

TECHNICAL BRIEF

SUPPORTING INCLUSION IN EUROPE THROUGH MICROFINANCE



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The working paper is printed in this form to communicate the result of an analytical work with the objective of generating further discussions on the issue.

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Executive summary

Microfinance covers all the financial services provided to unbanked or underbanked persons with an ultimate goal of giving impoverished people an opportunity to become self-sufficient and improve their quality of life. Microfinance is, by and large, a growing sector in many European countries, where it contributes to financial, economic and social inclusion. Various financial and non-financial services, ranging from microcredit to business advice, can enable previously underserved individuals to create jobs, improve their living conditions and finance other social needs, with significant benefits for communities and for society as a whole.

Microfinance Institutions (MFIs) in Europe are very heterogeneous in terms of their legal form, business model, objectives and country of operation. However, all of them are faced with challenges related to meeting the double bottom line of social and financial sustainability. Limited access to finance often constrains MFIs' outreach to targeted groups and curbs their growth. International Financial Institutions (IFIs) such as the Council of Europe Development Bank (CEB) can play an important role in enabling MFIs to reach more vulnerable Europeans in a financially sustainable way.

Building upon the CEB's microfinance operations to date, exchanges with other European IFIs and the European Microfinance Network (EMN), this Technical Brief highlights three areas where action by International Financial Institutions (IFIs) can be highly relevant in supporting MFIs, thus enabling them to reach their social and financial objectives.

- ▶ Expanding access to finance for MFIs by, first and foremost, helping close the growing market gap in loan financing that MFIs need for their on-lending activities. Other financial instruments such as guarantees and equity are often requested by European MFIs and some IFIs are already responding to such requests, albeit in very limited amounts. However, as many European MFIs remain relatively small, IFIs face significant transaction costs relative to the size of each operation. This may prevent the small, but often highly impactful MFIs from obtaining IFI funding. Optimising internal operations and working through funds or other types of intermediaries may help correct this market failure and increase the IFIs' outreach.
- ▶ Supporting the economic and social inclusion of vulnerable populations by providing adequate financing for social purpose loans in addition to business microcredit. Social purpose loans are typically used to finance personal investments in housing improvements and may significantly improve the end-borrowers' living conditions. In addition, technical assistance – already offered by all IFIs operating in Europe – is key to improving MFI efficiency and increasing outreach to more vulnerable, yet sometimes less accessible, sections of the population.
- ▶ Enhancing the social and – preferably – environmental impact of microfinance by measuring it in a more transparent and consistent manner. European MFIs are generally very conscious of and committed to the necessity to collect data related to their operations, but they sometimes lack the resources with which to do so and there is no set of commonly agreed indicators. This Brief discusses a number of indicators, which could be harmonised across MFIs and IFIs, to measure social impact and, when relevant, to better understand environmental trade-offs. The environmental footprint that microfinance operations may have, and the ways to best address possible trade-offs between the environmental and social objectives of IFI portfolios, should also be considered.

1. Introduction

Financial exclusion, or lack of access to formal financial services, can have significant negative financial, economic and social consequences for the businesses and individuals concerned and for the community at large. It often determines the patterns of household consumption, housing options and the ability to develop a business. Yet, in 2017, 138 million Europeans were financially cut off from society – without a bank account or any method of payment (Mastercard, 2017). The social groups most affected by limited or no access to financial services are the elderly, the unemployed, the less educated and the less well-off (Coffinet and Jadeau, 2017). In addition, many of the migrants and refugees arriving in Europe are also unbanked and in need of new financial instruments to facilitate their long-term social and economic integration.

Over the past four decades, microfinance has emerged as an effective tool to serve low-income populations in developing countries and, more recently, has been gaining traction in Europe. Less than 10% of the global outstanding microfinance portfolio is in Europe, but it has increasingly become an important instrument for empowering the most vulnerable social groups (BNP Paribas, 2017). Microfinance institutions (MFIs) provide financial and support services to microenterprises that cannot access more traditional sources of financing in order to facilitate self-employment, create jobs and increase productivity, with positive implications for public budgets. In addition, personal loans with a social purpose such as paying for education, healthcare or improving living conditions can contribute to social integration and cohesion within communities.

The Council of Europe Development Bank (CEB) has been lending to Micro-, Small and Medium-sized Enterprises (MSMEs) in its member countries for over twenty years and has contributed to microfinance operations for over a decade. According to its social mandate, the CEB's microfinance lending aims to increase financial and social inclusion and is focused on, but not limited to, creating jobs through self-employment, addressing the needs of vulnerable populations and reducing gender inequality.

Box 1: Microfinance at the CEB

The CEB's engagement with microfinance dates back to 2008, with the approval of several loans to Spanish MicroBank, a subsidiary of CaixaBank set up in 2007 and dedicated to financial inclusion through microlending. Since 2013, the CEB has broadened its support by reaching smaller MFIs, which often present a riskier profile and require funding from IFIs to achieve financial sustainability, while targeting more vulnerable or specific subgroups of the population. At end 2018, the CEB had approved sixteen loans for microfinance (totalling €465.5 million), in seven countries (Belgium, Bosnia and Herzegovina, Georgia, Italy, Montenegro, the Netherlands, and Spain). Since 2017, the CEB has also started financing personal microloans with a social purpose in addition to business microloans.

Besides providing loans to MFIs and banks, which on-lend the funds to micro-clients, the CEB can also provide financial support for technical assistance, capacity building, or guarantees for its own loans - most often in its target countries (via its Social Dividend Account – SDA).

This Technical Brief provides an overview of the role of microloans in supporting social integration in Europe, and explores possible further action to address the existing market gaps. The Brief is structured as follows: Section 2 presents the microfinance sector in Europe, the issues faced by MFIs when accessing external capital and the rationale for IFI action. Based on the CEB's experience, Section 3 discusses how IFIs can better support European MFIs. Finally, Section 4 provides a number of conclusions.

Data included in this Technical Brief comes from the CEB's projects in the sector, literature review, discussions with the European Microfinance Network (EMN) and their bi-annual survey of the microfinance sector in Europe, and interviews carried out with other international lenders operating in Europe.¹

2. Microfinance in Europe

2.1 General overview

Microfinance products and services are widely available across Europe today, provided by a number of institutions including specialised MFIs, non-governmental organisations, credit unions and commercial banks. The sector has been expanding over the years with currently nearly 1 million active micro-borrowers and €2 billion in microloans disbursed in 2017, both figures representing a 50% increase from 2014 (European Microfinance Network, 2018).

Microcredit² is the most commonly used microfinance product, traditionally offered to unbanked individuals to start or develop their business, improve their living conditions and/or establish a credit history. Indeed, more than half of the European Non-Bank Financial Institutions³ (NBFIs) focus primarily on micro-lending activities, which account for 75% of the overall turnover (Diriker at al., 2018). The total amount of microcredit disbursed in Europe is shared equally between business and personal loans (approximately €1 billion each). Personal microloans grew by 80% from 2014 to 2017 as borrowers started to require a more diversified offer of financial products to improve their employability and social inclusion (for example, to pay for personal transportation vehicles, education or healthcare) in addition to starting a micro-business (Corbucci, 2016). Some MFIs in Europe also offer savings products, insurance, leasing or mortgages, and non-financial services such as training or business advice (Diriker at al., 2018).

The microfinance landscape in Europe is heterogeneous because of distinct national legislation, historical legacy and social context. Most marked differences exist between the Eastern European countries, where microfinance developed after the collapse of the Soviet Union as a way to access finance and promote entrepreneurship for large sections of the population, and Western Europe, where many microfinance programmes were developed as a policy instrument to assist vulnerable groups and are usually implemented in over-protective environments (e.g. anti-usury measures enforcing very low interest rates) that intervene in free markets. As a consequence, MFIs in Eastern Europe tend to focus more on microenterprise lending activities and are, in general, more financially sustainable due to better economies of scale (Botti et al., 2016).

Conversely, Western European MFIs rarely reach a break-even point on their own as they prioritise the social and financial inclusion of the most vulnerable and offer more household loans or non-financial services (Balkenhol and Gloukoviezzoff, 2015). They often benefit from support in the form of capital or subsidies, either from a public authority or from (public or private) shareholders. Adie, the oldest MFI in France, calculated that in order to become financially sustainable while maintaining a wide spectrum of services, it would have to charge an interest rate of more than 30% on its microcredits (Adie, 2016). In addition, strict regulations in some European Union countries may hinder the profitability of MFIs. For example, under the Italian law on financing transactions, the applicable interest rate (plus applicable fees and expenses) cannot exceed a certain threshold, which is lower for MFIs than for commercial banks, thus limiting the ability of MFIs to expand in a financially sustainable manner.

¹ The European Investment Fund (EIF), the European Bank for Reconstruction and Development (EBRD), the European Fund for Southeast Europe (EFSE), the KfW Development Bank, the Dutch Development Bank (FMO).

² In the European Union (EU), microcredit (or microloan) refers to any loan below €25 000. A new – more nuanced – definition is currently under discussion, which should take into account more microcredit features such as client and institution type as well as the non-financial services offered.

³ In the EMN survey, a Non-Bank Financial Institution is defined as an institution that provides similar services to those of a Bank but is licensed under a separate category; generally due to lower capital requirements, limitations on financial service offerings, or to supervision under a different State agency.

Box 2: EMN Survey results: comparison of MFIs in Eastern and Western Europe

	MFIs in Eastern Europe		MFIs in Western Europe	
	2016	2017	2016	2017
Return on Equity (ROE)	9%	9%	-21%	-13%
Return on Assets (ROA)	3%	3%	-1%	2%
Operational Self Sufficiency (OSS)	65%	62%	55%	53%

“The portfolio quality of Eastern European MFIs is significantly better than their Western counterparts. (...) MFIs from Western countries are more focused on specific underserved target groups, such as the unemployed, immigrants and women compared to Eastern MFIs. They also serve potential entrepreneurs that are in the process of establishing their business as opposed to SMEs or microenterprises that are already in business, as is more common in Eastern Europe. As a result, loan collection from these vulnerable client groups might be more problematic and could be the reason for differences between portfolio quality indicators between Eastern and Western Europe. The overall financial sustainability of Western MFIs in terms of ROE, ROA and OSS is also relatively poor compared to Eastern MFIs. (...) Western MFIs are less focused on achieving self-sufficiency as they have better access to funding sources to cover their operational expenses and/or portfolio losses. Conversely, Eastern MFIs often have to generate enough revenues to cover all operating and financial expenses and loan defaults” (Diriker et al., 2018).

Even though it is difficult to measure the social impact of microfinance operations, the available data suggests that well-designed microfinance products and services can act as development instruments to address the social needs of the most vulnerable in Europe. First of all, microcredits help disadvantaged people establish their businesses with high survival rates (78% for Belgian “microStart” and 86% for Dutch “Qredits”). Second, studies have estimated that a business microloan often leads to the creation of jobs: 1.81 jobs on average among Spain’s “MicroBank” clients and 2.6 jobs in France (Cordobés, 2013 and Balkenhol and Guézennec, 2014). Monitoring of the CEB’s portfolio of microfinance operations shows that business microloans allow (at minimum) the entrepreneurs to create or maintain their own jobs. Third, KPMG calculated that €1 invested through a business microloan generated a social return on investment⁴ of €4 for “microStart” in Belgium and €2.38 for “Adie” in France (Walterus, 2017 and KPMG, 2016). Fourth, personal microloans seem to have a positive impact on social inclusion (63.5% of borrowers) and housing conditions (67.5%) (Gloukoviezoff and Palier, 2008). It is nonetheless very important to note that the impact studies for microfinance operations remain very context-specific and the results should not be generalised.

The EMN 2018 survey reports that European MFIs specifically target vulnerable groups, in particular women, rural populations, the unemployed and youth. The CEB’s loan to MI-BOSPO, a not-for-profit MFI in Bosnia and Herzegovina, contributes to women’s economic and social development in a country with significant gender imbalances (Box 3) and represents a typical example of targeted action.

⁴ The Social Return on Investment (SROI) measures, in monetary terms, extra-financial value (such as environmental and social), which is not reflected in financial accounts, relative to resources invested.

Box 3: MI-BOSPO Microcredit Foundation

The lack of financial resources for self-employment is among the challenges faced by Bosnian women when engaging in an economic activity and/or starting a small business. The 2016 Bosnian Labour Force Survey by the International Labour Organization (ILO) states that male and female labour force participation stand at 55% and 33.5%, respectively. In addition, women make up 45% of the unemployed population, but 62% of the inactive labour force. The fact that many women remain as unpaid family workers and that many others are discouraged to join the labour market, hence are not counted in the unemployment rate, exacerbates these figures.

To address the current unfavourable position of women in Bosnia and Herzegovina, in 2018 the CEB approved a €2 million loan to MI-BOSPO. Although it mainly targets women, who make up about two thirds of its clients, MI-BOSPO is not a “women-only” type of institution and also serves male clients. The project has the primary objective of contributing to gender equality, which overlaps very well with MI-BOSPO’s strategic focus. The CEB loan will finance private households, micro-entrepreneurs and smallholders (mostly women) with limited or no access to bank loans.

2.2 MFI access to finance

European MFIs often face a number of challenges. First of all, they have to find the right balance between financial sustainability and social objectives – the so-called “double bottom line” (Gloukoviezoff, 2016). Indeed, MFIs have to cover higher operational and funding costs than traditional banks because they manage and service many smaller loans with a significantly higher risk. Secondly, most European MFIs are non-deposit taking institutions; they therefore need continuous access to external debt finance for on-lending. Finally, legal frameworks or supervision by central banks are often not adapted to MFIs, thereby constraining their growth.

Funding and operational costs, credit write-offs and profit margins are the main determinants of the interest rates MFIs charge their clients, which in Europe vary from 2% to 34.3% for business loans and from 1.2% to 95% for personal microloans (Diriker et al., 2018). According to some estimates, the funding costs globally could make up, on average, one quarter of the interest rates charged to final clients (Diriker et al., 2018); similar figures emerge for the CEB’s portfolio. Adequate access to funding is therefore a prerequisite for both MFIs’ financial position and their ability to reach the most vulnerable social groups. The 156 European microfinance providers of all institutional types that the EMN surveyed in 2018 have an unmet additional funding need of at least €942 million, with three quarters (78%) of that amount required in debt financing, and the rest in grants, subsidies, equity and guarantees (Diriker et al., 2018). Only 5% of surveyed MFIs were reported as not facing any particular challenge to access finance, while for many others the main issue was to access additional support for business growth. For NBFIs the cost was the main challenge to securing sufficient funding (Diriker et al., 2018).

A recent EMN study corroborates the existence of a significant funding gap: in order to satisfy all the existing demand in Europe for business microloans alone, MFIs would need additional financing of €1.15 billion in loans (Unterberg, 2017). This gap could increase further because microfinance operations are expected to grow throughout Europe, thus leading to higher funding needs. At the same time, funding supplies may decrease because some regional, national and European policy makers may give priority to direct labour market activities (such as subsidising jobs directly) over measures to foster entrepreneurship, and because the negative impact of new strict financial regulations would curb the availability of affordable debt financing offered by commercial banks (Unterberg et al., 2014).

Yet, there is a strong twofold economic rationale for public and international lenders to intervene in the microfinance market. On the one hand, there is information asymmetry between commercial finance providers and relatively small MFIs with limited track records, virtually no collateral and a lack of established relationships with lenders (Lorenzi, 2016). This implies a market failure whereby even well-performing and financially sustainable MFIs may not be able to access funding. On the other hand, microfinance facilitates social and financial inclusion and thus generates positive externalities for society as a whole in terms of more economic activity and less social spending.

Recognising the importance of MFI access to finance, many International Financial Institutions support MFIs across Europe with financial and capacity building instruments.⁵ The majority of IFIs primarily lend to financial intermediaries – mostly banks – that channel micro or small loans to enterprises and individuals, which often leads to an overstatement of their support for microfinance. All of them make an effort to work directly with MFIs despite the higher relative operational cost inherent to smaller loan amounts. The microfinance portfolio of IFIs in Europe remains small, but is growing and many IFIs are willing to expand it in the future.

The EIF and the CEB are the only European actors that provide funding for microfinance on a wider European level, including in Western European countries. Most other IFIs support microfinance operations in the Western Balkans and even in several of the European Eastern Neighbourhood countries. IFIs usually offer preferential interest rates, set rather close to market terms to prevent distortion. For most IFIs, the minimum size of a loan to an MFI stands at around €1 million, with the most common debt maturity standing at 3 to 5 years. IFIs also take into consideration the typically higher credit risk profile of MFIs when considering their own portfolios. Despite the fact that MFIs are usually rated as riskier, the impact on IFI capital ratios is expected to remain limited as long as microfinance operations represent a rather marginal share of overall lending.

3. How IFIs can better support microfinance

Based on the CEB's experience, exchanges with other European IFIs and the EMN survey, this section looks at several ways in which IFIs can better support MFIs in reaching their social and financial objectives. These include providing adequate financial instruments to MFIs, optimising operations to reach smaller MFIs, extending support for social purpose borrowing, tackling MFIs' needs for technical assistance and capacity building, and improving measurement of the social impact of microloans, including ways to address possible trade-offs between environmental and social objectives.

3.1 Expanding access to finance for MFIs

Increasing the range of financial support

As discussed in the previous section, access to finance is a major concern for European MFIs. The biggest emerging funding needs are for loans to enable on-lending at sustainable and affordable interest rates. Access to other types of financial instruments is also crucial for MFIs to be able to serve the most vulnerable population groups. This presents an opportunity for IFIs to further expand their more traditional loans to MFIs.

For example, the EMN study estimates that European microfinance providers need over €100 million in portfolio guarantees on an annual basis (Unterberg, 2017). Relatively small but growing MFIs are interested in portfolio guarantees as a way to support their integration into local funding markets, through commercial banks that might otherwise not be willing or able to take on the MFIs' risk profiles, and to build relationships with commercial banks, which may bring opportunities for future additional funding, thereby facilitating a scale-up with a view to financial sustainability. Currently, the EIF is the

⁵ In addition to the CEB, this Technical Brief refers to microfinance activities carried out in Europe by the European Investment Fund (EIF), the European Bank for Reconstruction and Development (EBRD), the European Fund for Southeast Europe (EFSE) and national development banks such as the KfW Development Bank and the Dutch Development Bank (FMO).

principal provider of guarantees and supports financial intermediaries with portfolio guarantees (providing partial credit-risk protection for their portfolios) and counter-guarantees on their borrowings.

In addition, approximately 15% of non-bank financial institutions that participated in the EMN survey report a need for equity (Diriker et al., 2018). Many IFIs, including the EIF, EBRD, EFSE, FMO and KfW, may offer some equity to European MFIs, but by and large this instrument remains undersupplied relative to the expressed demand.

Optimising IFI operations to better deal with smaller loan amounts

Given the cost-intensive nature of very small ticket loans, IFIs tend to channel their investments via specialised microfinance and social funds or to directly finance only larger, financially sound MFIs. Initiatives for new vehicles are also being considered. The EIF, for example, has committed equity worth up to €5 million in Helenos, the first pan-European private equity fund providing equity and loans to MFIs and small FIs targeting micro businesses and social enterprises in Western and Eastern European countries. Helenos' first launch in 2018 stood at €10 million with a target to reach €25 million.

Such initiatives could provide opportunities for partnerships and intermediation to help reach even smaller MFIs and ensure that their social performance is well-assessed and satisfactory.

3.2 Supporting the economic and social inclusion of vulnerable populations

Extending microfinance to social purpose loans

Historically, microfinance has been considered as an instrument to support self-employment by helping microenterprises make productive investments. Personal microcredit, on the other hand, appears more controversial: whereas it aims to address important personal needs, thereby fostering social inclusion, it may fuel consumption and lead to over-indebtedness of the final clients, thus worsening their financial situation.

Nevertheless, personal microloans have grown significantly in recent years and now represent half of all microfinance activity in Europe. The rapid expansion of personal microcredit can be attributed to the conscious efforts made by MFIs to diversify their client base and to better serve the most excluded populations (including migrants and refugees). Today, half of the European MFIs provide personal loans (Diriker et al., 2018). At the same time, MFIs tend to consider personal microloans riskier, as these clients are usually not engaged in formal business activity, and often pertain to less advantaged population groups with irregular or sporadic incomes (e.g. incomes from day labour, on-call or substitute work, street trading and/or living on spousal/child support), frequently causing delays in repayments. These loans also require more operational resources because they are, on average, three times smaller than microenterprise loans and are offered on shorter terms (Diriker et al., 2018). As a result, annual percentage rates for personal microloans tend to be higher (on average 18% versus 11% for business loans) (Diriker et al., 2018).

Personal loans can be divided into two types: (i) consumer loans that mostly finance personal consumption (for example, vacations, family events or home appliances); and (ii) social purpose loans that serve to finance social household investments. Social purpose loans can pay for education, emergency healthcare or improvements in living conditions (e.g. for house improvements or small-scale energy efficiency investments). As such, they have a considerable impact on the social integration and well-being of vulnerable populations. They can even be considered “as an example of social innovation that addresses a double shortage: a market shortage, since some creditworthy people have no access to credit, and a social protection shortage, since once again in this field they cannot find suitable funding solutions fitting their needs” (Lacroix and Poidatz, 2016).⁶

⁶ It should be noted that the distinction between different types of microloans is not always clear-cut: indeed, financing a vehicle purchase, repairs, or acquiring a driving license could be considered as a consumer loan and as a social purpose loan if it serves to improve the end-borrowers' mobility and employability, and yet it is usually recorded under business lending.

Since 2017, the CEB has increased the scope of the microfinance loans it provides to allow on-lending in the form of social purpose loans, with the objectives of contributing to the financial inclusion of vulnerable populations, including rural communities, women, migrants and ethnic minorities, tackling regional disparities and addressing gender imbalances. For example, the CEB is supporting an MFI in Bosnia and Herzegovina that offers social purpose loans to households who undertake small-scale energy efficiency investments in their dwellings. The residential sector accounts for nearly half of the total final energy consumption in the country and buildings typically suffer from poor insulation and insufficient heating. In addition, the inefficient use of energy leads to elevated energy bills, which is a big concern, in particular for low-income households. This MFI has also received technical assistance through the Green for Growth Fund, Southeast Europe, to develop a strategy, a product offering and a web-based tool to calculate the expected energy savings and CO₂ emissions to be achieved through these small-scale energy efficiency investments.

In order to better capture and support the expanded objectives of microfinance operations to social purpose loans, microfinance could be considered by IFIs as a dedicated lending sector, separate from support for job creation in MSMEs. This could be further supported through the definition of specific indicators, as outlined in section 4.1.

Tackling the needs of MFIs to achieve better and more effective outreach

In their exchanges with the CEB, during appraisal or monitoring, MFIs typically express significant interest for technical assistance and funding thereof, in particular to improve their capacity in information technology and in the handling of legal matters when facing complex loan or subsidy contracts. The CEB clients would also like to do more market research to better identify their clients' financial and non-financial needs in order to better align their strategies to client demands and market trends. In addition, many MFIs cannot afford to hire the professional expertise required to collect data and carry out impact studies, which would allow them to better understand and demonstrate their contribution to socioeconomic inclusion.

Probably most importantly, all MFIs are concerned about adapting to digitalisation and fintech trends that are currently disrupting the financial industry. Digitalisation presents a double opportunity for MFIs with positive repercussions for their financial and social performance; namely increasing client outreach and decreasing operational costs. At the same time, MFIs are mindful of maintaining a human approach in their operations and the capability to serve clients with little digital literacy or internet access. Today 40% of European MFIs already offer online loan applications and 20% allow the uploading of documents to accompany their applications (Diriker et al., 2018). However, only 9% of institutions enable their clients to repay loans online and 49% offer no digital solutions at all (Diriker et al., 2018).

Many MFIs in Europe have limited internal resources to invest in their own capacity building and the development of new products. The Western European MFIs that often are not financially self-sustainable are particularly constrained, but at the same time they have more access to various public grants and large private (consulting) companies that may offer pro-bono services as part of their corporate and social responsibility policy. MFIs in Eastern Europe may have more internal resources, but also face more difficult institutional environments and much less, or no, public financing. The technical assistance offered by international lenders can therefore serve in many different cases as an important catalyst for improving the financial and social performance of MFIs.

The CEB and other IFIs in Europe interviewed for this Brief offer MFIs instruments to facilitate capacity building in order to enhance their risk management, refine their marketing strategies, improve their IT systems and provide staff training, among other things. Technical assistance for a specific need is typically identified during the due diligence process. In most cases, it is provided by external consultants, managed by the IFIs and financed through separate donor accounts, usually dedicated to specific sectors or geographical regions. Some IFIs cover only part of the technical assistance fees so as to ensure full buy-in from the MFI, which is required to finance the remaining part.

3.3 Enhancing the social impact of microfinance

Measuring social performance better

Microfinance operations are generally considered to be of high social impact, since they specifically target vulnerable populations and contribute to their financial and social inclusion. However, evidence of the social benefits of microfinance instruments is limited and often based on *ad-hoc* methods, which restrict possible comparisons, even within the same MFI.

Measuring the larger socioeconomic impact of microfinance operations is difficult and resource-intensive because it requires a large amount of data. MFIs often invest their own resources – or sometimes benefit from pro-bono consulting services – to study the social impact of their activities, which helps them underline their added value, thereby generating interest from investors and thus enhancing their access to funding. Many MFIs prepare impact studies, the results of which provide valuable insight as to the social impact of the CEB's loans. However, these studies are usually carried out every few years at best, and mostly present extrapolated results of a portion of the MFI's activities.

Numerous initiatives exist focused on microfinance indicators with the objective of harmonising the indicators for MFIs. For example, the Social Performance Task Force proposes a set of indicators agreed on among various microfinance players at global level.⁷ Moreover, many European microfinance providers report their data and indicators to the MIX market (Allet et al., 2015). However, a common international framework for IFIs is still lacking. Such a framework could be promoted and developed through the network of Harmonised Indicators for Private Sector Operations (HIPSPO), a partnership of 26 IFIs, including the CEB, aimed at fostering collaboration through the development of common output and outcome indicators to better assess the results of operations and serve clients by demonstrating results through common measurements.

The tables below propose a list of indicators for microloans based on the CEB's experience. In addition to standard employment data, these include further socioeconomic categorisation of the populations concerned – to better capture which targeted and/or vulnerable groups the MFI (hence the CEB) serves, and to what extent the loan contributes to their social inclusion.

Table 1. CEB indicators to measure the social impact of business microloans

MICROFINANCE – BUSINESS MICROLOANS		
	Indicators	Unit
Outputs	Number of end-borrowers financed and number of female end-borrowers financed (per sector)	Number and/or % share in total allocations
	Share of overall investment per sector of activity	% share in allocations
	Number of employees and number of female employees	Number and/or % share in total allocations
	Age group of end-borrowers ^a (per gender)	Number and/or % share in total allocations
	Number of start-ups ^b	Number and/or % share in total allocations
	Type of business served ^c	Number by type
	Additional information on entrepreneurs' socio-economic status ^d	Number by type
	Social Impact / Outcome	Number of jobs created and number of female jobs created
Growth of existing businesses (turnover) over time after receiving the micro-loan		Increase/Stable/Decrease

^a Typical age groups could be defined as <30, 30-55 and >55 (or adapted to each MFI's classification).

^b Definition of start-ups should differ for microfinance programmes (younger than 2 years).

^c Categorise between self-employed, micro-enterprise or small-sized enterprise.

^d Unemployed; recipient of any kind of social benefit (except for unemployment, already captured), immigrant/refugee.

⁷ For more information, please see <https://sptf.info/component/content/article?id=120:mix-sp-indicators>

Table 2. CEB indicators to measure the social impact of social purpose microloans

MICROFINANCE – PERSONAL MICROLOANS WITH A SOCIAL PURPOSE		
	Indicators	Unit
Outputs	Purpose of the loan	Education, housing, transportation, house improvement, etc.
	Typology of the expense	To be defined depending on loan purpose ^e
Social Impact / Outcome	Number of households or users benefitting directly from the loan	Number

^e e.g. in the case of house improvement: surface of housing unit, replacement of windows, boilers, insulation of walls, roofs, basement, installation of solar thermal panels, average reduction in energy use targeted, etc.; in the case of education: tuition fees, books and stationary, etc.; in the case of transportation: purchase of personal car, etc.

Dealing with environmental and social trade-offs

Some activities typically financed by microloans may have a significant impact on the environment. The CEB’s experience shows that relatively small programme loans with MFIs may substantially increase the carbon footprint of the IFI’s portfolio, often because micro-lending supports agriculture and vehicle purchase. A subsequent trade-off between social and environmental objectives may arise: the purchase of one or several cattle may ensure a livelihood for a whole family, especially in the Eastern European countries, but also carries negative effects in terms of greenhouse gas emissions.

At the same time, some argue that microfinance has an indirect positive effect on the environment since it promotes self-employment and a sustainable livelihood for vulnerable people who may otherwise be using and depleting natural resources to sustain themselves and their families. For example, the aforementioned family who bought cattle thanks to a microcredit may otherwise have engaged in illegal hunting or fishing for food. Another example, perhaps more relevant to urbanised Europe, is the upgrading of energy efficiency in housing using personal microcredits.

In addition, many of the MFIs in Europe are environmentally conscious and subscribe not only to the double, but to the triple bottom line, referred to as “people, planet and profit.” Some MFIs hold up sustainability as a precondition for awarding loans, while others encourage sustainable investments by offering lower interest rates to end-borrowers with greener business plans. Research suggests that, in Europe, larger and more mature MFIs tend to be more engaged in environmental responsibility, which is often closely related to interest and pressure from their investors (Forcella and Hudon, 2014).

MFIs often lack a set of established indicators to measure and monitor the environmental performance of their portfolio. Recognising this gap, MIX and the European Microfinance Platform (e-MFP), Microfinance & Environment Action Group, designed a survey to explore a set of quantitative green microfinance indicators with the aim of assessing their ease of use and relevance for decision-making. The report concludes that offering a strategic “way forward” will facilitate the gradual integration of green quantitative indicators into reporting standards for the microfinance sector (Allet et al., 2015).

IFIs have a role to play in promoting and incentivising environmental accountability within the microfinance sector. For example, some IFIs (e.g. EBRD, KfW) and many microfinance investors are signatories to the six Principles for Responsible Investment (PRIs), “a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating environmental, social and governance (ESG) issues into investment practice” (Principles for Responsible Investment, n.d.). Finally, more technical assistance could be provided to create tools and strategies for tracking green performance.

4. Conclusion

Microfinance in Europe can be a relevant instrument to address the needs of unbanked, underbanked and other vulnerable populations. The sector has developed differently in Eastern Europe, where the established MFIs are generally older, larger and more financially sustainable, and Western Europe, where MFIs are smaller and target the most vulnerable individuals.

Everywhere in Europe, microfinance activities are heavily dependent on external funding used for on-lending to the end-borrowers, but face significant funding gaps. As microfinance has been expanding in the past years and is expected to grow further, IFIs and other financiers active in Europe have an important role to play in enabling European MFIs to meet their social and economic objectives.

First of all, IFIs have the capacity to address existing market failures by providing financial and non-financial support to MFIs. The biggest emerging funding needs are for loans to enable on-lending at sustainable and affordable interest rates. In addition to traditional loans, MFIs have been voicing their need for other financial instruments such as portfolio guarantees and equity. Several IFIs in Europe are already experimenting with these instruments, but the offer remains limited. Even though all IFIs acting in Europe recognise the high social impact of MFIs, in general MFI financing operations often remain very, or even prohibitively, resource-intensive for IFIs due to small loan amounts and the investment needed to assess and service each project. New partnerships or funds to help reach smaller MFIs at a lower operating cost are being considered.

Secondly, IFIs have significant leverage to support MFIs in reaching the more vulnerable populations in Europe by addressing their diverse needs. For example, IFIs can extend financing for personal social purpose microloans that help vulnerable individuals make long-term investments in their human capital or house improvements. Moreover, technical assistance that is already proposed by many IFIs on an as-needed basis can play a key role in building MFIs' internal capacity, developing new tools and strategies in order to expand their services and outreach to target groups, and improving their sustainability.

Finally, it is very important to back the relevance of microfinance instruments in addressing social issues with relevant data and commonly accepted benchmarks. In some cases, the social impact of microfinance operations can also be mitigated by negative environmental externalities. Thorough and systematic social and environmental impact assessment, including through enhanced coordination among different IFIs operating in Europe, can help better identify different outcomes and direct resources in a more efficient way.

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