy by EU mobility programmes such as 'Erasmus for young entrepreneurs'.

Training and business support

While the finance function is central to microcredit, it is however, not sufficient. Other functions such as capacity building and business support need to be integrated to accompany the financing, in particular for groups with little alphabetisation. In some cases the individual legal coaching is provided for free by charity workers, but in other cases structural funds can subsidise the business support measures that precede or accompany microcredit. Training and business support need to be result-oriented as requested by the new regulations.

In its Entrepreneurship Promotion Fund, Lithuania integrated in a one-stop-shop both the provision of trainings, individual consultations and the possibility to apply for a microcredit, thereby providing a simplification for the entrepreneur. In Spain, the regional and local network of Chambers of Commerce will provide microcredit alongside trainings and will give access to its incubator network for entrepreneurs to find the ideal place for business start-ups[22].

A role can also be played by cities and local authorities to develop a more favourable environment, especially for micro-finance – not merely for local banks but open to any financer actor who engages in new approaches to finance entrepreneurship[23]. Local authorities should ensure that a proper business environment is in place that allows companies to be set up within three days and for less than €100 as requested in the *ex ante* conditionality principle.

Conclusions

Microcredit answers a growing need for self-employment in the EU. Cohesion policy has contributed to its development and will continue to provide support within the cohesion package for the 2014-2020 programming period. The EC envisages a new Programme for Social Change and Innovation (PSCI) with an axis on Microfinance and Social Entrepreneurship (€191 million), which plans to set up a one-stop-shop for EU micro-finance support (financing and capacity-building) – with a focus on vulnerable groups – to improve access to finance for social enterprises.

Furthermore, the EC proposals for the future ERDF and ESF funds emphasise additional financial engineering instruments. The possibility to have multi-fund operational programmes in the next programming period, rather than mono-fund ones as is currently the case, may also open future possibilities for microcredit schemes to cover a wider range of beneficiaries and to create more synergies between funds. A further opportunity is the explicit reference to social enterprises in order to combat poverty in the proposed future ERDF regulation[24].

While preparing their future operational programmes, Member States need to think about how to build up microfinance schemes. A greater use of financial instruments should be accompanied by quality assessments of SME financing gaps, reinforced attention to ensure added value and requirements for leverage from the private sector, more synergies between structural funds, as well as proper systems that allow compliance with EU rules. Training and business support must also be foreseen to complement the financing function for beneficiaries in order to fully maximise success in business ventures. Finally, enhancing of microcredit will also rely on both the simplification of the rules for financial instruments and increasing legal certainty for all parties through proper and timely guidance by the European Commission.

Finance is central, but microcredit requires training.

Notes

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1 Source: Eurostat.

2 EU manages the Microfinance Programmes within the 9th European Development Fund (EDF) in ACP (African, Caribbean and Pacific), worth €15 million. Between 2005 and 2010 as the number of clients increased by 150% to 775 000, several MFIs grew in strength, and training and technical assistance was provided. A further investment of €15 million is foreseen in the 10th EDF.

3 Microcredit is defined as a loan of up to €25 000; but in reality many businesses need even smaller amounts of capital in some cases as little as €1 000 to set up their business, with the majority being around €5 000. See Commission Staff Working Paper, 'Microcredit for European small businesses', 2004, p. 5

4 Report on Implementation of the European Progress Microfinance Facility, COM/2011/0195 final

5 A cooperative model was developed with a network of partners to economise on existing public promotion functions, to support local MFIs and link the functions of financing and consultancy in a sophisticated incentive system. Microfinance in Germany and Europe, *KfW Bankengruppe*, April 2007, p. 73.

6 See results in Report 2000-2006, Acceder Promoting Roma Employment, Fundacion Secretariado Gitano (FSG). The banking partner Caixa Catalunya developed a specialised unit microcredit branch Un Mon Sol.

7 Providing microcredits from €1250 to €25 000 for economic revitalisation of neighbourhoods in the Priority Intervention Zone of the Brussels-Capital Region, www.srib.be

8 www.mvzrt.hu

9 The Ministry of Labour and Social Affairs assigned in 2010 the GLS Bank to establish an agency network through which more than 15,000 loans will be disbursed until 2015.

10 The Lithuanian Ministry of Finance, Ministry of Social Security and Labour, and a guarantee institution, INVEGA, selected the Lithuanian Central Credit Unions and the consortium of 57 credit unions to allocate 50 million Litas by 2015. The objective is to create 1000 new jobs, grant 1200 loans to individuals or SMEs and to deliver business training for 5000 people.

11 www.sfirs.it

12 MicroStart was launched to support buying inventory, equipment, treasury or a second-hand vehicle with a loan from €500 to a maximum of €10 000, www.microstart.be

13 Commission Recommendation 2003/361/EC of 6 May 2003.

14 Article 45, Commission Regulation (EC) No 1828/2006 of 8 December 2006.

15 Article 1(8)(b) Regulation (EU) No 539/2010 of 16 June 2010 amending Council Regulation (EC) No 1083/2006.

16 Guidance Note on Financial Engineering Instruments under Article 44 of Council Regulation (EC) No 1083/2006, COCOF version 21 February 2011.

17 The Italian National Committee for Microcredit (ENM) is working on a national Italian ESF project to integrate microcredit, active labour market policies and local productive systems. www.microcreditoitalia.org

18 www.nfu.hu (Description of tenders under GOP-2011-2.1.1/M and KMOP-2011-1.2.1/M)

19 Financial Instruments for SMEs co-financed by ERDF, European Court of Auditors Special Report No 2, p. 41-44.

20 Third progress report, www.kiutprogram.hu

21 Proceedings from EIPA seminar 'Better Access to Finance: Using the EU Microcredit Initiatives', 29-30 March 2012, Regione Molise, Brussels

22 www.incyde.org

23 See Leipzig Action Plan http://urbact.eu/en/projects/human-capital-entrepreneurship/fin-urb-act/our-partners/

24 Article 5, Proposal for a Regulation of the European Parliament and of the Council on specific provisions concerning the European Regional Development Fund and the Investment for growth and jobs goal and repealing Regulation (EC) No 1080/2006, COM(2011) 614 final.